Phoenix Natural Gas Limited
Directors' Report and Financial Statements
Year ended 31 December 2010

Company number: NI 32809

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Directors and other information

Directors	P V Dixon (resigned 30 March 2010) W F M McKinstry(resigned 30 March 2010) A J Pollock I R Bell P Ritson (appointed 15 February 2010) D Russell (appointed 15 February 2010) R Fulton (appointed 15 February 2010)
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
Solicitors	McGrigors Arnott House 12-16 Bridge Street Belfast BT1 1LS
Registered office	197 Airport Road West Belfast BT3 9ED
Company registration number	NI 32809

Directors' report

The directors present their report and the audited financial statements for the year ended 31 December 2010.

Principal activities
The company (PNG) is the owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. PNG is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The network currently extends to 3,091 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 50% of the population of Northern Ireland.

The company manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast; already some 139,000 customers have been connected to natural gas in the 14 years since it has become available in Northern Ireland.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

Review of business and future developments
PNG was originally established under a licence granted in 1996 but the business was transferred into a new subsidiary to facilitate the sale of the transmission business to Northern Ireland Energy Holdings (NIEH) on 31st March 2008.

During 2009, PNG undertook an extensive rating process with Fitch and Moody's which culminated in a new subsidiary Phoenix Natural Gas Finance plc, issuing £275m of 5.5% bonds repayable in 2017, guaranteed by both 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.

An additional £80m 3-year bank facility was also arranged to finance the future capital expenditure and working capital requirements of PNG.

Growth and Investment
Turnover of £39.5m in 2010 was £2.2m higher than that in 2009, generated mainly through the application of published conveyance charges to all gas distribution system users based on the volume of gas conveyed in the year. Charges are set annually in advance of the year (inclusive of an estimate of any surplus/deficit from the previous year) in

Directors' report (Continued)

order to recover the maximum allowed income for each year within PNG's Price Control for the 5-year period ending on 31st December 2011 as determined by NIAUR.

Income generated was higher than the regulatory 'determined' level for 2010 because actual volumes were significantly higher than those used when setting distribution prices. Consequently an over recovery of income of £5.0m has been accumulated at the end of 2010 (compared to £3.3m surplus at end of 2009). This will be carried forward and returned to all system users through lower conveyance charges in subsequent years.

128.0 million therms (mt) of natural gas was transported through the network, 16.4mt more than 2009. Volumes are estimated to have been higher than forecast by 14.4mt because average temperatures across the year were 1.3 degrees centigrade colder than the 5 year average, with the extremely cold first quarter and last quarter making 2010 one of the coldest years in recent history. This compares to 2009 when volumes were 0.2mt higher than forecast as a result of temperatures being marginally colder than average.

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) rose by 5.3mt, largely due to growth in throughput at one specific new customer in 2010. Otherwise demand continues to be influenced by economic pressures on business customers and the continued focus on energy efficiency and environmental initiatives.

Elsewhere, throughput in the domestic and smaller industrial & commercial sectors rose by 11.3mt with demand driven by colder weather in 2010 together with an increasing number of customers connected to the network and some load growth within existing users.

Operating profits of £15.7m were £0.2m lower than in 2009 with the growth in distribution income being offset by increases in operating costs. Actual operating costs in PNG are monitored closely in real terms against the levels assessed by NIAUR in determining allowed income. Whilst the implication of growth in business will drive cost increases each year this has been partially offset in 2010 by ongoing efficiencies being delivered by the business.

PNG invested a further £12.9m in capital expenditure during 2010, constructing 73km of new network and connecting 8,081 new customers. By year-end, PNG had 3,091km of network in operation, making gas available to 283,780 premises in its licence area, with a total of 138,754 (49%) already connected.

Directors' report (Continued)

Operations and regulation

The company met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending Public Reported Escapes, targets were exceeded.

During 2010, the distribution network continued to operate without major incident. No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2010.

A 'peak day' for demand of 24.4 GWH was recorded on 21st December 2010, which compares to the 2009 'peak day' of 18.3 GWH. However it should be noted that in 2010 throughput on this peak day was driven by exceptionally low temperatures (-10.1 degrees centigrade) compared to the temperatures on the previous 2009 peak day of +0.8 degrees centigrade.

PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is recognised as exemplary when compared against to other organisations throughout Northern Ireland. In addition its operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO14001 and 18001.

PNG continued to build upon the solid regulatory foundation established in 2006 through the 40 year licence agreement with NIAUR by completing a modification to its licence to remove the cap on the number of pay as you go (PAYG) meters that it is allowed within its regulatory cost base. PAYG meters are widely requested by consumers in the PNG Licence area and as a result are now provided to 50% of the connected customer base. In addition the ring fencing conditions, which were implemented through a licence modification in 2009, came into full effect in 2010. A key requirement of these conditions was to ensure that the majority of the directors in PNG were non executive, an obligation that has now been fulfilled. These conditions bring PNG in line with other regulated utilities within Northern Ireland and the rest of the UK.

Market Overview and Outlook

The Northern Ireland Housing Executive (NIHE), is the body responsible for all of Northern Ireland's public housing. Over the last 15 years PNG has been involved in helping develop heating replacement programs in line with the development of the natural gas infrastructure. A high proportion of available NIHE properties have already been connected to natural gas and the number of new connections in this sector is planned to slow down over the forthcoming years.

Directors' report (Continued)

Within the new build housing market, 2010 saw a continued slowdown in activity, both in terms of house sales as well as new housing schemes getting started. However PNG has seen a build-up of new schemes within the planning system, many of which have been re-worked to make them economic. Therefore based on its success at capturing virtually all new developments within its licence area to date, PNG is well positioned to provide natural gas to all new housing projects in Greater Belfast during 2011 and beyond, once the market conditions become more favourable.

In the owner occupied sector PNG, whilst having met all its obligations regarding the provision of gas network, continues to expand in owner occupied areas. Further investment is planned throughout 2011 to extend the gas network in established private residential areas where a strong propensity for customers to convert can be demonstrated.

In 2011 PNG plans to invest in a further 70km of new distribution network to bring the opportunity of natural gas to a further 8,000 potential new customers as well as undertaking a strategic reinforcement of its system in a key industrial area of Belfast due to future expected increases in demand.

PNG has established a large network of manufacturers, distributors, merchants, retailers, and installers throughout its Licence area. This network focuses on meeting the needs of new users and developing incentives and offers to encourage customers to switch to natural gas. Through its ongoing relationship with Government agencies, PNG maximises consumer opportunities provided by Government funded schemes, such as 'Warm Homes', "Cosy Homes", "Healthy Homes", "Snug Plus" - converting the fuel poor to a modern and efficient natural gas heating system. PNG continues to lobby for the introduction of a 'Boiler Scrappage' scheme similar to the scheme, which has been made available within other parts of UK.

Principal risks and uncertainties

From the perspective of the company, the principal risks and uncertainties are integrated with the principal risks of Kellen Investments Limited. Accordingly the principal risks and uncertainties are discussed in the annual report and accounts of Kellen Investments Limited, which does not form part of this report.

Key Performance Indicators

The company's directors are of the opinion that analysis using turnover, gross profit, operating profit and net assets as provided in the financial statements is sufficient to understand the development, performance and position of the business.

Results and dividends

The loss for the financial year is £1,370,351 (2009: profit £1,948,530). No dividend is recommended.

Directors' report (Continued)

Political and charitable donations
The company made charitable donations amounting to £21,177 during the year (2009: £16,244).

Directors and their interests
The directors who served during the period are shown on page 3.

Employment policies
Equal Opportunities
The company is committed to a proactive approach in promoting equality of opportunity. The company ensures that it operates fairly and equitably in its dealings with employees and prospective employees. The company is opposed to all forms of unlawful and unfair discrimination. The company ensures through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the company provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Nationality, race or ethnic origin
- Sexual orientation
- Age

Disability
The company has taken active steps to implement the Disability Discrimination Act. It is Company policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

Employee Participation
Within the bounds of commercial confidentiality, information is disseminated to all levels of staff about matters that affect progress of the company and are of interest and concern to them as employees, thereby encouraging their involvement in the group's performance.

Policy and practice on payment of creditors
The company is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all of its suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry.
Trade creditors at the year end represented 21 days (2009: 26 days). It is the company's policy in respect of all suppliers to agree payment terms in advance of the supply of goods and to adhere to those payment terms.

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

Directors' report (Continued)

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.

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

By order of the board

P Ritson ***Date: 23rd June 2011***
Director

Statement of directors' responsibilities

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 year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 to enable them to ensure that the 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

P Ritson ***Date: 23rd June 2011***
Director

Independent auditors' report

We have audited the financial statements of Phoenix Natural Gas Limited for the year ended 31 December 2010 which comprise the profit and loss account, the statement of total recognised gains and loss, the balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

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 on financial statements

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 UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditors' report (Continued)

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

Profit and loss account

	Note	2010 £'000	2009 £'000
Turnover	*2*	**39,529**	**37,307**
Cost of sales		0	0
Gross profit		**39,529**	**37,307**
Net operating expenses	*3*	(23,875)	(21,434)
Operating profit	*4*	**15,654**	**15,873**
Loss on sale of fixed asset		(44)	(121)
Interest payable and similar charges	*7*	(17,100)	(12,941)
Interest receivable and similar income	8	352	1,691
(Loss)/Profit on ordinary activities before taxation		**(1,138)**	**4,502**
Taxation	*9*	(234)	(2,553)
(Loss)/Profit for the financial year	*20*	**(1,372)**	**1,949**

A statement of movements on reserves is given in Note 20.

The notes on pages 16 to 25 form part of these financial statements.

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.

Statement of total recognised gains and losses

	2010 £'000	2009 £'000
(Loss)/Profit for the financial year	(1,372)	1,949
Total recognised (Loss)/Profit since last report	**(1,372)**	**1,949**

The notes on pages 16 to 25 form part of these financial statements.

Balance sheet

	Note	2010 £'000	2009 £'000
Fixed assets			
Tangible assets	*10*	196,699	189,584
Intangible assets	*11*	151,855	155,959
Investments	*12*	50	50
		348,604	**345,593**
Current assets			
Stocks	*13*	1,091	804
Debtors: Amounts falling due within one year	*14*	32,418	26,716
Debtors: Amounts falling due after one year	*14*	0	0
Cash at bank and in hand		11,366	4,686
Total current assets		**44,875**	**32,206**
Creditors: Amounts falling due within one year	*15*	(325,656)	(303,745)
Net current liabilities		**(280,781)**	**(271,539)**
Total assets less current liabilities		**67,823**	**74,054**
Creditors: Amounts falling due after one year	*16*	0	(5,000)
Provisions for liabilities and charges	*17*	(15,751)	(15,576)
Deferred income	*18*	(2,514)	(2,548)
Net Assets		**49,558**	**50,930**
Capital and reserves			
Called up share capital - ordinary	*19*	54,682	54,682
Profit and loss account	*20*	(5,124)	(3,752)
Equity shareholders' funds	***21***	**49,558**	**50,930**

On behalf of the board of directors

P Ritson
Director

Date: 23rd June 2011

Company registration number: NI 32809

The notes on pages 16 to 25 form part of these financial statements.

Notes forming part of the financial statements

1 Accounting policies

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

Basis of preparation

The company is exempt by virtue of the Companies Act 2006 from the requirement to prepare group financial statements on the grounds that its results are included in the group accounts of Kellen Investments Limited which are publicly available. These financial statements present information about the company as an individual undertaking and not about its group.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Business Review section of the Directors' Report on pages 4 to 9.

The company and its immediate parent company, Phoenix Distribution Holdings Ltd., are guarantors to £275m of 5.5% bonds issued by the company's subsidiary, Phoenix Natural Gas Finance plc (PNGF) which are due for redemption in 2017. The Bond proceeds were loaned to the company to facilitate reorganisation of intercompany arrangements and thereby repay existing debt providers across the Kellen Group.

The company also entered into an £80m 3-year bank facility in 2009, guaranteed by PDHL, to finance future capital expenditure and working capital requirements of the company and its affiliate, Phoenix Supply Limited.

The PDHL Group (PDHL, PNGF & the company) is expected to continue to generate positive cash flows for the foreseeable future after setting aside interest payable under its intercompany loan from PNGF to facilitate interest payable under the PNGF Bonds and resources available to it under its banking arrangements.

The PDHL Group forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that it is capable of operating well within the level of its current facilities and also meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

Revenue recognition

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of energy and transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

Cash flow statement

In accordance with Financial Reporting Standard No.1, the company is exempt from the requirement to present a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

1 Accounting policies (continued)

Intangible assets
The distribution licence is eliminated by amortisation through the profit and loss account over its useful economic life. The useful economic life of the asset shown in Note 11 has been estimated by the directors at forty years. FRS 10 "Goodwill and Intangible Assets" requires goodwill to be accounted for as an asset and amortised over its useful economic life.

Tangible fixed assets
The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.
The economic lives used are as follows:

		Years
Distribution mains	-	60
Distribution services	-	35
Distribution meters	-	20
Office equipment and fixtures & fittings	-	5

Debtors
Debtors are stated after provision has been made against all debts considered doubtful of collection.

Pensions
The company operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the company will benefit from the employee's services.

Turnover
Turnover represents the invoiced value of goods supplied during the year excluding value added tax. Revenue from gas sales is recognised upon delivery of the product to the customer.

Deferred taxation
Deferred tax is recognised in respect of material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements. Deferred tax assets and liabilities recognised have not been discounted.

Foreign currencies
Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. All assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. The resulting gain or loss is dealt with in the profit and loss account.

Stocks
Stock has been valued at the lower of cost and net realisable value.

1 Accounting policies (continued)

Government grants
The European Regional Development Grant relates specifically to capital expenditure on the distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

Operating leases
Costs in respect of operating leases are charged on a straight line basis over the lease term.

Cash Long Term Incentive Plan
The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

Investments
Investments held by the company in subsidiary undertakings are stated at cost less amounts written off.

2 Analysis of turnover and profits
Turnover and profits relate to the company's main activity of gas distribution which is carried out in Northern Ireland.

3 Net operating expenses
Net operating expenses were all considered to be administrative expenses.

4 Operating profit

This is stated after charging/(crediting):	**2010**	**2009**
	£'000	**£'000**
Depreciation – owned assets	5,785	5,462
Licence amortisation	4,104	4,104
European Regional Development Grant release	(34)	(52)
Operating lease rentals	969	991
Auditors' remuneration	14	14

5 Employee information

The average number of persons employed by the company (including executive directors) analysed by category during the period was as follows:

	2010	2009
	No	No
Operational	79	70
Administration	37	36
	116	**106**

The aggregate staff costs of these persons were as follows:

	2010	2009
	£'000	£'000
Wages and salaries	4,256	3,812
Social security costs	527	443
Other pension costs	483	429
	5,266	**4,684**

6 Directors' remuneration

	2010	2009
	£'000	£'000
Emoluments	772	1,004
Amount receivable under long term incentive schemes	140	156
Company pension contributions	99	142
	1,011	**1,302**

Details in respect of the highest paid director are as follows:

	2010	2009
	£'000	£'000
Emoluments	250	470
Amount receivable under long term incentive schemes	39	75
Company pension contributions	0	0
	289	**545**

7 Interest payable and similar charges

	2010	2009
	£'000	£'000
Amounts payable on bank loans and overdrafts	969	1,219
Amounts payable on inter-company loans	15,435	11,603
Amounts payable on loan notes	0	0
Other	696	119
	17,100	**12,941**

8 Interest receivable and similar income

	2010	2009
	£'000	£'000
Amounts receivable on bank deposits	15	334
Amounts receivable on inter-company loans	337	1,357
	352	**1,691**

9 Taxation charge

	2010	2009
	£'000	£'000
Current tax		
UK corporation tax for the period	28	4,154
Adjustments relating to earlier years	31	2,177
Total current tax charge/(credit)	**59**	**6,331**
Deferred tax (see note 16)		
Origination/reversal of timing differences	789	(1,635)
Effect of reduction in tax rate	(583)	0
Adjustments relating to earlier years	(31)	(2,143)
Total deferred tax (credit)/charge	**175**	**(3,778)**
Total tax charge/(credit)	**234**	**2,553**

The current tax charge for the period is higher than (2009: higher) the standard rate of corporation tax in the UK. The differences are explained below:

	2010	2009
	£'000	£'000
Current tax reconciliation		
(Loss) on ordinary activities before tax	(1,138)	4,502
Current tax at 28% (December 2009: 28%)	(319)	1,261
Effects of:		
Expenses not deductible for tax purposes	1,136	1,252
Capital allowances for period in excess of depreciation	(789)	1,515
Adjustment relating to earlier years	31	2,182
Other timing differences	0	121
Total current tax charge/(credit)	**59**	**6,331**

The directors are not aware of any factors that may have a significant impact on the future tax charge of the company.

10 Tangible fixed assets

	Office equipment £'000	Furniture & fixtures £'000	Distribution system £'000	Transmission pipeline £'000	Total £'000
Cost					
At 1 January 2010	1,717	3,121	223,636	0	**228,474**
Additions	90	52	12,802	0	**12,944**
Disposals	0	0	(76)	0	**(76)**
At 31 December 2010	1,807	3,173	236,362	0	**241,342**
Depreciation					
At 1 January 2010	1,709	1,491	35,690	0	**38,890**
Charge for the year	104	141	5,540	0	**5,785**
Disposals	0	0	(32)	0	**(32)**
At 31 December 2010	1,813	1,632	41,198	0	**44,643**
Net book value					
At 31 December 2009	8	1,630	187,946	0	**189,584**
At 31 December 2010	(6)	1,541	195,164	0	**196,699**

11 Intangible fixed assets

	Licence fee £'000	Total £'000
Cost		
At 1 January 2010	164,167	**164,167**
Additions	0	**0**
Disposals	0	**0**
At 31 December 2010	164,167	**164,167**
Amortisation		
At 1 January 2010	8,208	**8,208**
Charge for the year	4,104	**4,104**
Disposals	0	**0**
At 31 December 2010	12,312	**12,312**
Net book value		
At 31 December 2009	155,959	**155,959**
At 31 December 2010	151,855	**151,855**

12 Investments

Shares in subsidiary undertakings	**£'000**	**£'000**
Cost and net book value at 1 January	50	0
Acquisition	0	50
Cost and net book value at 31 December	50	50

The company has an ordinary share investment in the following company as at 31 Dec 2010

Company name	**Holding**	**Country of incorporation**	**Activity**
Phoenix Natural Gas Finance plc	100%	Great Britain	note (i)

Note (i) In 2009 the company acquired the entire share capital of Phoenix Natural Gas Finance plc, a company set up to raise funds through a bond issue to support the long term financing requirements of the company.

13 Stock

	2010	**2009**
	£'000	**£'000**
Stock of spares and meters	1,091	804

14 Debtors

	2010	**2009**
	£'000	**£'000**
Amounts falling due within one year		
Trade debtors	217	142
Amounts owed by parent company	1,573	3,989
Amounts owed by fellow subsidiary undertakings	22,467	14,468
Other debtors	781	744
Prepayments and accrued income	7,380	7,373
	32,418	**26,716**

15 Creditors

	2010	**2009**
	£'000	**£'000**
Amounts falling due within one year		
Trade creditors	1,837	2,129
Amounts owed to parent company	30	6,414
Amounts owed to fellow subsidiary undertakings	279,094	268,562
Other creditors	11,610	10023
Corporation tax	0	0
Accruals and deferred income	33,085	16,617
	325,656	**303,745**

16 Creditors

	2010	2009
	£'000	£'000
Amounts falling due between one and two years		
Bank Loan	0	0
	0	**0**
Amounts falling due between two and five years		
Bank Loan	0	5,000
	0	**5,000**

- During the prior year the company's existing borrowing were refinanced through the issue of a bond held by Phoenix Natural Gas Finance plc. The amounts falling due between two and five years relate to new 3 year bank borrowings taken out separately by the company to finance future capital expenditure and working capital requirements.
- The company's borrowings are denominated in sterling.
- The fair value of financial assets and liabilities is the same as book value.
- The bonds issued by its subsidiary, Phoenix Natural Gas Finance plc,. are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.

17 Provisions for liabilities and charges

	2010	2009
	£'000	£'000
Deferred taxation		
Accelerated capital allowances	16,826	16,626
Short term timing differences	(1,075)	(1,050)
	15,751	**15,576**

Deferred tax liability	**£'000**	**£'000**
At 1 January 2010	**15,576**	**19,354**
(Credited)/Charged to profit and loss account	175	(3,778)
Transfer from fellow subsidiary on transfer of business	0	0
At 31 December 2010	**15,751**	**15,576**

18 Deferred income

	£'000
ERDF grant received	
At 1 January 2010	2,548
Credit to profit and loss account	(34)
At 31 December 2010	**2,514**

19 Called up share capital

	2010	2009
	£	£
Allotted and fully paid:		
Ordinary shares of £1 each	54,681,891	54,681,891

During the prior year 54,681,889 ordinary shares of £1 each were issued as part of the refinancing of the group.

20 Reconciliation of movements in reserves

	2010	2009
	£'000	£'000
At 1 January 2010	(3,752)	(5,701)
(Loss)/Profit for the financial year	(1,372)	1,949
Revenue reserves carried forward	**(5,124)**	**(3,752)**

21 Reconciliation of movements in shareholders' funds

	2010	2009
	£'000	£'000
Opening shareholders' funds/(deficit)	50,930	(5,701)
Ordinary share capital issued	0	54,682
(Loss)/Profit for the financial year	(1,372)	1,949
Closing shareholders' funds	**49,558**	**50,930**

22 Pension commitments

There are two pension schemes available to employees of the company:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £483,533 (2009:£429,506).

23 Capital commitments

	2010 £'000	2009 £'000
Capital expenditure		
Contracted for but not provided	2,966	4,586

24 Contingent liabilities

At 31 December 2010 the company had no contingent liabilities (31 December 2009: £nil).

25 Financial commitments

At 31 December 2010 the company had annual commitments under non-cancellable operating leases expiring as follows:

	Motor Vehicles 2010 £'000	Motor Vehicles 2009 £'000	Property 2010 £'000	Property 2009 £'000
Within one year	56	12	0	0
Within two to five years	470	459	0	0
After five years	0	0	520	520
	526	**471**	**520**	**520**

26 Related party disclosures

As the company is a wholly owned subsidiary of a UK incorporated company advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

27 Ultimate controlling party

The immediate parent company and controlling company is Phoenix Distribution Holdings Limited, a company incorporated in England, with registered office address 5 New Street Square, London EC4A 3TW.

Kellen Investments Limited, (a subsidiary of Carmel Capital II Sarl), is the parent company of the largest group of companies of which Phoenix Natural Gas Limited is a member and for which group accounts are drawn up, copies of which can be obtained from the address above.

The directors regard TFCP Holdings Limited, a company registered in Guernsey, to be the ultimate parent company and controlling party.

Phoenix Natural Gas Limited
Directors' Report and Financial Statements
Year ended 31 December 2011

Company number: NI 32809

Table of contents

Directors and other information

Directors	A J Pollock I R Bell P Ritson D Russell R Fulton
Secretary	W F M McKinstry
Auditors	KPMG 17/25 College Square East Belfast BT1 6DH
Bankers	Northern Bank Donegall Square West Belfast BT1 6JS The Royal Bank of Scotland plc 135 Bishopsgate London EC2M 3UR
Solicitors	Pinsent Masons Arnott House 12-16 Bridge Street Belfast BT1 1LS
Registered office	197 Airport Road West Belfast BT3 9ED
Company registration number	NI 32809

Directors' report

The directors present their report and the audited financial statements for the year ended 31 December 2011

Principal activities

The company (PNG) is the owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. PNG is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The network currently extends to 3,148 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 50% of the population of Northern Ireland.

The company manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast; already some 148,000 customers have been connected to the natural gas network in the 15 years since natural gas first became available in Northern Ireland.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

Review of business and future developments

PNG was originally established under a licence granted in 1996 but the business was transferred into a new subsidiary to facilitate the sale of the transmission business to Northern Ireland Energy Holdings (NIEH) on 31st March 2008.

The business is partially funded by £275m of 5.5% bonds issued in 2009 and repayable in 2017 by its subsidiary Phoenix Natural Gas Finance plc, guaranteed by both 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.

In addition the company took the opportunity to re-finance its £60m bank facilities during the year in order to finance its future capital expenditure and working capital requirements over the next three years.

Growth and Investment

Turnover of £39.2m in 2011 was £0.3m lower than that in 2010, generated mainly through the application of published conveyance charges to all gas distribution system users based on the volume of gas conveyed in the year. Charges are set annually in advance of the year (inclusive of an estimate of any surplus/deficit from the previous year) in order to recover the maximum allowed income for each year as detailed within PNG's 5-year Price Control ending on 31st December 2011, as previously determined by NIAUR.

Directors' report (Continued)

PNG's allowable regulated income is profiled to 2046 so as to provide a flat real price per therm to customers in line with expected growth in the business across that period and deliver a return on allowable costs of 7.5% real to 2016 with return beyond 2016 being subject to review by NIAUR as part of future price controls. In addition any differences between allowable regulated income and actual income is carried forward as a 'Z' balance at the end of each year and allowable regulated income adjusted as appropriate in subsequent years.

Actual income generated was lower than the regulatory 'determined' level for 2011 however this reflected the return of a proportion of over-recovered income (Z) to customers from previous years. Consequently the level of 'Z' brought forward into 2011 of £5.0m has reduced to £2.4m by the end of the year. The balance remaining will be carried forward and returned to all system users through lower conveyance charges in subsequent years.

117.3 million therms (mt) of natural gas was transported through the network, 10.7mt less than 2010. Volumes are estimated to have been lower than forecast by 7.2mt because average temperatures across the year were 0.4 degrees centigrade warmer than the 5-year average, most notably in the final quarter. This compares to 2010 when volumes were an estimated 14.4mt higher than forecast as a result of temperatures being exceptionally cold relative to historic averages.

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) fell by 2.4mt, largely due to reduced consumption in temperature sensitive sites. Otherwise demand continues to be influenced by the economic pressures on business customers and the continued focus on energy efficiency and environmental initiatives. Elsewhere, throughput in the domestic and smaller industrial & commercial sectors fell by 8.3mt, with lower demand driven by warmer weather relative to 2010 offset to some extent by a 7% a increase in the number of customers connected to the network and some load growth within existing users.

Operating profits of £14.0m were £1.7m lower than in 2010 as a result of a slight reduction in distribution income together with an expected increase in operating costs, which is reflective of the growth in the size of the network. Actual operating costs in PNG are monitored closely in real terms against the levels determined by NIAUR during the price control reviews. Whilst the implication of growth in the business is that costs will increase each year, this has been partially offset in 2011 by the business delivering ongoing efficiency improvements.

PNG invested a further £12.3m in capital expenditure during 2011, constructing 57km of new network and connecting 9,719 new customers. By year-end, PNG had 3,148km of network in operation, making gas available to 291,855 premises in its licence area, with a total of 148,474 (51%) already connected.

Directors' report (Continued)

Operations and regulation
The company met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending Public Reported Escapes, targets were exceeded.

During 2011, the distribution network continued to operate without major incident. No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2011.

A 'peak day' for demand of 19.9 GWH was recorded on 20th January 2011, which compares to the 2010 'peak day' of 24.4 GWH. However it should be noted that in 2010 throughput on this peak day was driven by exceptionally low temperatures (-10.1 degrees centigrade) compared to the temperatures during the 2011 peak day of -1.9 degrees centigrade.

PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is recognised as exemplary when benchmarked against other organisations throughout Northern Ireland. PNG's ongoing operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO 14001 and 18001.

During 2011 the company progressed with its price control review with NIAUR, which is required in order to determine the allowable capital, operating expenditure and income for the period 2012 to 2013 inclusive.

In August 2011 NIAUR issued its draft proposals which, as well as indicating their view on allowable costs, also unexpectedly included a proposal to retrospectively remove a proportion of the company's regulated asset base referred to within its licence as Total Regulatory Value (TRV). NIAUR proposed that although the two parties had reached a comprehensive value sharing agreement for the benefit of customers in 2006 and subsequently included as part of 2007 licence amendments, they were now looking to share further value with customers through a retrospective reopening of the Agreement and a retrospective adjustment to the TRV which was codified within the Licence in 2007.

The company responded to NIAUR's statutory public consultation of its draft position by registering its strong opposition to such proposals, clearly laying its rationale for taking such a position and confirming that it would be unable to accept such proposals if issued as a final determination.

Directors' report (Continued)

In January 2012 NIAUR issued its final price control review determination and also a proposed licence modification to implement the adjustment to the TRV. On the 6th February 2012 the company rejected the price control review determination and the TRV licence modification issued by the NIAUR.

As no agreement could be reached between the company and NIAUR over the Price Control proposals NIAUR made a reference to the Competition Commission on the 28th March 2012. The Competition Commission has a period of six months (which could be extended if required by a further six months) to issue its decision in respect to the Price Control determination that should apply to the company.

Gas on Gas Competition
PNG has been instrumental in ensuring the necessary systems and processes are in place to ensure that competition for the supply of natural gas to customers across all market sectors in Greater Belfast is now in place, with the project to facilitate competition within the 'Pay As you Go' metering sector coming on-stream as planned in August 2011.

Currently six suppliers hold licences for the supply of natural gas in the Phoenix Licence area however only four actually supplied gas to customers during 2011, with only firmus energy and Phoenix Supply Limited actually engaged in competition within the domestic tariff market at present.

Market Overview and Outlook
PNG has developed its market into four distinct sectors (NIHE, New Build, Owner Occupied and I&C) each with its own dynamic.

The Northern Ireland Housing Executive (NIHE) is the body responsible for all of Northern Ireland's public housing. Over the last sixteen years PNG has been involved in assisting NIHE to develop heating replacement programs which were aligned to the development of the natural gas infrastructure. With a high proportion of available NIHE properties having already connected to natural gas, the number of new connections in this sector is expected to reduce somewhat in forthcoming years from historic levels.

Within the new build housing market, gas is now invariably the fuel of choice and therefore PNG's activity is highly dependent on the state of the housing market. 2011 saw a continued slowdown in activity, both in terms of house sales as well as new housing schemes starting up, with the majority of schemes that were completed being developed on the back of public sector funding by Housing Associations. Whilst a large number of private sector developers have ceased trading in recent years, PNG has seen a more hopeful build-up in 2011 of reworked planning applications coming forward for design. Some of these are due to commence in 2012 with developers approaching these construction projects on a much more conservative basis than in the past to reduce cash flow implications. PNG

Directors’ report (Continued)

is well positioned to provide natural gas to all new housing projects in Greater Belfast during 2012 and beyond, once the market conditions become more favourable.

In the owner occupied sector PNG has met its licence obligations in respect to its network development plan’ and therefore further investment in established private residential areas is likely to be more limited going forward. Connections in 2011 have significantly benefitted from the accumulated effect of a number of factors such as: the cold weather at the end of 2010 which forced many customers into replacing their existing boilers and converting to gas in early 2011; the sustained high cost of oil relative to gas particularly in the first half of 2011, the increase in gas marketing activities both directly by PNG and also indirectly from new gas suppliers entering the market thereby stimulating demand throughout the past year. In addition weak house sales has provided an added stimulus to the home improvement market, with upgrading of central heating systems recognised as providing both immediate lifestyle and other benefits as well as adding value to a home in the longer term.

In 2012 PNG plans to invest in a further 55km of new distribution network to bring the opportunity of natural gas to a further 5,400 potential new customers across all sectors as well as extending our network in the South East of our licence area to Millisle.

PNG has established a wide network of gas related businesses such as manufacturers, distributors, merchants, retailers, and installers, throughout its licence area. This network focuses on meeting the needs of new gas users and developing incentives and offers to encourage customers to switch to natural gas. Through our ongoing relationship with Government agencies, PNG will maximise consumer opportunities provided by Government funded schemes, such as ‘Warm Homes’, “Cosy Homes”, “Healthy Homes”, “Snug Plus” – which are designed to lift households out of fuel poverty by supplying a modern and efficient natural gas heating system. PNG continues to lobby the Northern Ireland Assembly to introduce a government funded ‘Boiler Scrappage’ scheme similar to the scheme which has been made available within other parts of UK.

Principal risks and uncertainties
From the perspective of the company, the principal risks and uncertainties are integrated with the principal risks of Kellen Investments Limited. Accordingly the principal risks and uncertainties are discussed in the annual report and accounts of Kellen Investments Limited, which does not form part of this report.

Key Performance Indicators
The company’s directors are of the opinion that analysis using turnover, gross profit, operating profit and net assets as provided in the financial statements is sufficient to understand the development, performance and position of the business.

Directors' report (Continued)

Results and dividends
The loss for the financial year is £1,332k (2010: loss £1,372k). No dividend is recommended.

Political and charitable donations
The company made charitable donations amounting to £28,218 during the year (2010: £21,177).

Directors and their interests
The directors who served during the period are shown on page 3.

Employment policies
Equal Opportunities
The company is committed to a proactive approach in promoting equality of opportunity. The company ensures that it operates fairly and equitably in its dealings with employees and prospective employees. The company is opposed to all forms of unlawful and unfair discrimination. The company ensures through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the company provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Nationality, race or ethnic origin
- Sexual orientation
- Age

Disability
The company has taken active steps to implement the Disability Discrimination Act. It is Company policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

Employee Participation
Within the bounds of commercial confidentiality, information is disseminated to all levels of staff about matters that affect progress of the company and are of interest and concern to them as employees, thereby encouraging their involvement in the group's performance.

Policy and practice on payment of creditors
The company is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all of its suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry.
Trade creditors at the year end represented 23 days (2010: 21 days). It is the company's policy in respect of all suppliers to agree payment terms in advance of the supply of goods and to adhere to those payment terms.

Directors' report (Continued)

Post Balance Sheet Event
On 16th May 2012, Phoenix Energy Holdings Limited (PEHL), the holding company of PDHL, announced that it had entered into an agreement to sell 100% of the share capital of both Phoenix Supply Limited and Phoenix Energy Limited, to SSE plc, through its subsidiaries Airtricity (Energy Supply) Northern Ireland Limited & its Republic of Ireland-registered subsidiary Airtricity Limited for £19.1m excluding working capital adjustments.

With the necessary approval by the Irish Competition Authority having been granted the sale is expected to be completed during June 2012.

As part of the sale, the existing loan arrangement between Phoenix Natural Gas Limited and Phoenix Supply Limited will be repaid in full.

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.

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

By order of the board

P Ritson
Director

Date: 22nd June 2012

Statement of directors' responsibilities

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 year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 to enable them to ensure that the 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

A Pollock ***Date: 22nd June 2012***
Director

Independent auditors' report

We have audited the financial statements of Phoenix Natural Gas Limited for the year ended 31 December 2011 which comprise the profit and loss account, the statement of total recognised gains and loss, the balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

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 on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditors' report (Continued)

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

Date: 22nd June 2012

Profit and loss account

	Note	**2011** **£'000**	**2010** **£'000**
Turnover	*2*	**39,177**	**39,529**
Cost of sales		(9)	0
Gross profit		**39,168**	**39,529**
Net operating expenses	*3*	(25,136)	(23,875)
Operating profit	*4*	**14,032**	**15,654**
Loss on sale of fixed asset		(88)	(44)
Interest payable and similar charges	*7*	(16,141)	(17,100)
Interest receivable and similar income	8	246	352
(Loss) on ordinary activities before taxation		**(1,951)**	**(1,138)**
Taxation	*9*	619	(234)
(Loss) for the financial year	*19*	**(1,332)**	**(1,372)**

A statement of movements on reserves is given in Note 19.

The notes on pages 17 to 26 form part of these financial statements.

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.

Statement of total recognised gains and losses

	2011 £'000	2010 £'000
(Loss) for the financial year	(1,332)	(1,372)
Total recognised (Loss) since last report	**(1,332)**	**(1,372)**

The notes on pages 17 to 26 form part of these financial statements.

Balance sheet

	Note	2011 £'000	2010 £'000
Fixed assets			
Tangible assets	*10*	202,778	196,699
Intangible assets	*11*	147,750	151,855
Investments	*12*	50	50
		350,578	**348,604**
Current assets			
Stocks	*13*	1,053	1,091
Debtors: Amounts falling due within one year	*14*	60,606	32,418
Debtors: Amounts falling due after one year	*14*	0	0
Cash at bank and in hand		4,044	11,366
Total current assets		**65,703**	**44,875**
Creditors: Amounts falling due within one year	*15*	(339,284)	(325,656)
Net current liabilities		**(273,581)**	**(280,781)**
Total assets less current liabilities		**76,997**	**67,823**
Creditors: Amounts falling due after one year	*15*	(10,000)	0
Provisions for liabilities and charges	*16*	(16,308)	(15,751)
Deferred income	*17*	(2,463)	(2,514)
Net Assets		**48,226**	**49,558**
Capital and reserves			
Called up share capital - ordinary	*18*	54,682	54,682
Profit and loss account	*19*	(6,456)	(5,124)
Equity shareholders' funds	***20***	**48,226**	**49,558**

On behalf of the board of directors

P Ritson
Director

Date: 22nd June 2012

Company registration number: NI 32809

The notes on pages 17 to 26 form part of these financial statements.

Notes forming part of the financial statements

1 Accounting policies

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

Basis of preparation

The company is exempt by virtue of the Companies Act 2006 from the requirement to prepare group financial statements on the grounds that its results are included in the group accounts of Kellen Investments Limited which are publicly available. These financial statements present information about the company as an individual undertaking and not about its group.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Business Review section of the Directors' Report on pages 4 to 10.

The company and its immediate parent company, Phoenix Distribution Holdings Ltd., are guarantors to £275m of 5.5% bonds issued by the company's subsidiary, Phoenix Natural Gas Finance plc (PNGF) which are due for redemption in 2017. The Bond proceeds were loaned to the company to facilitate reorganisation of intercompany arrangements and thereby repay existing debt providers across the Kellen Group.

The company has also refinanced its £60m bank facility for a further 3 years in 2011. This is guaranteed by PDHL and has been put in place to finance future capital expenditure and working capital requirements of the company and its affiliate, Phoenix Supply Limited.

The PDHL Group (PDHL, PNGF & the company) is expected to continue to generate positive cash flows for the foreseeable future after setting aside interest payable under its intercompany loan from PNGF to facilitate interest payable under the PNGF Bonds and resources available to it under its banking arrangements.

The PDHL Group forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that it is capable of operating well within the level of its current facilities and also meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

Revenue recognition

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of transportation services supplied to customers between the date of the last invoice and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

Cash flow statement

In accordance with Financial Reporting Standard No.1, the company is exempt from the requirement to present a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

1 Accounting policies (continued)

Intangible assets
The distribution licence is eliminated by amortisation through the profit and loss account over its useful economic life. The useful economic life of the asset shown in Note 11 has been estimated by the directors at forty years. FRS 10 "Goodwill and Intangible Assets" requires goodwill to be accounted for as an asset and amortised over its useful economic life.

Tangible fixed assets
The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.
The economic lives used are as follows:

		Years
Distribution mains	-	60
Distribution services	-	35
Distribution meters	-	20
Office equipment and fixtures & fittings	-	5

Debtors
Debtors are stated after provision has been made against all debts considered doubtful of collection.

Pensions
The company operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the company will benefit from the employee's services.

Turnover
Turnover represents the invoiced value of goods supplied during the year excluding value added tax. Revenue from gas sales is recognised upon delivery of the product to the customer.

Deferred taxation
Deferred tax is recognised in respect of material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements. Deferred tax assets and liabilities recognised have not been discounted.

Foreign currencies
Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. All assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. The resulting gain or loss is dealt with in the profit and loss account.

Stocks
Stock has been valued at the lower of cost and net realisable value.

1 Accounting policies (continued)

Government grants
The European Regional Development Grant relates specifically to capital expenditure on the distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

Operating leases
Costs in respect of operating leases are charged on a straight line basis over the lease term.

Cash Long Term Incentive Plan
The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

Investments
Investments held by the company in subsidiary undertakings are stated at cost less amounts written off.

2 Analysis of turnover and profits
Turnover and profits relate to the company's main activity of gas distribution which is carried out in Northern Ireland.

3 Net operating expenses
Net operating expenses were all considered to be administrative expenses.

4 Operating profit

This is stated after charging/(crediting):	**2011**	**2010**
	£'000	**£'000**
Depreciation – owned assets	6,139	5,785
Licence amortisation	4,105	4,104
European Regional Development Grant release	(51)	(34)
Operating lease rentals	907	969
Auditors' remuneration	12	14

5 Employee information

The average number of persons employed by the company (including executive directors) analysed by category during the period was as follows:

	2011	2010
	No	No
Operational	77	79
Administration	41	37
	118	**116**

The aggregate staff costs of these persons were as follows:

	2011	2010
	£'000	£'000
Wages and salaries	4,567	4,256
Social security costs	554	527
Other pension costs	437	483
	5,558	**5,266**

6 Directors' remuneration

	2011	2010
	£'000	£'000
Emoluments	414	772
Amount receivable under long term incentive schemes	84	140
Company pension contributions	88	99
	586	**1,011**

Details in respect of the highest paid director are as follows:

	2011	2010
	£'000	£'000
Emoluments	172	250
Amount receivable under long term incentive schemes	45	39
Company pension contributions	42	0
	259	**289**

7 Interest payable and similar charges

	2011	2010
	£'000	£'000
Amounts payable on bank loans and overdrafts	633	969
Amounts payable on inter-company loans	14,914	15,435
Other	594	696
	16,141	**17,100**

8 Interest receivable and similar income

	2011 £'000	2010 £'000
Amounts receivable on bank deposits	23	15
Amounts receivable on inter-company loans	223	337
	246	**352**

9 Taxation charge

	2011 £'000	2010 £'000
Current tax		
UK corporation tax for the period	(1,176)	28
Adjustments relating to earlier years	0	31
Total current tax (credit)/charge	**(1,176)**	**59**
Deferred tax (see note 16)		
Origination/reversal of timing differences	1,781	789
Effect of reduction in tax rate	(1,271)	(583)
Adjustments relating to earlier years	47	(31)
Total deferred tax (credit)/charge	**557**	**175**
Total tax (credit)/charge	**(619)**	**234**

The current tax charge for the period is lower than (2010: higher) the standard rate of corporation tax in the UK. The differences are explained below:

	2011 £'000	2010 £'000
Current tax reconciliation		
(Loss) on ordinary activities before tax	(1,951)	(1,138)
Current tax at 26.5% (December 2010: 28%)	(517)	(319)
Effects of:		
Expenses not deductible for tax purposes	1,122	1,136
Capital allowances for period in excess of depreciation	(1,861)	(789)
Adjustment relating to earlier years	0	31
Other timing differences	80	0
Total current tax (credit)/charge	**(1,176)**	**59**

9 Taxation charge (continued)

Factors that may affect future tax charges:

Finance Act 2011 provided for the reduction in the main rate of corporation tax from 26% to 25% with effect from 1 April 2012.

On 22 March 2012, the Government announced its intention to further reduce the main rate of corporation tax to 24% with effect from 1 April 2012 with future reductions of 1% each year with the rate reducing to 22% by 1 April 2014. The reduction in the rate of corporation tax to 24% was enacted on 26 March 2012.

The deferred tax balances as at 31 December 2011 have been determined with reference to the enacted corporation tax rate at that date of 25%.The directors are not aware of any factors that may have a significant impact on the future tax charge of the company.

10 Tangible fixed assets

	Office equipment £'000	Furniture & fixtures £'000	Distribution system £'000	Transmission pipeline £'000	Total £'000
Cost					
At 1 January 2011	1,807	3,173	236,362	0	**241,342**
Additions	136	(47)	12,217	0	**12,306**
Disposals	0	0	(169)	0	**(169)**
At 31 December 2011	1,943	3,126	248,410	0	**253,479**
Depreciation					
At 1 January 2011	1,813	1,632	41,198	0	**44,643**
Charge for the year	72	139	5,928	0	**6,139**
Disposals	0	0	(81)	0	**(81)**
At 31 December 2011	1,885	1,771	47,045	0	**50,701**
Net book value					
At 31 December 2010	(6)	1,541	195,164	0	**196,699**
At 31 December 2011	58	1,355	201,365	0	**202,778**

11 Intangible fixed assets

	Licence fee £’000	Total £’000
Cost		
At 1 January 2011	164,167	**164,167**
Additions	0	**0**
Disposals	0	**0**
At 31 December 2011	164,167	**164,167**
Amortisation		
At 1 January 2011	12,312	**12,312**
Charge for the year	4,105	**4,105**
Disposals	0	**0**
At 31 December 2011	16,417	**16,417**
Net book value		
At 31 December 2010	151,855	**151,855**
At 31 December 2011	147,750	**147,750**

12 Investments

	2011	2010
Shares in subsidiary undertakings	**£'000**	**£'000**
Cost and net book value at 1 January	50	50
Acquisition	0	0
Cost and net book value at 31 December	50	50

The company has an ordinary share investment in the following company as at 31 Dec 2011

Company name	**Holding**	**Country of incorporation**	**Activity**
Phoenix Natural Gas Finance plc	100%	Great Britain	Financing Company

13 Stock

	2011 £'000	2010 £'000
Stock of spares and meters	1,053	1,091

14 Debtors

	2011	2010
	£'000	**£'000**
Amounts falling due within one year		
Trade debtors	161	217
Amounts owed by parent company	2,986	1,573
Amounts owed by fellow subsidiary undertakings	50,090	22,467
Other debtors	720	781
Prepayments and accrued income	6,649	7,380
	60,606	**32,418**

15 Creditors

	2011	2010
	£'000	**£'000**
Amounts falling due within one year		
Trade creditors	2,127	1,837
Amounts owed to parent company	5,034	30
Amounts owed to fellow subsidiary undertakings	302,150	279,094
Other creditors	11,839	11,610
Corporation tax	0	0
Accruals and deferred income	18,134	33,085
	339,284	**325,656**
Amounts falling due between one and two years		
Bank Loan	0	0
	0	**0**
Amounts falling due between two and five years		
Bank Loan	10,000	0
	10,000	**0**

- During 2009 the company's existing borrowing were refinanced through the issue of a bond held by Phoenix Natural Gas Finance plc. The amounts falling due between two and five years relate to bank borrowings renewed in 2011 for 3 years by the company to finance future capital expenditure and working capital requirements.

- The company's borrowings are denominated in sterling.

- The fair value of financial assets and liabilities is the same as book value.

- The bonds issued by its subsidiary, Phoenix Natural Gas Finance plc,. are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.

16 Provisions for liabilities and charges

	2011	2010
	£'000	£'000
Deferred taxation		
Accelerated capital allowances	17,337	16,826
Short term timing differences	(1,029)	(1,075)
	16,308	**15,751**

Deferred tax liability	**£'000**	**£'000**
At 1 January 2011	**15,751**	**15,576**
Charged to profit and loss account	557	175
Transfer from fellow subsidiary on transfer of business	0	0
At 31 December 2011	**16,308**	**15,751**

17 Deferred income

	£'000
ERDF grant received	
At 1 January 2011	2,514
Credit to profit and loss account	(51)
At 31 December 2011	**2,463**

18 Called up share capital

	2011	2010
	£	£
Allotted and fully paid:		
Ordinary shares of £1 each	54,681,891	54,681,891

19 Reconciliation of movements in reserves

	2011	2010
	£'000	£'000
At 1 January	(5,124)	(3,752)
(Loss)/Profit for the financial year	(1,332)	(1,372)
Revenue reserves carried forward	**(6,456)**	**(5,124)**

20 Reconciliation of movements in shareholders' funds

	2011	2010
	£'000	£'000
Opening shareholders' funds/(deficit)	49,558	50,930
(Loss)/Profit for the financial year	(1,332)	(1,372)
Closing shareholders' funds	**48,226**	**49,558**

21 Pension commitments

There are two pension schemes available to employees of the company:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £436,541 (2010:£483,533).

22 Capital commitments

	2011 £'000	2010 £'000
Capital expenditure		
Contracted for but not provided	3,028	2,966

23 Contingent liabilities

At 31 December 2011 the company had no contingent liabilities (31 December 2010: £nil).

24 Financial commitments

At 31 December 2011 the company had annual commitments under non-cancellable operating leases expiring as follows:

	Vehicles 2011 £'000	Vehicles 2010 £'000	Property 2011 £'000	Property 2010 £'000
Within one year	30	56	0	0
Within two to five years	475	470	520	0
After five years	0	0	0	520
	505	**526**	**520**	**520**

26 Related party disclosures

As the company is a wholly owned subsidiary of a UK incorporated company advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

27 Ultimate controlling party

The immediate parent company and controlling company is Phoenix Distribution Holdings Limited, a company incorporated in England, with registered office address 5 New Street Square, London EC4A 3TW.

Kellen Investments Limited, (a subsidiary of Carmel Capital II Sarl), is the parent company of the largest group of companies of which Phoenix Natural Gas Limited is a member and for which group accounts are drawn up, copies of which can be obtained from the address above.

The directors regard TFCP Capital Investments Limited to be the ultimate parent company and Guy Hands to be the ultimate controlling party.

Phoenix Natural Gas Limited
Directors' Report and Financial Statements
Year ended 31 December 2012

Company number: NI 32809

Phoenix Natural Gas Limited
Directors' Report and Financial Statements
Year ended 31 December 2012

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Directors and other information

Directors	A J Pollock I R Bell P Ritson D Russell R Fulton
Secretary	W F M McKinstry
Auditors	KPMG 17/25 College Square East Belfast BT1 6DH
Bankers	Northern Bank Donegall Square West Belfast BT1 6JS The Royal Bank of Scotland plc 135 Bishopsgate London EC2M 3UR
Solicitors	Pinsent Masons Arnott House 12-16 Bridge Street Belfast BT1 1LS
Registered office	197 Airport Road West Belfast BT3 9ED
Company registration number	NI 32809

Directors' report

The directors present their report and the audited financial statements for the year ended 31 December 2012

Principal activities

The company (PNG) is the owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. The distribution business is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The network currently extends to 3,192 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 40% of the population of Northern Ireland.

PNG manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast including the marketing of natural gas to new gas consumers and the related management and support associated with customer up until point of connection; already some 159,000 customers have been connected to the natural gas network in the 16 years since natural gas first became available in Northern Ireland.

The business is natural monopoly and as such is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR)

Review of business and future developments

PNG was originally established under a licence granted in 1996 but the business was transferred into a new subsidiary to facilitate the sale of the business remaining, the transmission business, to Northern Ireland Energy Holdings (NIEH) on 31st March 2008

The business is partially financed by £275m of 5.5% bonds issued in 2009 and repayable in 2017 through its subsidiary Phoenix Natural Gas Finance plc., guaranteed by both 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. In addition in 2009 the company entered into £80m bank facilities for a 3-year period in order to finance its future capital expenditure and working capital requirements. These facilities have been subsequently refinanced in 2011 reducing the value of the facilities to £60m with a maturity of 2014.

Growth and Investment

PNG Income of £45.1m in 2012 was £5.9m higher than that in 2011, generated mainly through the application of published conveyance charges to all gas distribution system users, based on the volume of gas conveyed in the year. Charges are set annually in advance of the year

Directors' report (Continued)

(inclusive of an estimate of any surplus/deficit from the previous year) in order to recover the maximum allowed income for each year, as determined by NIAUR as part of the price control process.

PNG's allowable regulated income is profiled to 2046 so as to provide a flat real price per therm to customers in line with expected growth in the business across that period and deliver a return on allowable costs of 7.5% real to 2016, with return beyond 2016 being subject to review as part of future price controls. In addition because PNG operate with an 'income cap', any differences between allowable regulated income and actual income charged each year is carried forward in a correction mechanism, referred to as a 'Z' with allowable regulated income corrected by a compensating amount in subsequent years.

In respect to allowed income for 2012, this was determined as part of the PNGL12 Price Control process which was the subject of the Competition Commission (CC) referral in 2012. In the absence of a 'determined' allowed income at the time distribution charges were due to be published (September 2011) for 2012, PNG agreed with the NIAUR to apply an inflationary uplift to previous years income and assume no over recovery brought forward. In practice, based on the outcome of the CC process, allowed income was determined at £47.0m for 2012, £2.3m higher than the actual income that was actually charged in the year. However with an over-recovery brought forward into 2012 ('Z') amounting to £2.4m, the net impact at the end of 2012 is that only a small £0.1m 'Z' over recovery remains. This will be carried forward and returned to all system users through slightly lower conveyance charges in subsequent years.

128.7 million therms (mt) of natural gas was transported through the network, 11.4mt more than 2012. Volumes are estimated to have been only marginally affected by weather in the year (by the equivalent of 0.4mt) with average temperatures marginally colder than the five year average. This compares to 2011 when volumes were estimated to be 7.2mt lower as a result of temperatures being 0.4° C warmer relative to historic averages.

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) increased by an estimated 1.9mt in the year, with consumption benefitting at heating related sites by the relatively colder weather in 2012 when compared to 2011. Otherwise demand has been impacted by changes in production levels, utilisation of gas for Combined Heat and Power purposes and the continued focus on energy efficiency and environmental initiatives focused on reducing consumption.

Throughput in the domestic and smaller industrial & commercial sectors increased by 9.5mt compared to 2011, with higher consumption impacted by temperatures returning to average in 2012 in comparison to the previous year when weather was much warmer than average. In addition 2012 consumption benefitted by an estimated 4mt through a 7% increase in the number of users connected to the network.

Directors' report (Continued)

Operating profits of £15.9m were £1.9m higher than in 2011 with the £5.9m increase in distribution income being offset in part by a £4.0m increase in operating costs, driven mainly by the adviser costs and regulatory licence fees associated with the Competition Commission process. It should be noted that the £1.35m of adviser costs awarded to PNG by the Commission, the increased licence fees associated with the the CC process incurred by NIAUR and the costs of the CC itself will be passed through to customers in future prices.

Otherwise cost increases have been driven by marketing & incentive costs associated to higher levels of new connections and growth in maintenance and emergency response costs associated with larger and a slightly older network. Actual operating costs in PNG are monitored closely in real terms against the levels determined by NIAUR during the price control reviews. Whilst the implication of growth in the business is that costs will increase each year, this has been partially offset in 2012 by the business delivering ongoing efficiency improvements.

PNG invested a further £12.6m in capital expenditure during 2012, constructing 44km of new network and connecting 10,523 new customers. By year-end, PNG had 3,192km of network in operation, making gas available to 296,364 premises in its licensed area, with a total of 158,997 (54%) already connected.

Operations

PNG met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending public reported escapes, targets were exceeded.

During 2012, the distribution network continued to operate without major incident. No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2012.

Prior to the winter of 2012 four of Northern Ireland's strategic infrastructure providers, BT, Northern Ireland Electricity, Northern Ireland Water and PNG agreed a 'mutual aid' protocol which will ensure that during exceptional events these critical infrastructure providers will work together to share assets and resources to aid quick restoration of service for the greater good of the Northern Ireland population and economy. The initiative was very much welcomed as a practical approach to prepare for emergencies by both the Minister responsible for energy and the Minister responsible for roads.

A 'peak day' for demand in the year of 19.9 GWH was recorded on 11th December 2012, which is consistent with the 2011 'peak day' which was also 19.9 GWH. However it should be noted that relative mean temperature on the peak day in 2012 was 1.8°C, compared with -1.9°C on the 2011 peak day. The all-time peak day occurred in 2010 of 24.4

Directors' report (Continued)

GWH however this was driven by exceptionally low temperatures -10.1°C).

PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is classified as being exemplary when benchmarked against other organisations throughout Northern Ireland. PNG's ongoing operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO 14001 and 18001.

Regulation

As a regulated distribution business, PNG is subject to periodic (normally 5-yearly) price controls undertaken by its regulatory authority (NIAUR). PNG rejected the latest price control determination issued by NIAUR together with the related licence modifications proposed. As a result the matter was referred to the Competition Commission for review during 2012 and a full timeline of this process is provided below:

Regulatory Price Control (PNGL12) – Timeline of events

The PNGL12 price control was instigated by NIAUR as a 'mini' two-year review covering the period 2012 and 2013, in order to align PNG's price control periods with that of firmus energy from 2014 onwards.

Sep-10 PNG submitted its actualisation submission covering the three years from 2007 to 2009 to NIAUR.

Nov-10 PNG made its PNGL12 price control submission to NIAUR; and detailed discussions between NIAUR and PNG started to enable NIAUR to determine the allowed revenue for the period 2012 to 2013.

Aug-11 NIAUR published its draft proposals for consultation which, as well as indicating their view on allowable costs, unexpectedly included a proposal to retrospectively reduce by c.£80m PNG's regulated asset base referred to within its licence as Total Regulatory Value (TRV).

Oct-11 PNG registered its strong opposition to NIAUR's August 2011 draft proposals, clearly stating its rationale and confirming that it would be unable to accept the final determination, if this contained the retrospective reduction to the TRV as proposed by NIAUR.

Jan-12 NIAUR published its final PNG12 price control determination and proposed a separate licence modification to implement the retrospective adjustment to the TRV.

Directors' report (Continued)

Feb-12	On 6th February 2012 PNG issued a disapplication notice rejecting NIAUR's final PNGL12 price control determination and NIAUR's related licence modification to implement the retrospective adjustment to the TRV.
Mar-12	On 28th March 2012 NIAUR made a reference under Article 15 of the Gas (Northern Ireland) Order 1996 to the Competition Commission. The Competition Commission had a period of six months (a two month extension was later granted) to issue its final determination.
Nov-12	On 28th November 2012 the Competition Commission issued its final determination. The Competition Commission concluded that the NIAUR's c.£80m adjustment was not in the public interest and that only two small adjustments to PNG's TRV (£13.6 million in total) should be made. The Competition Commission's involvement in this process and its final determination should provide the basis for a more stable regulatory environment for Northern Ireland, which will benefit consumers and investors alike.
Feb-13	NIAUR published its notice of the proposed modifications to the conditions of PNG's licence to give effect to the conclusions of the Competition Commission. NIAUR also published a draft copy of the Replacement Determination Notice it proposes to issue to PNG.
Mar-13	PNG submitted its response to NIAUR's February 2013 proposals.

Regulatory Price Control (GD14)

A subsequent price control (GD14) was instigated by NIAUR in 2012, as a five-year review covering the period 2014 to 2018.

PNG made its GD14 price control submission to NIAUR in December 2012; and detailed information requests and discussions between NIAUR and PNG have commenced to determine the allowed revenue for the GD14 review.

NIAUR issued a consultation paper in December 2012 on the scope of the GD14 review. In March 2013 NIAUR issued an update on its overall approach. The key milestones are:

Directors' report (Continued)

Key Points	Proposed Date
Stakeholder engagement	April – June 2013
Publication of draft price control determination for consultation	July 2013
Stakeholder engagement during consultation period	July – September 2013
Closure of public consultation	September 2013
Price control final determination published	November / December 2013

NIAUR have also stated in its March paper that it is minded to shorten the duration of GD14, to a 3-year control period. This would mean that GD14 would run from 2014 – 2016. The final decision will be made as part of the final determination and any comments will be considered before then.

Gas on Gas Competition

PNG has been instrumental in the successful delivery of gas supply competition across all market sectors in Greater Belfast & Larne thereby ensuring that the necessary systems and processes enabling customers to switch from one supplier to another in response to the supply offering available are in place.

Currently seven suppliers hold licences for the supply of natural gas in the PNG Licensed area with four actually supplying gas to customers during 2012. Currently firmus energy and Airtricity (Energy Supply) NI (formerly Phoenix Supply) are the only suppliers actively competing within the domestic tariff market. Another supplier is progressing with the implementation of the required systems and processes in order to be in the position to supply to industrial and commercial customers from the second quarter of 2013.

Market Overview and Outlook

PNG has connected on average around 10,000 homes and businesses each year to natural gas since forming the industry in Northern Ireland in 1996. Its challenge has been to make natural gas available to around half the population and to establish natural gas as the fuel of choice for households, businesses, housing associations, developers and architects.

A recent report by Lord Whitty, which was commissioned by the NI Consumer Council, highlighted difficulties with the current energy mix

Directors' report (Continued)

in Northern Ireland and the report argued strongly for the need for heating oil to be replaced by natural gas and for energy efficiency measures to be better promoted.

Other reports have highlighted the fact that there is a strong correlation between the number of homes in Northern Ireland using heating oil and the incidence of fuel poverty. In recent years this has been publicly recognised by local politicians and agencies, with greater support becoming evident for the need to displace dependency on more expensive and less environmentally friendly fuels like heating oil by making natural gas available to more households.

This aspiration is reflected in the Northern Ireland Executive's target to make natural gas available to around 70 per cent of the population.

Growing Support

PNG and the wider local gas industry have campaigned for the introduction of a boiler scrappage scheme since January 2010 when such a UK boiler scheme was launched by the Government that included England, Scotland and Wales, but excluded Northern Ireland.

Since then PNG has successfully operated a relatively small privately funded boiler scrappage scheme of its own which has been consistently oversubscribed. Following the success of this pilot, and with the support of the local gas industry, a government funded boiler scheme was eventually launched regionally by the Department for Social Development in September 2012. This scheme has secured government backing for at least 3 more years and a further application has been made to the Northern Ireland Executive for additional funding.

A renewables focused Green New Deal was not supported by the Northern Ireland Executive for economic reasons, and it was cited that the boiler replacement scheme will aim to deliver on many of the goals that the former proposal hoped to achieve, including: reducing the amount of energy properties are using, cutting energy bills and lowering domestic carbon emissions with A-rated high efficiency boilers that are around 90% per cent efficient. To put this into context, many homes are still using old costly boilers that can be as low as 60% efficient. In these cases for every £1,000 a householder spends on fuel, around £400 of that spend is being lost straight away.

In the first six months since the government grant was launched around 30,000 customers have registered their interest in participating in this scheme and this has in turn helped to create a wider awareness in Northern Ireland of the importance of energy efficiency in the home.

Directors' report (Continued)

Helping Tackle Fuel Poverty

Northern Ireland has been identified as having one of the highest levels of fuel poverty in the UK. PNG continues to play its part in helping to identify those who need some additional help and support.

PNG provides continued energy efficiency training to all 'customer facing' staff. These staff must hold a minimum qualification that allows them to provide advice to householders on how to reduce their energy consumption. An energy audit is completed as part of the visit to every home and from this evaluation PNG representatives are able to provide key information to help with energy efficiency requirements and suggested improvements.

Discussions surrounding levels of spend as well as household income allows PNG to signpost householders to a wide range of schemes provided by the government; where they may be eligible for further assistance. In many cases PNG are able to highlight the government's Warm Homes Scheme, where the homeowner may qualify for a new heating system funded entirely through a grant.

PNG continue to be instrumental in helping to identify consumers who qualify for a natural gas heating installation through a wider range of schemes, where funding provided by Government is collectively in the region of around £30 million per year.

Industry Recognition

PNG have continued to attract visits from senior gas industry officials from around the world who are undertaking or who are about to undertake the development of gas infrastructure on a commercial basis.
In 2012 a delegation of leading gas industry representatives from Serbia, including the Serbian Utility Regulator, visited PNG as part of a best practice visit to learn more about the unique development of the Northern Ireland gas industry.

The underground natural gas network throughout Greater Belfast remains one of the most modern of its kind in the world, built using the latest and most innovative engineering technologies. In recognition of its world-class expertise PNG has also previously attracted similar delegations from countries as far afield as: India, Brazil, Argentina, China and Israel. Such visits remain important for PNG staff development as engineers and executives are able to be challenged by, and share best practice with, other industry experts.

New Build Innovations

Within the new build housing sector, natural gas is now almost exclusively the fuel of choice and therefore PNG's connections activity is highly dependent in this area on the state of the general housing market. 2012 saw a continued slowdown in activity in this particular

Directors' report (Continued)

market, both in terms of house sales and new housing schemes starting up, with the majority of schemes that were completed being developed on the back of public sector funding by Housing Associations. Recent planning and build activity did however notably continue to improve throughout 2012 and PNG are currently working on plans to develop over 10,000 properties that have received planning permission and are in various stages of being brought to the market.

There have been a small number of property developers who have experimented with renewable technologies and have used these technologies as marketing tools to promote and ultimately sell their properties.

During 2012 PNG completed the changing over of heating systems from biomass to natural gas at Northern Ireland's first eco-village in Lisburn, County Antrim.

In the marketing literature homeowners at the eco-village were promised they would see major savings but it soon turned out that the company providing the biomass heating would serve notice to the residents that the renewables system would have to be shut down.

These property owners were faced with the prospect of high energy bills, a winter without heating or hot water and a developer in administration. PNG worked in conjunction with each of the property owners and local politicians, and after a short period of discussion 100% of the properties owners agreed that they wanted to convert their homes to natural gas. There were 200 homes in the original scheme and an additional 200 homes that were to be added. PNG was able to use its experience of innovative and leading edge solutions to make natural gas available to every property in the eco-village development. There were many operational and legal difficulties with this project that needed to be addressed and overcome, and gaining the support and co-operation from both public representatives and the householders meant natural gas was introduced to the eco-village and is now playing its part alongside other remaining renewable technologies.

Improving Customer Service

Throughout 2012 PNG and the local industry continued to maintain and improve upon its high levels of customer service. The growth of PNG has established a wide network of gas related businesses such as manufacturers, distributers, merchants, retailers, training centres and installers throughout its licence area. PNG acts as an incubator to these networks, which are essential to the overall development of the wider industry and ensure that leading technologies are installed in homes, businesses and in the public sector.

PNG has also formally established the Northern Ireland Natural Gas Association (NINGA), providing it with its own identity, website and training capabilities. There are now a significant number of companies

Directors' report (Continued)

and individuals that regularly attend NINGA training events and this helps to underpin the strong customer focused ethos and reputation that Phoenix sets out to attain.

There is of course an amount of inevitable disruption involved in digging up roads, digging driveways, removing radiators, oil tanks and boilers. Despite this, independent market research continues to indicate that around 98% of customers would recommend getting natural gas installed. Customer expectations continue to be exceeded, and this is a testament to the hard work and investment by PNG and others in the local industry.

Principal risks and uncertainties
From the perspective of the company, the principal risks and uncertainties are integrated with the principal risks of Kellen Investments Limited. Accordingly the principal risks and uncertainties are discussed in the annual report and accounts of Kellen Investments Limited, which does not form part of this report.

Key Performance Indicators
The company's directors are of the opinion that analysis using turnover, gross profit, operating profit and net assets as provided in the financial statements is sufficient to understand the development, performance and position of the business.

Results and dividends
The loss for the financial year is £73k (2011: loss £1,332k). No dividend is recommended.

Political and charitable donations
The company made charitable donations amounting to £26,833 during the year (2011: £28,218).

Directors and their interests
The directors who served during the period are shown on page 3.

Employment policies

Equal Opportunities
The company is committed to a proactive approach in promoting equality of opportunity. The company ensures that it operates fairly and equitably in its dealings with employees and prospective employees. The company is opposed to all forms of unlawful and unfair discrimination. The company ensures through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the company provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Nationality, race or ethnic origin

Directors' report (Continued)

- Sexual orientation
- Age

Disability
The company has taken active steps to implement the Disability Discrimination Act. It is Company policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

Employee Participation
Within the bounds of commercial confidentiality, information is disseminated to all levels of staff about matters that affect progress of the company and are of interest and concern to them as employees, thereby encouraging their involvement in the group's performance.

Policy and practice on payment of creditors
The company is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all of its suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry. Trade creditors at the year end represented 21 days (2011: 23 days). It is the company's policy in respect of all suppliers to agree payment terms in advance of the supply of goods and to adhere to those payment terms.

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.

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

By order of the board

P Ritson
Director

Date: 19th June 2013

Statement of directors' responsibilities

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 year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 to enable them to ensure that the 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

P Ritson
Date: 19 June 2013
Director

Independent auditors’ report

We have audited the financial statements of Phoenix Natural Gas Limited for the year ended 31 December 2012 which comprise the profit and loss account, the statement of total recognised gains and loss, the balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company’s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its loss for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditors’ report (Continued)

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

Date: 19 June 2013

Profit and loss account

	Note	2012 £'000	2011 £'000
Turnover	*2*	**45,112**	**39,177**
Cost of sales		(11)	(9)
Gross profit		**45,101**	**39,168**
Net operating expenses	*3*	(29,213)	(25,136)
Operating profit	*4*	**15,888**	**14,032**
Loss on sale of fixed asset		(108)	(88)
Interest payable and similar charges	*7*	(16,557)	(16,141)
Interest receivable and similar income	*8*	206	246
Loss on ordinary activities before taxation		**(571)**	**(1,951)**
Taxation	*9*	498	619
Loss for the financial year	*19*	**(73)**	**(1,332)**

A statement of movements on reserves is given in Note 19.

The notes on pages 21 to 30 form part of these financial statements.

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.

Statement of total recognised gains and losses

	2012 £'000	2011 £'000
Loss for the financial year	(73)	(1,332)
Total recognised Loss since last report	**(73)**	**(1,332)**

The notes on pages 21 to 30 form part of these financial statements.

Balance sheet

	Note	**2012**	**2011**
		£'000	**£'000**
Fixed assets			
Tangible assets	*10*	208,879	202,778
Intangible assets	*11*	143,646	147,750
Investments	*12*	50	50
		352,575	**350,578**
Current assets			
Stocks	*13*	1,141	1,053
Debtors: Amounts falling due within one year	*14*	8,650	60,606
Debtors: Amounts falling due after one year	*14*	-	-
Cash at bank and in hand		11,059	4,044
Total current assets		**20,850**	**65,703**
Creditors: Amounts falling due within one year	*15*	(301,390)	(339,284)
Net current liabilities		**(280,540)**	**(273,581)**
Total assets less current liabilities		**72,035**	**76,997**
Creditors: Amounts falling due after one year	*15*	(5,000)	(10,000)
Provisions for liabilities and charges	*16*	(16,491)	(16,308)
Deferred income	*17*	(2,391)	(2,463)
Net Assets		**48,153**	**48,226**
Capital and reserves			
Called up share capital - ordinary	*18*	54,682	54,682
Profit and loss account	*19*	(6,529)	(6,456)
Equity shareholders' funds	***20***	**48,153**	**48,226**

On behalf of the board of directors

P Ritson
Director

Date: 19th June 2013

Company registration number: NI 32809

The notes on pages 21 to 30 form part of these financial statements.

Notes forming part of the financial statements

1 Accounting policies

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

Basis of preparation

The company is exempt by virtue of the Companies Act 2006 from the requirement to prepare group financial statements on the grounds that its results are included in the group accounts of Kellen Investments Limited which are publicly available. These financial statements present information about the company as an individual undertaking and not about its group.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Business Review section of the Directors' Report on pages 4 to 13.

The company and its immediate parent company, Phoenix Distribution Holdings Ltd., are guarantors to £275m of 5.5% bonds issued by the company's subsidiary, Phoenix Natural Gas Finance plc (PNGF) which are due for redemption in 2017. The Bond proceeds were loaned to the company to facilitate reorganisation of intercompany arrangements and thereby repay existing debt providers across the Kellen Group.

The company has also refinanced its £60m bank facility for a further 3 years until 2014. This is guaranteed by PDHL and has been put in place to finance future capital expenditure and working capital requirements of the company and its affiliate, Phoenix Supply Limited.

The PDHL Group (PDHL, PNGF & the company) is expected to continue to generate positive cash flows for the foreseeable future after setting aside interest payable under its intercompany loan from PNGF to facilitate interest payable under the PNGF Bonds and resources available to it under its banking arrangements.

The PDHL Group forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that it is capable of operating well within the level of its current facilities and also meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

Revenue recognition

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of transportation services supplied to customers between the date of the last invoice and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

Cash flow statement

In accordance with Financial Reporting Standard No.1 (Revised), the company is exempt from the requirement to present a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

1 Accounting policies (continued)

Intangible assets

The distribution licence is eliminated by amortisation through the profit and loss account over its useful economic life. The useful economic life of the asset shown in Note 11 has been estimated by the directors at forty years. FRS 10 "Goodwill and Intangible Assets" requires goodwill to be accounted for as an asset and amortised over its useful economic life.

Tangible fixed assets

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.

The economic lives used are as follows:

		Years
Distribution mains	-	60
Distribution services	-	35
Distribution meters	-	20
Office equipment and fixtures & fittings	-	5

Debtors

Debtors are stated after provision has been made against all debts considered doubtful of collection.

Pensions

The company operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the company will benefit from the employee's services.

Turnover

Turnover represents the invoiced value of goods supplied during the year excluding value added tax. Revenue from gas sales is recognised upon delivery of the product to the customer.

Deferred taxation

Deferred tax is recognised in respect of material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements. Deferred tax assets and liabilities recognised have not been discounted.

Foreign currencies

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. All assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. The resulting gain or loss is dealt with in the profit and loss account.

Stocks

Stock has been valued at the lower of cost and net realisable value.

1 Accounting policies (continued)

Government grants

The European Regional Development Grant relates specifically to capital expenditure on the distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

Operating leases

Costs in respect of operating leases are charged on a straight line basis over the lease term.

Cash Long Term Incentive Plan

The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

Investments

Investments held by the company in subsidiary undertakings are stated at cost less amounts written off.

2 Analysis of turnover and profits

Turnover and profits relate to the company's main activity of gas distribution which is carried out in Northern Ireland.

3 Net operating expenses

Net operating expenses were all considered to be administrative expenses.

4 Operating profit

This is stated after charging/(crediting):	**2012**	**2011**
	£'000	**£'000**
Depreciation – owned assets	6,410	6,139
Licence amortisation	4,104	4,105
European Regional Development Grant release	(72)	(51)
Operating lease rentals	1,011	907
Auditors' remuneration	12	12

5 Employee information

The average number of persons employed by the company (including executive directors) analysed by category during the period was as follows:

	2012 No	2011 No
Operational	69	77
Administration	52	41
	121	**118**

The aggregate staff costs of these persons were as follows:

	2012 £'000	2011 £'000
Wages and salaries	5,042	4,567
Social security costs	621	554
Other pension costs	459	437
	6,122	**5,558**

6 Directors' remuneration

	2012 £'000	2011 £'000
Emoluments	424	414
Amount receivable under long term incentive schemes	88	84
Company pension contributions	84	88
	596	**586**

Details in respect of the highest paid director are as follows:

	£'000	£'000
Emoluments	176	172
Amount receivable under long term incentive schemes	46	45
Company pension contributions	42	42
	264	**259**

7 Interest payable and similar charges

	2012 £'000	2011 £'000
Amounts payable on bank loans and overdrafts	249	633
Amounts payable on inter-company loans	15,883	14,914
Other	425	594
	16,557	**16,141**

8 Interest receivable and similar income

	2012	**2011**
	£'000	**£'000**
Amounts receivable on bank deposits	14	23
Amounts receivable on inter-company loans	192	223
	206	**246**

9 Taxation charge

	2012	**2011**
	£'000	**£'000**
Current tax		
UK corporation tax for the period	(683)	(1,176)
Adjustments relating to earlier years	2	-
Total current tax credit	**(681)**	**(1,176)**
Deferred tax (see note 16)		
Origination/reversal of timing differences	1,587	1,781
Effect of reduction in tax rate	(1,402)	(1,271)
Adjustments relating to earlier years	(2)	47
Total deferred tax (credit)/charge	**183**	**557**
Total tax credit	**(498)**	**(619)**

The current tax charge for the period is lower than (2011: lower) the standard rate of corporation tax in the UK. The differences are explained below:

	2012	**2011**
	£'000	**£'000**
Current tax reconciliation		
Loss on ordinary activities before tax	(571)	(1,951)
Current tax at 24.5% (December 2011: 26.5%)	(140)	(517)
Effects of:		
Expenses not deductible for tax purposes	1,043	1,122
Capital allowances for period in excess of depreciation	(1,587)	(1,861)
Adjustment relating to earlier years	2	-
Other timing differences	1	80
Total current tax credit	**(681)**	**(1,176)**

9 Taxation charge (continued)

Factors that may affect future tax charges:

The UK Budget in 2012 announced that the UK corporation tax rate was to reduce to 21% over a period of three years from 2012. The first reduction in the UK corporation tax rate from 28% to 27% (effective from 1 April 2011) was substantively enacted in July 2010, and further reductions to 26% (effective from 1 April 2011) and 25% (effective from 1 April 2012) were substantively enacted in March 2011 and July 2011 respectively.

The Finance Act 2012, which was substantively enacted on 17 July 2012, amended the main rate of corporation tax to 24% effective from 1 April 2012 and to 23% effective from 1 April 2013. This will reduce the group's future current tax charge accordingly.

UK deferred tax balances have been calculated based on the rate of 23% substantively enacted at the reporting date..

10 Tangible fixed assets

	Office equipment £'000	Furniture & fixtures £'000	Distribution system £'000	Transmission pipeline £'000	Total £'000
Cost					
At 1 January 2012	1,943	3,126	248,410	-	**253,479**
Additions/Transfers	1,250	(1,060)	12,429	-	**12,619**
Disposals	-	-	(207)	-	**(207)**
At 31 December 2012	3,193	2,066	260,632	-	**265,891**
Depreciation					
At 1 January 2012	1,885	1,771	47,045	-	**50,701**
Charge for the year	494	(263)	6,179	-	**6,410**
Disposals	-	-	(99)	-	**(99)**
At 31 December 2012	2,379	1,508	53,125	-	**57,012**
Net book value					
At 31 December 2011	58	1,355	201,365	-	**202,778**
At 31 December 2012	814	558	207,507	-	**208,879**

11 Intangible fixed assets

	Licence fee £'000	Total £'000
Cost		
At 1 January 2012	164,167	**164,167**
Additions	-	**-**
Disposals	-	**-**
At 31 December 2012	164,167	**164,167**
Amortisation		
At 1 January 2012	16,417	**16,417**
Charge for the year	4,104	**4,104**
Disposals	-	**-**
At 31 December 2012	20,521	**20,521**
Net book value		
At 31 December 2011	147,750	**147,750**
At 31 December 2012	143,646	**143,646**

12 Investments

Shares in subsidiary undertakings	2012 £'000	2011 £'000
Cost and net book value at 1 January	50	50
Acquisition	-	-
Cost and net book value at 31 December	50	50

The company has an ordinary share investment in the following company as at 31 Dec 2012

Company name	Holding	Country of incorporation	Nature of trade
Phoenix Natural Gas Finance plc	100%	Great Britain	Financing Company

13 Stock

	2012 £'000	2011 £'000
Stock of spares and meters	1,141	1,053

14 Debtors

	2012 £'000	2011 £'000
Amounts falling due within one year		
Trade debtors	195	161
Amounts owed by parent company	600	2,986
Amounts owed by fellow subsidiary undertakings	1,237	50,090
Other debtors	-	720
Prepayments and accrued income	6,618	6,649
	8,650	**60,606**

15 Creditors

	2012 £'000	2011 £'000
Amounts falling due within one year		
Trade creditors	2,598	2,127
Amounts owed to parent company	-	5,034
Amounts owed to fellow subsidiary undertakings	275,249	302,150
Other creditors	6,118	11,839
Corporation tax	-	-
Accruals and deferred income	17,425	18,134
	301,390	**339,284**
Amounts falling due between one and two years		
Bank Loan	-	-
	-	**-**
Amounts falling due between two and five years		
Bank Loan	5,000	10,000
	5,000	**10,000**

- During 2009 the company's existing borrowing were refinanced through the issue of a bond held by Phoenix Natural Gas Finance plc. The amounts falling due between two and five years relate to bank borrowings renewed in 2011 for 3 years by the company to finance future capital expenditure and working capital requirements.

- The company's borrowings are denominated in sterling.

- The fair value of financial assets and liabilities is the same as book value.

- The bonds issued by its subsidiary, Phoenix Natural Gas Finance plc, are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.

16 Provisions for liabilities and charges

	2012 £'000	2011 £'000
Deferred taxation		
Accelerated capital allowances	17,322	17,337
Short term timing differences	(831)	(1,029)
	16,491	**16,308**

Deferred tax liability	**£'000**	**£'000**
At 1 January 2012	**16,308**	**15,751**
Charged to profit and loss account	183	557
Transfer from fellow subsidiary on transfer of business	-	-
At 31 December 2012	**16,491**	**16,308**

17 Deferred income

	£'000
ERDF grant received	
At 1 January 2012	2,463
Credit to profit and loss account	(72)
At 31 December 2012	**2,391**

18 Called up share capital

	2012 £	2011 £
Allotted and fully paid:		
Ordinary shares of £1 each	54,681,891	54,681,891

19 Reconciliation of movements in reserves

	2012 £'000	2011 £'000
At 1 January	(6,456)	(5,124)
Loss for the financial year	(73)	(1,332)
Revenue reserves carried forward	**(6,529)**	**(6,456)**

20 Reconciliation of movements in shareholders' funds

	2012 £'000	2011 £'000
Opening shareholders' funds	48,226	49,558
Loss for the financial year	(73)	(1,332)
Closing shareholders' funds	**48,153**	**48,226**

21 Pension commitments

There are two pension schemes available to employees of the company:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £458,912 (2011:£436,541).

22 Capital commitments

	2012 **£'000**	**2011** **£'000**
Capital expenditure		
Contracted for but not provided	2,632	3,028

23 Contingent liabilities

At 31 December 2012 the company had no contingent liabilities (31 December 2011: £nil).

24 Financial commitments

At 31 December 2012 the company had annual commitments under non-cancellable operating leases expiring as follows:

	Vehicles 2012 £'000	**Vehicles 2011 £'000**	**Property 2012 £'000**	**Property 2011 £'000**
Within one year	17	30	-	-
Within two to five years	249	475	520	520
After five years	-	-	-	-
	266	**505**	**520**	**520**

25 Related party disclosures

As the company is a wholly owned subsidiary of a UK incorporated company advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

26 Ultimate controlling party

The immediate parent company and controlling company is Phoenix Distribution Holdings Limited, a company incorporated in England, with registered office address 5 New Street Square, London EC4A 3TW.

Kellen Investments Limited, (a subsidiary of Carmel Capital II Sarl), is the parent company of the largest group of companies of which Phoenix Natural Gas Limited is a member and for which group accounts are drawn up, copies of which can be obtained from the address above.

The directors regard TFCP Capital Investments Limited to be the ultimate parent company and Guy Hands to be the ultimate controlling party.

KG KELLEN GROUP

ANNUAL REPORT & ACCOUNTS 2010

Business in the Community AWARDS 2010
Big Tick re-accreditation

PHOENIX

CONTENTS

KELLEN GROUP HISTORY

1996 **Launch of Phoenix Natural Gas by British Gas plc in September.** At the time of its launch, the Phoenix development was one of the largest 'greenfield' private sector-led integrated gas transmission, distribution and supply investments in the world. This first year saw a licence being granted, construction commencing and the first customer connected.

1997 **Purchase of a 24.5% stake in Phoenix by Keyspan.** February marked an Anglo-American link-up, with the owners of The Brooklyn Union Gas Company.

2001 **Purchase of a 24.5% stake in Phoenix by ESH plc.** East Surrey Holdings (ESH) plc (a GB based water and gas utility) took a 24.5% in Phoenix reducing the BG holding to 51%.

2001 **Established Phoenix Energy Services Limited** as a provider of downstream services into the Northern Ireland energy market.

2003 **Purchase of remaining 75.5% stake by ESH plc.** ESH raised the finance to complete a buy-out of other partners, becoming sole owner of Phoenix.

2005 **Purchase of ESH plc by Terra Firma.** Through its Kellen vehicle, Terra Firma secured the purchase of East Surrey Holdings plc by the end of 2005.

2006 **Sale of Sutton and East Surrey Water (SESW) plus subsidiaries.** In spring, the sale of the SESW to Deutsche Bank was completed. In summer that same year, ESP (East Surrey Pipelines) was sold to ABN AMRO Infrastructure.

2007 **Separation of Phoenix Supply Division.** In line with the requirements of the Second EU Gas Directive 2003/55/EC, Phoenix legally separated its gas trading and supply division from its transmission and distribution business on 1st January 2007.

2008 **Separation of Phoenix Natural Gas.** On 1st January 2008 Phoenix completed the separation of its distribution division from that of transmission.

2008 **Sale of Transmission Division.** Phoenix completed the sale of its transmission assets to Northern Ireland Energy Holdings (NIEH) on 31st March 2008.

2009 **Issue of £275m of Bonds due 2017 at rate of 5.5% by Phoenix Natural Gas Finance plc,** guaranteed by Phoenix Natural Gas Limited and Phoenix Distribution Holdings Limited, with the proceeds being used as part of a restructuring process to refinance Group activities. These Bonds received a rating of Baa2 by Moody's and BBB+ by Fitch.

2009 **Phoenix extends its supply operations** into the Republic of Ireland as its new subsidiary Phoenix Energy Limited commences trading.

THE KELLEN GROUP

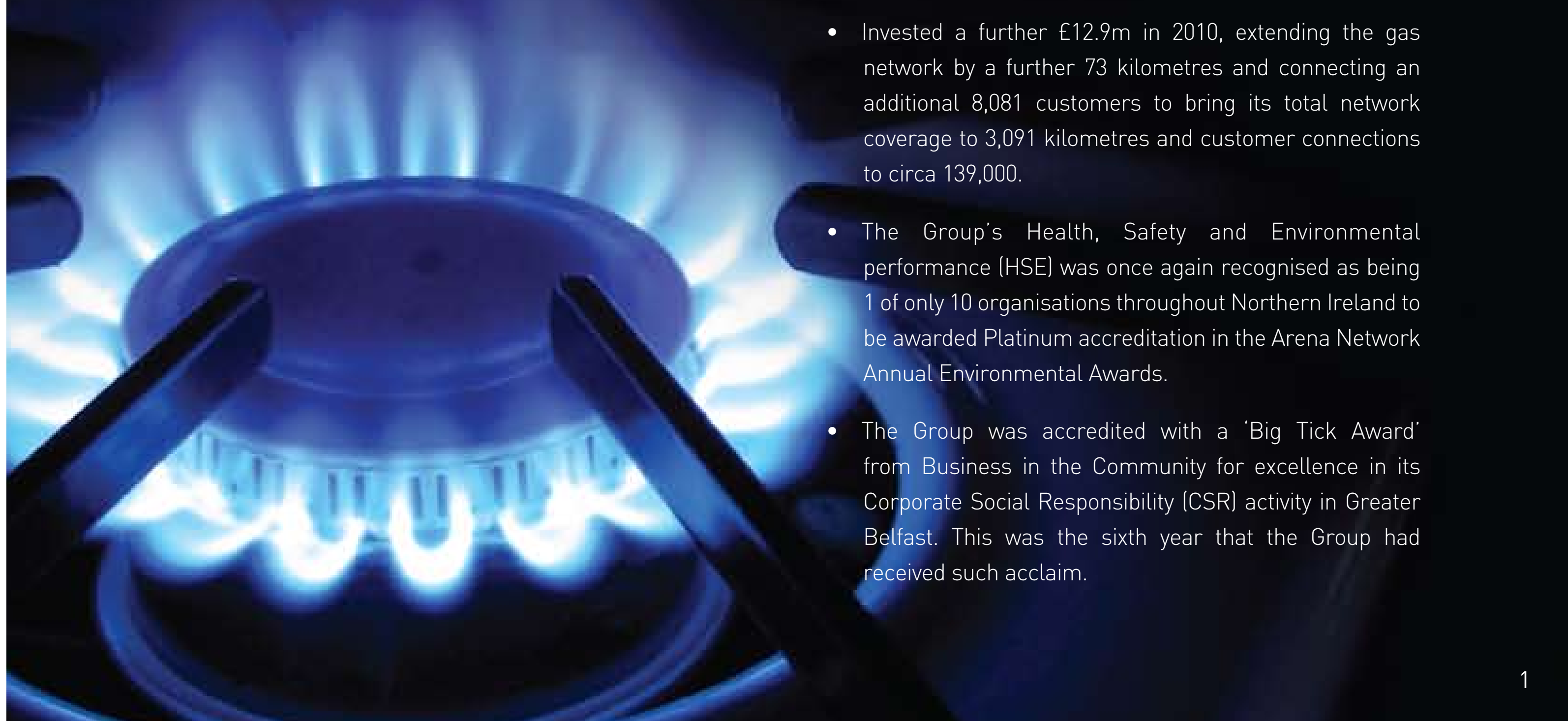
The Kellen Group, trading under the Phoenix banner, is the pre-eminent natural gas distribution, supply and service business in Northern Ireland. Since 1996 Phoenix has been successful in introducing natural gas to a new market and establishing a strong and vibrant supporting industry. In the process, the Phoenix has gained a strong international reputation for its innovative commercial and infrastructural development in a 'greenfield' environment. Coupled with its significant operational achievements Phoenix has also been recognised for its outstanding performance within the arena of safety and corporate social responsibility culminating in the award of its second British Safety Council 'Sword of Honour' in recognition of world-class health, safety and environmental practices. In addition, the Group received Business in the Community's 'Big Tick Award' for a sixth consecutive year, celebrating excellence in the delivery of leading edge corporate social responsibility programmes. This award underlines its commitment to its staff and the community it serves.

FINANCIAL HIGHLIGHTS

- Increase in Group turnover of £2.6m (2.4%), from £108.4m in 2009 to £111.0m in 2010, driven by increase in volume of gas delivered to its customers offsetting the impact of lower selling prices to customers as a result of the lower wholesale cost of gas purchased.
- Group Operating profit of £17.9m, down £2.7m from £20.6m in 2009, driven mainly by some of the surplus profits generated in 2009 within the regulated part of its supply business being returned to customers in lower prices in 2010.
- An operating cash-flow of £33.0m was generated in 2010 compared to £32.3m in the previous year.

OPERATIONAL HIGHLIGHTS

- Transported 128.0 million therms of gas to users in 2010 through its gas distribution network in Northern Ireland, 16.4 million therms more than 2009.
- Invested a further £12.9m in 2010, extending the gas network by a further 73 kilometres and connecting an additional 8,081 customers to bring its total network coverage to 3,091 kilometres and customer connections to circa 139,000.
- The Group's Health, Safety and Environmental performance (HSE) was once again recognised as being 1 of only 10 organisations throughout Northern Ireland to be awarded Platinum accreditation in the Arena Network Annual Environmental Awards.
- The Group was accredited with a 'Big Tick Award' from Business in the Community for excellence in its Corporate Social Responsibility (CSR) activity in Greater Belfast. This was the sixth year that the Group had received such acclaim.



KELLEN GROUP AT A GLANCE

DISTRIBUTION

Owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. The distribution business is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The Phoenix network currently extends to 3,091 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 50% of the population of Northern Ireland. Phoenix Natural Gas manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast; already some 139,000 customers have been connected to the natural gas network in the 14 years since natural gas first became available in Northern Ireland.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

SUPPLY NI

Phoenix Supply is the market leader in gas supply in Northern Ireland delivering natural gas to customers using the Phoenix Natural Gas distribution network. The supply business competes directly with other gas suppliers in its licence area, which mirrors the Group's distribution business in Greater Belfast and Larne. At the end of 2010 the company supplied 99% of all customers connected with gas. In addition, Phoenix Supply trades gas on the wholesale market and provides billing services for its expanding customer base, together with that of its affiliate, Phoenix Energy, from its offices in Belfast.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

SUPPLY ROI

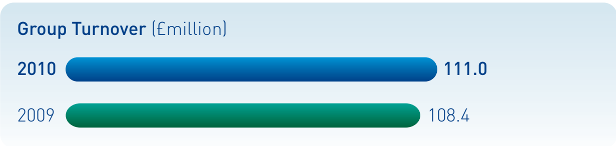
During the latter half of 2009, Phoenix Energy commenced supplying natural gas in the Republic of Ireland, expanding the service offering of Phoenix Supply Limited across the island of Ireland. In 2010 the combined volumes of Phoenix Supply Limited and Phoenix Energy Limited made Phoenix the second largest supplier of natural gas to homes and businesses on the island of Ireland.

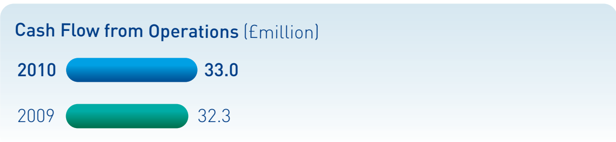
The company operates in a separate regulatory environment within the Republic of Ireland, having been awarded a licence to supply natural gas in 2008.

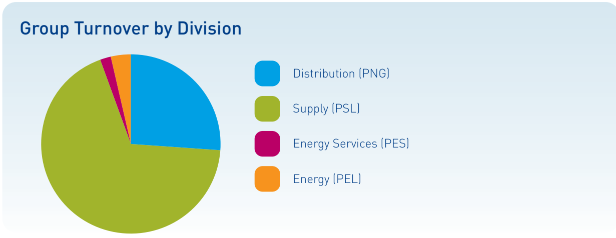
The business is regulated under licence by the Commission for Energy Regulation (CER) in Dublin.

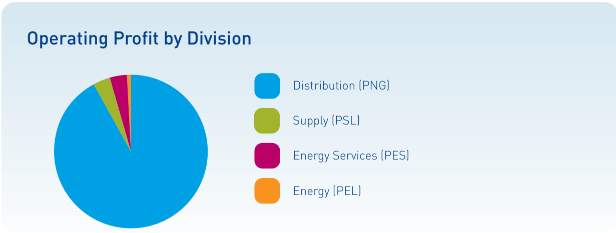
ENERGY SERVICES

A specialist provider of downstream services into the Northern Ireland energy market, Energy Services' remit includes the provision of a 24/7 emergency response to Phoenix Natural Gas, together with metering and meter reading services across the natural gas industry in Greater Belfast and Larne. In addition, the company delivers a range of other services to energy users on a demand and contract basis.









CHAIRMAN'S STATEMENT

I am pleased to report that Kellen has continued to grow its business and deliver results ahead of expectations again this year. Despite the poor economic climate, consumers continue to invest in reducing their energy costs by switching to natural gas. This growth underlines the strength of the Group and the resilience of its cash flows. The Group remains well placed in 2011 to benefit from the continued shift to natural gas from other fossil fuels such as oil and also from any upturn in the UK and Irish economies.

During 2010, the Group operated through four main revenue-generating divisions, one of which, Phoenix Energy Limited, traded in its first full year. All four divisions have delivered trading results ahead of expectations, despite the negative market conditions. The continued 'dash for gas' globally and its resulting impact on wholesale costs, the poor investment environment for prospective customers, uncertainty in employment, the challenges of operating within a rising inflationary environment for a regulated business and the operational challenges arising from extremely cold weather, all played their part in making 2010 another challenging year.

Gas demand was impacted significantly by severe weather conditions at both the beginning and end of 2010. These conditions increased gas consumption in the domestic and small commercial sectors and helped boost heating demand in the large user sector, thereby offsetting the impact on demand arising from poor economic conditions. Gas users will continue to focus on energy conservation measures which will impact on assumptions underpinning average consumer volumes going forward.

On a positive note for our customers, despite the rise in gas costs towards the latter part of the year, these were not sufficient to necessitate a review of our prices as part of our regulatory price control mechanism. During 2010 therefore, domestic and small commercial gas users enjoyed a year of prices fixed at levels set in 2009. However, prices in the large user market, which are directly linked to wholesale market prices, did change in line with market movements throughout the year. By contrast, consumers in the unregulated market of mainland GB have borne the brunt of higher costs in advance of the winter as suppliers moved to ensure that tariff prices matched rising wholesale market prices.

I am pleased to note that across the Group a strong focus has been maintained on the delivery of efficiency and cost savings to offset the regulatory price control targets placed upon both our gas distribution and supply businesses in Northern Ireland. This tight operating cost regime has also assisted our energy services business to grow its service offering and for our new Republic of Ireland trading company to compete aggressively for new business. The current operating regime puts the Group in a strong position to continue developing its various businesses in 2011.

Phoenix Natural Gas, our gas distribution business in Northern Ireland, has maintained its investment grade

rating and met all of its covenant obligations under its bond and bank finance. This company, being the main infrastructure asset owner within the Group, has a stable funding platform for 2011, with the existing 3-year bank facilities maturing in November 2012. Although wholly undrawn at this time, refinancing discussions are expected to commence during the forthcoming year in consideration of future business requirements. The Group remains in a strong position to make the most of any future growth opportunities both within its existing licence area and beyond, either through organic growth or acquisition.

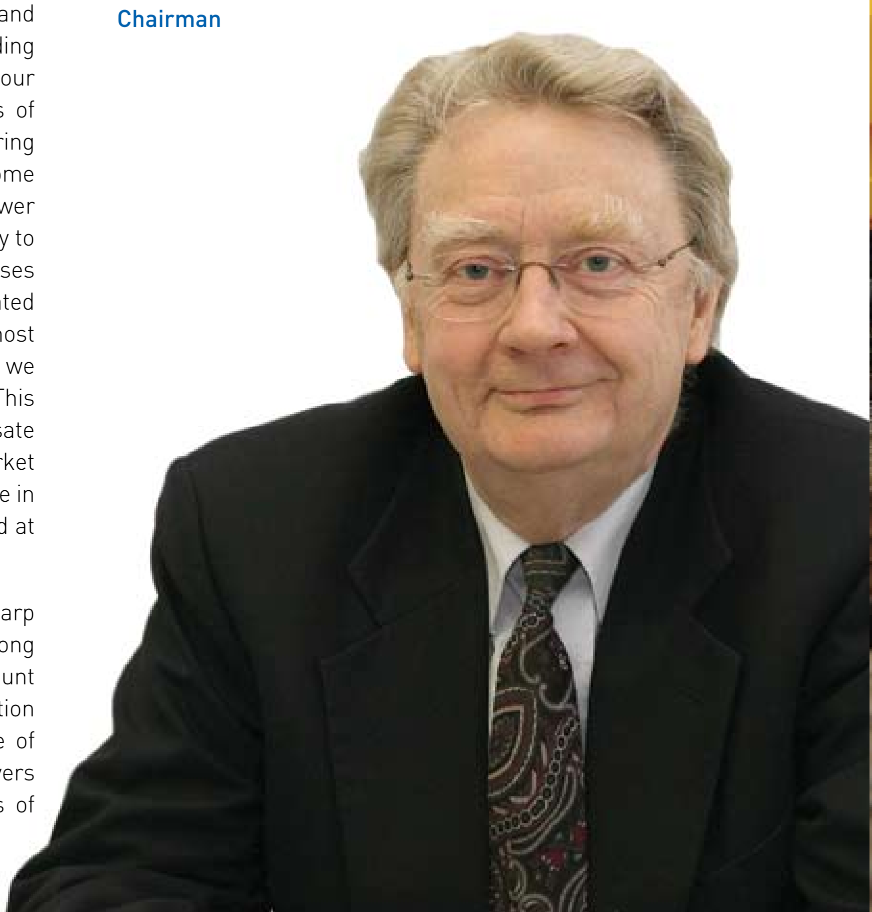
With all its operating subsidiaries firmly established, the Board believes that the long-term prospects for the Group remain excellent and that demand for natural gas will continue to expand in Phoenix's current licence area and beyond.

We are confident that each part of the Group has a clear focus and the ability to work through the challenges of growth, in existing and new markets, despite the highly competitive nature of the local energy market. Transparency, innovation and reliability continue to be the cornerstone of our approach to ensure that we expand the natural gas network, attract new customers to gas and service them thereafter through our trading businesses in an orderly and efficient manner. The additional success of our new trading business operating in the Republic of Ireland underlines our confidence to compete successfully in market sectors of our choice. As a result of our continued success in securing new gas loads in Ireland in 2010, Phoenix has now become the second largest natural gas supplier, excluding power generation volumes, on the island of Ireland; second only to the state-owned monopoly BGE. The Board fully recognises that success cannot be assumed in such a tightly regulated and competitive market and that it requires the utmost commitment and focus of all our people to ensure we deliver our promises to both investors and customers. This should help the gas market to grow and help to compensate our supply business for the inevitable reduction in its market share. At the same time we should be allowed to compete in all the other markets for natural gas in Northern Ireland at the earliest opportunity.

The severe weather conditions in 2010 brought into sharp focus the need to ensure that operational readiness, along with a keen focus on health and safety are of paramount importance in all our plans and are a priority in relation to governance. Kellen board members are fully aware of their responsibilities as directors of a Group which delivers essential utility services on a 24/7 basis and which is of such strategic importance to Northern Ireland's economy and general population. We are therefore fully committed to ensuring high standards of performance and monitoring in relation to our stewardship of our responsibilities and in minimising the risk to the public from our extensive operations and construction activity. The Group was once again recognised for its positive contribution to the environment by Business in the Community through its Arena Network Environmental Awards. Our ongoing strategic operational procedures in the areas of environmental performance and occupational health and safety were recognised by successfully retaining accreditations ISO 14001 and 18001.

Kellen Group is Northern Ireland's leading gas distributor and supplier and continues to ensure that customers enjoy outstanding support from our growing service division. The expansion of the Group's activities into the Republic of Ireland has greatly enhanced its standing across the island of Ireland, which the company will seek to build upon in 2011. We look to the future with confidence and with grateful acknowledgment to all our people who have made the past twelve months so successful despite the severe weather conditions and general economic gloom.

Dr George Greener CBE
Chairman

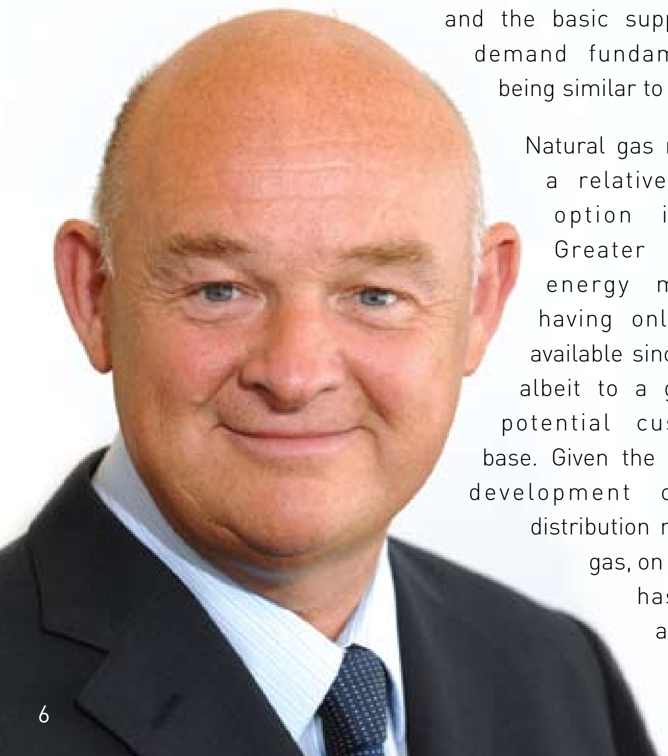


CHIEF EXECUTIVE'S REVIEW

I am pleased to report that the Kellen Group delivered an operating profit of £17.9m in 2010. The underlying value of the Group was greatly enhanced by a strong performance from all operating divisions in combination with further development of its gas network and growth of the customer base. Despite the poor economic conditions, we continued to grow by ensuring that our product offering met the needs of our growing customer base. The extremely cold weather provided customers with an added stimulus to replace their old oil boilers with gas ones to reduce consumption and save money. Whilst the cold weather significantly boosted gas usage throughput in the year, underlying consumption data still suggests that customers are continuing to focus on saving money through energy efficiency. 2010 performance was ahead of expectations in most areas across the Group and our ability to deliver performance despite the difficult economic climate that we face underlines the robustness of our business plan and strength of our management and staff. I am confident that, despite the ongoing economic challenges that we will face in the years ahead, the Group is well placed to deliver on its business plan and thereby to build upon past success.

THE MARKET

The severe winter conditions at the start and end of 2010 played their part in shaping energy prices for the year. These conditions, linked to commodity speculation and constrained levels of storage, ensured that 2010 summer prices remained relatively high and forward curve prices rose steadily towards the latter part of the year and even more so for the early part of 2011. This upward pressure on gas costs occurred despite apparent underlying energy demand being generally subdued and the basic supply and demand fundamentals being similar to 2009.



Natural gas remains a relatively new option in the Greater Belfast energy market, having only been available since 1996, albeit to a growing potential customer base. Given the ongoing development of the distribution network, gas, on average has been available at the doorstep of approximately 280,000 homes and businesses for 10-years.

Kellen, under the Phoenix brand, holds licences for the distribution and supply of natural gas in the Greater Belfast area and more recently acquired a supply licence in the Republic of Ireland. The Phoenix Group operates through 4 separate businesses: Phoenix Natural Gas (PNG), Phoenix Supply (PSL), Phoenix Energy Services (PES) in Northern Ireland and Phoenix Energy (PEL) in the Republic of Ireland. All of these businesses, in the context of Northern Ireland, are significant in their own right with over 350 staff employed directly, or through operating and alliance partnerships. Phoenix is now the largest natural gas distributor and supplier in Northern Ireland and the second largest in the island of Ireland. This growth is a result of the recent expansion into the gas supply market in the Republic of Ireland (ROI) and continued growth in the North.

PNG's primary objective is to make natural gas available to around 90% of all households and businesses in the Greater Belfast area by 2016, connecting circa 60% of these potential gas customers to the gas network by this date. This entails ensuring that new properties and developments are built with gas heating incorporated and that existing properties are converted to gas, either when existing heating equipment needs to be replaced or as a result of marketing aimed at accelerating customer acquisition. The principal challenge for natural gas is to

displace oil as the main energy source for homes and businesses. Oil is still the dominant fuel for domestic heating and an embedded 'oil culture' remains very strong across Northern Ireland given the limited availability of natural gas outside the PNG licence area. Oil prices remained volatile throughout 2010 reminding those homeowners and businesses who have not yet converted to natural gas of the high cost of oil, both in terms of the commodity price and the low efficiency of typical indigenous oil boilers. However cost is not the only driver as many people making the decision to change to gas do so in recognition of its convenience, reliability and efficiency. These considerations, linked to the cost of conversion, remain key factors in the switch to gas.

Green issues continue to dominate overall Government energy policy and this is also reflected in the political agenda in Northern Ireland. Given the lower carbon footprint of natural gas, the pressure to move away from more polluting fossil fuels, such as oil, continues to assist our conversion programme and expansion. This necessity to address the impact of climate change and the pressure to move towards a lower carbon economy greatly assists our efforts to promote the conversion to natural gas. As an example, homeowners switching from oil to natural gas can reduce their carbon footprint by up to half.

THE BUSINESS

The Group continues to build on its success to date and 2010 was yet another year of solid growth. The four operating divisions of the Group have strong plans to maximise their potential and they remain on course to deliver their key objectives. PNG continues to expand its network coverage and connections to homes and businesses.

The supply businesses (PSL and PEL) continue to enhance their service offering to customers and deliver gas at highly competitive but sustainable rates; underpinned by key market fundamentals in relation to costs. The early success of PEL in the ROI, where the aim is initially to supply large industrial and commercial users with gas, has exceeded initial expectations. In addition, our supply businesses have also continued to strengthen their gas trading expertise which underpins their ability to offer flexible and competitive gas prices to large users with complex price and volume requirements. At the same time they have expanded the gas market information provided to customers, with real time gas commodity price data delivered direct to customers mobile phones' and web-based applications.

Meanwhile PES continues to grow its share of the downstream after-sales market with repeat business and new product offerings underpinning the growth of this business, alongside its key role in supporting the metering, maintenance and emergency response activities of its other Group companies.

An active awareness of market changes, a keen eye for operating and capital efficiencies, and a strong process culture remain the cornerstones of our operations across the Group. 2010 has been no exception in demonstrating that these simple measures are the foundation of our success and that a strong 'can do' mentality underpins the culture of the organisation and the strength of its people.

During the year, PNG invested a further £12.9m in extending its network by a further 73 kilometres to establish gas in developing areas and to enable the connection of new customers to gas for the first time. The Group continues to seek new opportunities to expand PNG's current Licence areas in relation to both its distribution and supply activities. Gas expansion remains a key focus for Government; with a consultation document expected in late 2011 outlining the potential of taking gas to the West of the Province to areas such as Enniskillen, Omagh, Cookstown and Dungannon. The outcome of this consultation should be known in 2012.

Whilst the Greater Belfast Licence Area has been open for 'gas on gas' competition for the past eight years in the industrial and larger commercial markets and since 2007 for domestic and small commercial markets, 2010 saw real and active customer competition across all market sectors with new suppliers aggressively marketing to existing gas users. New suppliers are on the ground selling 'door to door', supported by very high levels of advertising aimed at customer acquisition. Currently PSL's cost base, potential margin and tariff price are all price controlled. As the only regulated gas supplier PSL still retains a dominant market share, however, as its market share falls the need for a regulated market also changes. Recently in ROI the regulator, the CER, responsible for regulation of the gas and electricity sectors, has removed regulatory market restrictions from ESB in the electricity market, as its market share fell to 60%. This is similar to the situation in Great Britain, where the energy markets operate on a competitive market basis.

THE FUTURE

The continuing depressed economic climate currently presents major challenges to PNG's ability to grow its connected customer base and thereby maximise utilisation of its gas distribution network. PNG has already connected 49% of all the homes and businesses who are readily connectable to its network. Despite the challenges its plan assumes that we will continue to increase this penetration to reach c.60% by 2016, with the addition of circa 8,000 new connections per year to the gas network within the existing licence area.

There also remain significant and challenging regulatory targets in relation to operating and capital efficiencies, connection growth and obligations set within the supply price control. The respective regulatory price control periods for both PNG & PSL in Northern Ireland run out in 2011 and both businesses are engaged with the Utility Regulatory in providing information. Ultimately new cost, efficiency and income cap targets will be set. The PNG price control will be set for 2-year period this time and then revert to 5 years thereafter in order to align with other gas distribution price controls in Northern Ireland. A final decision on the term of the PSL price control has yet to be made.

We expect 'gas on gas' competition in Greater Belfast to fully establish itself as the norm in 2011. The gas market outside of Belfast in the ten towns, being developed by Bord Gas Eireann's subsidiary, firmus energy, will open up to competition in October 2012. This will provide further opportunities for the Group's supply companies to compete fully across the island of Ireland. We aim to offset losses of load and customers by our trading business in Greater Belfast with loads gained both in the Republic of Ireland and elsewhere in Northern Ireland as the market outside opens fully in the forthcoming years.

Given that the objectives we must deliver remain unchanged, our priorities are consistent with those of 2010. Regardless of the wider economic pressures, we must continue to create our own success and each day win new customers and retain existing ones with unstinting enthusiasm and dedication to service. Our past was built upon and our future success depends on our outstanding people, their attention to detail and willingness to adapt to change and maintain the 'can do' mentality.

Peter Dixon
Group Chief Executive

ANNUAL REPORT & ACCOUNTS 2010
KELLEN GROUP
SECTION 2 : BUSINESS REVIEW

CORPORATE SOCIAL RESPONSIBILITY

Kellen Group's award-winning integrated Corporate Social Responsibility (CSR) programme is called 'LIFE' and stands for;

Leadership in the marketplace
Investing in our people
Fostering our community
Environmental responsibility.

'LIFE' has been developed to provide an overarching framework for the range of ongoing initiatives carried out by the Group that positively impact our marketplace, workplace, environment and community. We are delighted to have, for the sixth year running, received national recognition for our efforts by collecting a Business In The Community (BITC) 'Big Tick' award for CSR excellence.

LEADERSHIP IN THE MARKETPLACE

During 2010 the Group has continued to evaluate, enhance and show leadership in all aspects of Phoenix LIFE. The Group continues to be a strong advocate and corporate member of BITC, sitting on its Northern Ireland board and chairing its environmental arm – Arena Network.

Education Outreach

An integral part of Phoenix LIFE has been the Group's Education Outreach programme, which involves working with pupils of Primary school age right up to students who are involved in further education at Universities and Colleges. One of the initiatives within the programme in the past year saw post-graduate students from Queens University's Business School complete a collaborative partnership programme with Phoenix on the development of a 'Carbon Calculator'. The Phoenix carbon savings model was reviewed by the post-graduate students, who are studying Environmental Management, as part of a consultancy module at the Belfast University. The purpose of the Carbon Calculator is to allow householders and businesses to, on an ongoing basis, evaluate the carbon savings they are achieving as a result of switching their main energy source to natural gas from other fuel sources like oil or coal.

Also in the Spring of 2010, as part of national 'Engineers Week', and in conjunction with the Institution of Civil Engineers, Phoenix hosted an 'Engineers Day' for a large number of first year Secondary school children wanting to learn more about possible careers in engineering. The pupils spent the day learning engineering techniques and innovations relating to the gas industry. In addition, several presentations from senior engineering managers were delivered covering a wide range of activities linked to mechanical, gas and construction engineering subjects. The UK Government recently identified the areas of Science, Technology, Engineering and Maths (STEM) as being subjects that they would like to see youngsters strive to get qualifications in and this initiative over 'Engineers Week' was one of many that the Group were involved in throughout the year in an effort to help promote STEM.

In addition Phoenix continues to work closely with local Primary schools on a range of educational projects, most recently agreeing to mentor a group of 8-year-old children as part of the national 'Time To Read' programme. This involves a commitment from staff, across the Group, to attend local schools once a week for a full year, playing a key role in helping to improve the literacy levels of children by reading books with them.

INVESTING IN OUR PEOPLE

The Group also continues to invest in its most important asset – its people. Increasingly, there is evidence that Phoenix's reputation as a socially responsible organisation is helping to attract job candidates who recognise Phoenix as a company with a strong focus on its people. Furthermore Phoenix's staff turnover has fallen significantly over the last year and staff satisfaction surveys suggest that corporate social responsibility activities are a key reason for people staying with Phoenix.

According to recent surveys 98% of staff believe the Group's monthly 'Phoenix Fifteen' information sessions, are an "excellent" aspect of Phoenix LIFE.

Phoenix has also recently given its support to the BITC 'Business Action on Health Campaign'. This formal pledge confirms and again highlights Phoenix's ongoing commitment to providing a healthy workplace and to offering our staff support and information to help improve their overall health and well-being, whether it be inside or outside of work. We believe that this emphasis has significantly contributed towards the further falls in our absenteeism levels, which were already well below all industry benchmarks.

The Group continues to invest in the development of its staff through the application of a training programme across its businesses. This ethos has contributed to the fact that over 35% of staff within the Group have been promoted at least once during their time with the organisation.

CORPORATE SOCIAL RESPONSIBILITY

FOSTERING OUR COMMUNITY

Phoenix has a long history of supporting young people and providing them with as much help as possible in meeting their potential goals in life. Phoenix continues its commitment to support the Ulster Rugby Academy, which is known as the Phoenix Ulster Rugby Academy. It is designed to nurture, develop and prepare, the next generation of Ulster and Ireland rugby stars.

In 2010 the Group was also recognised by Arts & Business for its 10-year partnership with Belfast's Grand Opera House.

However it is Phoenix's Energy for Children Charitable Trust that undoubtedly continues to have the greatest impact in terms of changing people's lives in Northern Ireland for the better. The Trust was founded with the objective to break new ground and reach deeper into the heart of the local communities throughout Greater Belfast and beyond to improve the lives of disadvantaged children. Through staff and wider industry efforts, the Trust has so far raised over £300,000, every penny of which goes to needy children.

The Trust focuses on helping individuals or groups who, for whatever reason, have slipped through the net of the more established charity network. Behind the scenes Phoenix provides all fundraising, administration and operational support.

To date the Energy for Children Charitable Trust has helped well over 5,000 individual children. Industry enthusiasm for fundraising and wider support means we believe we will continue to help many more in the years ahead.

ENVIRONMENTAL RESPONSIBILITY

Around 2.6 million tonnes of carbon dioxide (CO2) has already been prevented from entering the local atmosphere by consumers switching to gas in the Phoenix Natural Gas licence area, with continued savings of around 250,000 tonnes of CO2 per annum (the equivalent of removing approximately 80,000 cars from Northern Ireland's roads each year).

Phoenix Energy Advisors have in the last year on average visited 200 homes every week to provide essential energy awareness and savings advice tailored to each individual home (over 10,000 homes a year). Through these audits,

Phoenix encourages people to: switch to what is a lower carbon fuel, to use more energy efficient appliances, to protect their homes from heat loss, to add insulation measures and to reduce overall energy consumption. In 2010 Phoenix's energy efficiency focused marketing campaigns were communicated to over 300,000 homes in Northern Ireland.

Phoenix continues to actively promote environmental awareness both internally and externally, through its in-house environmental team, involvement with local award schemes and through publicity campaigns. In 2010 Phoenix was assessed to be in the 1st quintile by ARENA Network in terms of environmental performance, meaning that the Group scored 80%+ in their environmental benchmarking survey.

Phoenix's investment in Corporate Social Responsibility has been developed to optimise the benefit to the Group and society, delivering a clear win-win situation. The financial resources attributed to LIFE are far outweighed by the voluntary effort, commitment and time given by staff to maximise the impact of all initiatives pursued.

DIVISIONAL REVIEW

PHOENIX NATURAL GAS

DISTRIBUTION

Phoenix Natural Gas (PNG) is the owner and operator of 3,091km of distribution network within its licence area, in the Greater Belfast and Larne areas of Northern Ireland, and has already made gas available to 284,000 premises and connected circa 139,000 customers to its network. The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

During 2009, PNG undertook an extensive rating process with Fitch and Moody's which culminated in a new subsidiary, Phoenix Natural Gas Finance plc, issuing £275m of 5.5% bonds repayable in 2017, guaranteed by both 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 received were used to repay existing acquisition debt providers across the Group, reorganise intercompany arrangements, repay fees and other costs and facilitate the return of any surplus to investors.

An additional £80m 3-year bank facility was also arranged to finance the future capital expenditure and working capital requirements of PNG.

GROWTH AND INVESTMENT

Distribution income of £39.5m in 2010 was £2.2m higher than that in 2009, generated mainly through the application of published conveyance charges to all gas distribution system users based on the volume of gas conveyed in the year. Charges are set annually in advance of the year (inclusive of an estimate of any surplus/deficit from the previous year) in order to recover the maximum allowed income for each year within PNG's Price Control for the 5-year period ending on 31st December 2011, as determined by NIAUR.

Income generated was higher than the regulatory 'determined' level for 2010, because actual volumes were significantly higher than those used when setting distribution prices. Consequently an over recovery of income of £5.0m has been accumulated at the end of 2010 (compared to £3.3m surplus at end of 2009). This will be carried forward and returned to all system users through lower conveyance charges in subsequent years.

128.0 million therms (mt) of natural gas was transported through the network, 16.4mt more than 2009. Volumes are estimated to have been higher than forcast by 14.4mt because average temperatures across the year were 1.3 degrees centigrade colder than the 5 year average, with the extremely cold first quarter and last quarter making 2010 one of the coldest years in recent history. This compares to 2009 when volumes were 0.2mt higher than forecast as a result of temperatures being marginally colder than average.

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) rose by 5.3mt, largely due to growth in throughput at one specific new customer in 2010. Otherwise demand continues to be influenced by economic pressures on business customers and the continued focus on energy efficiency and environmental initiatives.

Elsewhere, throughput in the domestic and smaller industrial & commercial sectors rose by 11.3mt with demand driven by colder weather in 2010 together with an increasing number of customers connected to the network and some load growth within existing users.

Operating profits of £15.7m were £0.2m lower than in 2009 with the growth in distribution income being offset by increases in operating costs. Actual operating costs in PNG are monitored closely in real terms against the levels assessed by NIAUR in determining allowed income. Whilst the implication of growth in business will drive cost increases each year, this has been partially offset in 2010 by ongoing efficiencies being delivered by the business.

PNG invested a further £12.9m in capital expenditure during 2010, constructing 73km of new network and connecting

8,081 new customers. By year-end, PNG had 3,091km of network in operation, making gas available to 283,780 premises in its licence area, with a total of 138,754 (49%) already connected.

OPERATIONS AND REGULATION

The company met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending Public Reported Escapes, targets were exceeded.

During 2010, the distribution network continued to operate without major incident.

No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2010.

A 'peak day' for demand of 24.4 GWH was recorded on 21st December 2010, which compares to the 2009 'peak day' of 18.3 GWH. However it should be noted that in 2010 throughput on this peak day was driven by exceptionally low temperatures (-10.1 degrees centigrade) compared to the temperatures on the previous 2009 peak day of +0.8 degrees centigrade.

PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is recognised as exemplary when benchmarked against other organisations throughout Northern Ireland. Our ongoing operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO 14001 and 18001.

PNG continued to build upon the solid regulatory foundation established in 2006 through the 40 year licence agreement with NIAUR by completing a modification to its licence to remove the cap on the number of pay as you go (PAYG) meters that it is allowed within its regulatory cost base. PAYG meters are widely requested by consumers in the PNG licence area and as a result account for half of the connected customer base. In addition the ring fencing conditions, which were implemented through a licence modification in 2009, came into full effect in 2010. A key requirement of these conditions was to ensure that the majority of the directors in PNG were non-executive, an obligation that has now been fulfilled. These conditions bring PNG in line with other regulated utilities within Northern Ireland and the rest of the UK.

MARKET OVERVIEW AND OUTLOOK

The Northern Ireland Housing Executive (NIHE), is the body responsible for all of Northern Ireland's public housing. Over the last 15 years PNG has been involved in helping to develop heating replacement programs in line with the development of the natural gas infrastructure. A high proportion of available NIHE properties have already been connected to natural gas and the number of new connections in this sector is planned to slow down over the forthcoming years.

Within the new build housing market, 2010 saw a continued slowdown in activity, both in terms of house sales as well as new housing schemes starting up. However PNG has seen a build-up of new schemes within the planning system, many

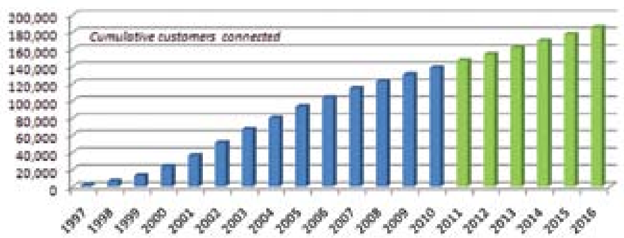
DIVISIONAL REVIEW

of which have been re-worked to make them economic. Therefore based on its success at capturing virtually all new developments within its licence area to date, PNG is well positioned to provide natural gas to all new housing projects in Greater Belfast during 2011 and beyond, once the market conditions become more favourable.

In the owner occupied sector PNG, whilst having met all of its obligations regarding the provision of gas network, continues to expand. Further investment is planned throughout 2011 to extend the gas network in established private residential areas where a strong propensity for customers to convert can be demonstrated.

In 2011 PNG plans to invest in a further 70km of new distribution network to bring the opportunity of natural gas to a further 8,000 potential new customers as well as undertaking a strategic reinforcement of its system in a key industrial area of Belfast because of future expected increases in demand.

PNG has established a large network of manufacturers, distributors, merchants, retailers, and installers throughout its licence area. This network focuses on meeting the needs of new gas users and developing incentives and offers to encourage customers to switch to natural gas. Through our ongoing relationship with Government agencies, PNG will maximise consumer opportunities provided by Government funded schemes, such as 'Warm Homes', "Cosy Homes", "Healthy Homes", "Snug Plus" - converting the fuel poor to a modern and efficient natural gas heating system. PNG continues to lobby for the introduction of a 'Boiler Scrappage' scheme similar to the scheme which has been made available within other parts of UK.



DIVISIONAL REVIEW

SUPPLY (NI)

Phoenix Supply Limited (PSL) is the largest natural gas supplier in Northern Ireland supplying more than 99% of all customers connected to the Phoenix Natural Gas (PNG) network in Greater Belfast and Larne with natural gas.

OPERATING PERFORMANCE

Turnover for the year of £101.1 million was £5.3 million lower than in 2009 as a result of the significant fall in wholesale gas costs being passed on to its customers through lower selling prices.

During 2009 published selling prices in the tariff sector were reduced by 22.1% in January and by a further reduction of 19% in October. However during 2010 selling prices in the tariff sector remained unchanged at this lower level. As the majority of contracts within the large industrial and commercial sector have pricing arrangements directly linked to the wholesale gas market, these selling prices reflected directly the reduction in wholesale gas costs applicable to this sector.

The fall in turnover as a result of lower selling prices was partially offset by higher volumes supplied to customers during the year. The volume of gas supplied in 2010 was 112.9 million therms (mt) which represented an increase of 7.6mt (7%) from the volume of gas supplied in the previous year. This was driven largely by the exceptionally cold weather at both the start and end of the year together with a growth of new customers connected to the network. This was partially offset by the volume associated with customers which have transferred to other gas suppliers as competition develops in the PNG distribution licence area.

Operating profits of £0.6 million were £2.9 million below the level reported in 2009. This was due to gas costs savings generated in previous periods being returned to customers during the year, in line with the PSL's price control mechanism.

Under the terms of PSL's regulatory price control, all gas cost savings are required to be returned to customers at the subsequent tariff review. This principle provides significant protection to customers and is demonstrated by the scale of price reductions applied by PSL in 2009 in contrast to the response by other suppliers across the UK where no such arrangement is in place.

Under the terms of the £80m capital expenditure and working capital facilities taken out by PNG, PSL has indirect access of up to £20m to support its own working capital requirements.

GROWTH AND DEVELOPMENT

The company continued to grow during the year with 8,081 new customers being supplied by PSL following their connection to the gas network. Despite the intensification of competition from other gas suppliers PSL supplied over 89% of the total gas supplied to customers within the Greater Belfast licence area.

PSL continues to be innovative, developing new products which underpin the strong customer focused ethos of the business. During the year a mobile text alert service was developed which provides a summary of wholesale market prices to customers via a text alert to their mobile telephone or other portable device. This ensures customers can be provided with the latest wholesale gas market data in a timely and convenient manner.

The strong customer service credentials of the company were recognised by the company winning a Best Business Award for Best Customer Focus and being finalists in the customer care categories of the Utility Industry Achievement Awards and National Business Awards. These national awards showcase best in class customer service and the company is proud to have reached the finals of these prestigious award programmes.

DIVISIONAL REVIEW

PHOENIX NATURAL GAS SUPPLY

MARKET OVERVIEW AND OUTLOOK

WHOLESALE GAS MARKET OVERVIEW

Generally, wholesale gas prices rose steadily across the year after having fallen significantly in 2009 with a number of factors helping to support this price movement.

At the start of the year, temperatures were well below seasonal normal levels. As a result of record demand, National Grid issued four Gas Balancing Alerts (GBA) in January 2010. This level of intervention was unprecedented as only one GBA had previously been issued since their introduction. A GBA is issued when some form of supply or demand side response is required to ensure the physical balance of the system.

Higher demand at the start of 2010 ensured that the level of stocks in the UK's long term storage site at Rough depleted very rapidly and the site reached 7.5% fullness by mid-March. This was much lower than in previous years when storage was around 25% full at the end of the winter. As a consequence there was higher demand during the summer period as a higher level of injections were required in order to replenish storage stocks in advance of the winter period commencing.

The Rough storage facility only reached 91.5% fullness by the start of the winter on 1st October 2010. In previous years the site had been almost 100% full and the lower level of storage stocks led to concerns among traders that there could be difficulty balancing the UK system if there was a cold winter.

As it transpired, there was a cold start to the winter and December 2010 was one of the coldest months in the UK in over 100 years. Storage levels depleted rapidly and by the end of the year stood at 45% fullness compared to 82% at the same time the previous year. This added to nervousness in the wholesale market and fed bullish sentiment.

Despite there being record levels of liquefied natural gas (LNG) reaching the UK in 2010 the downward pressure on wholesale prices of this increased supply was more than offset by an increase in demand which, during the summer, was also supported by a higher level of exports through the Interconnector to Europe.

The average System Average Price (SAP) for the summer of 2010 was 40.7 pence per therm which was higher than the average SAP for the previous winter of 31.5 pence per therm. Wholesale gas prices have continued to increase and for the most recent winter the average SAP was 54.6 pence per therm.

Since the year end wholesale gas costs have continued to increase largely as a result of social and political instability in North Africa and the Middle East and the potential impact on the nuclear power industry of the earthquake and tsunami in Japan on 11th March 2011. As a direct result of this increase in wholesale gas costs, PSL increased its tariff prices by 39.1% on 1st May 2011.

GAS ON GAS COMPETITION

Market conditions in 2011 are expected to be challenging with the company facing competition from other suppliers in supplying gas to customers across all market sectors for the first time. Until the end of October 2010 the company enjoyed 100% market share of the domestic sector. However active competition commenced in November 2010 when firmus energy (a subsidiary of the ROI's publicly owned gas supply company BGE) entered the market and directly discounted PSL's regulated tariff.

The company will continue to focus on providing customer service which exceeds customer expectations which is the foundation of its customer retention strategy. However whilst it retains a significant market share, PSL will continue to be subject to regulatory controls on its tariff prices.

It is expected that the retail market in the 'Ten Towns' outside Greater Belfast, which are being developed by firmus energy, will open to competition for the large industrial and commercial sector from 1st October 2012. This market is currently closed to PSL and the company looks forward to being able to compete in this market.

PSL currently operates under a supply price control which covers the period from 2009 to 2011, inclusive. During 2011 further discussions will take place with the Utility Regulator in respect of a new price control which will cover a period yet to be confirmed.

PSL continues to be regarded as the premier provider of wholesale gas market information to industrial and commercial customers and provides a weekly wholesale gas market review to around 1,000 energy buyers and senior executives across the island of Ireland. Our dedicated gas purchasing team, based in Belfast, continues to provide bespoke gas purchasing solutions and advice to customers in the industrial and commercial market sector.

DIVISIONAL REVIEW

PHOENIX ENERGY LIMITED

SUPPLY (ROI)

Phoenix Energy Limited commenced supplying natural gas in the Republic of Ireland towards the end of 2009 and by the end of 2010 when combined with supply activities in Northern Ireland, Phoenix gas supply businesses were established as the second largest on the island of Ireland.

OPERATING PERFORMANCE

Turnover in 2010 of £5.4 million was generated by the business in its first full year of trading having only commenced supplying its first customer towards the end of 2009.

The company supplies customers in the large industrial and commercial sectors in ROI on an individual contract basis with pricing arrangements directly linked to the wholesale gas market and relevant published conveyance charges. Therefore, average selling prices across the year tend to directly reflect monthly movements in the wholesale gas market.

The volume of gas supplied in 2010 amounted to 10.0 million therms representing the throughput from its growing industrial and commercial customer base as they transferred from other gas suppliers during the year. Phoenix Energy's customer base now extends across manufacturing, pharmaceutical, agrifood, hospitality and public sectors and includes the largest industrial user ever to switch from the incumbent supplier, BG Energy, (owned by Board Gas Eireann) in ROI.

The company generated an operating profit of £0.1 million during the year which represents a £0.2 million increase in performance compared to 2009, when it recorded a small loss associated with the costs of market entry.

While the company operates under a licence granted by the Commission for Energy Regulation (CER), it is not subject to price regulation, allowing PEL to compete directly with other licensed gas suppliers in the ROI.

GROWTH AND DEVELOPMENT

PEL provides a comprehensive range of flexible gas purchasing options to in the Irish marketplace including fixed and variable pricing options. The company also provides innovative and bespoke capacity management products tailored to individual customer requirements, procurement strategies and risk appetite.

Competition in the ROI is more established than in NI with a total of nine licensed natural gas suppliers active in the market. PEL's initial entry into the market was to compete in the above regulated tariff formula (RTF) sector, which contains the largest industrial and commercial users in Ireland. By the end of 2010 PEL had already grown its market share supplying 23% of all volumes in this sector with gas, with BG Energy supplying the remainder.

PEL has since extended its offering into the RTF market and expects to grow its market share in this sector throughout 2011.

During the year the company achieved recognition for its impressive growth and development by receiving the Spirit of Enterprise Award. The award, organised by Chartered Accountants Ireland (Ulster Society) and Northern Bank were established to reward indigenous companies which demonstrate real entrepreneurial spirit combined with the innovation and creativity to succeed.

OUTLOOK

The natural gas market in the ROI is over four times larger than in NI and provides significant opportunity for a further period of growth in 2011. PEL has the platform, brand and team to continue to deliver strong growth by winning new customers across the industrial and commercial sectors in which it operates and by consolidating its position in the Irish market.

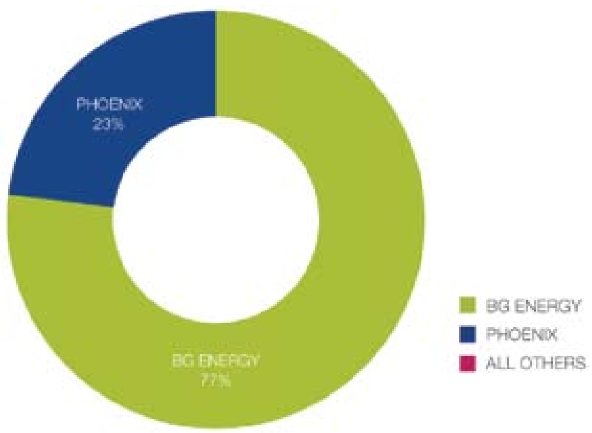


Figure 1
Market share of above RTF
(non power generation) sector in 2010

DIVISIONAL REVIEW

PHOENIX ENERGY SERVICES

ENERGY SERVICES

Phoenix Energy Services (PES) is the leading provider of natural gas boiler and appliance servicing, emergency response, gas metering and meter reading services in Northern Ireland. From a business start-up position in 2001, the company now undertakes more than 45,000 service engineering and 269,000 meter reading visits annually, using a professional team of Gas Safe Registered engineers and other multi-skilled staff.

BUSINESS REVIEW

Turnover of £3.5m in PES was £0.6m higher than in 2009, in line with the continued expansion of the business, both internally to PNG and PSL and externally through growth in services to home owners and businesses. Operating profits increased to £0.6m.

Phoenix Energy Services is now a well established brand in Northern Ireland's growing natural gas market. Along with the proven capability of delivering a world-class emergency service to gas consumers, the business also provides professional support to the Group's distribution and supply businesses through a range of other business-critical activities, including gas asset installation, maintenance and meter reading.

The achievements of the company over the past year have been recognised within the industry with the presentation, for the third year in succession, of the CORGI "Installer of the Year" for Northern Ireland award 2010. There was further recognition from the Institution of Gas Engineers and Managers (IGEM) for the company's innovative apprentice development programme with the presentation in May in London of the Business Skills Award.

24/7 Emergency Response Service

PES continues to deliver a professional downstream emergency response service to the core distribution division, ahead of agreed industry standards. This area of operations currently accounts for 34% of the service engineering visits undertaken, with activity growing alongside the expanding natural gas infrastructure in Northern Ireland.

Asset Installation and Maintenance

This arm of the business delivers a range of meter installation and maintenance services to the distribution division and constitutes a further 43% of downstream service engineering activity. While minimising unnecessary activity in this area will obviously be a focus for the distribution business, activities will grow in line with the increasing customer base, competition in the supply market and the changing age profile of the network.

Customer Support Services

PES provides a one-stop-shop for boiler and appliance maintenance, repair, landlord inspection, commercial planned maintenance and boiler insurance breakdown protection. This work constitutes 23% of the downstream service engineering activity and continued to deliver increased revenue into the business in 2010 despite the general economic downturn. This expansion reflects continued success in this developing market and is the result of building customer loyalty through excellent service delivery and the innovative marketing of products such as the boiler insurance breakdown package "Phoenix ServiceCare". A series of focused marketing campaigns has also delivered growth in the boiler service and repair areas.

Meter Reading and Related Activities

Meter reading activities have been further developed in 2010 with an emphasis on increasing productivity through better use of technology. A total of 269,000 reads were completed in support of the billing programme of its main meter reading customer, Phoenix Supply.

MARKET OVERVIEW AND OUTLOOK

Trading conditions remain buoyant in the customer support services sector, due to ongoing targeted marketing supported by continued repeat business despite the challenging economic conditions. Customer awareness of increased energy efficiency across all areas of the economy has been a strong driver for proactive maintenance of all appliances. With volatile fuel and other domestic costs, the benefits of fixed price boiler insurance packages such as 'Phoenix ServiceCare' remain attractive.

Emergency services and asset maintenance activities will continue to grow in tandem with the expanding natural gas market in Northern Ireland. The increasing age of installed plant and equipment will also be an ongoing source of work in this safety critical area. Meter reading services will continue to focus on increasing productivity in order to support the efficiency targets placed upon the regulated supply business.

Overall, the future growth prospects of PES are looking extremely healthy, thanks to anticipated further growth of the Northern Ireland gas infrastructure and consumer market.

BOARD OF DIRECTORS

DR GEORGE GREENER CBE
CHAIRMAN

George Greener brings to Kellen significant and varied experience at directorship level, most recently as Chairman of the National Health Service in London. Before joining the Kellen Board, he was Senior Independent Director of Reckitt Benckiser plc, as well as Chairman of the British Waterways Board, The Big Food Group plc, Swallow Hotels plc, Allied Dunbar Assurance plc, Eagle Star Holdings plc and Threadneedle Asset Management plc. In addition, George held the posts of Chief Executive Officer of BAT Financial Services and Director of BAT Industries plc. George has also served as Group Chief Executive Officer of Hillsdown Holdings plc.

SAMI KASSAM
NON EXECUTIVE DIRECTOR

Sami is an Associate Director at TFCP. Sami brings with him significant transaction experience, having been on the investment team at TFCP since 2006. Whilst at TFCP, Sami has been primarily focused on the energy and infrastructure space, with recent notable transactions including the refinancing of Infinis, the take private of Novera Energy and the acquisition of Consolidated Pastoral Company. Prior to joining TFCP, Sami worked as an Investment Banker within Citigroup's M&A team.

LORENZO LEVI
NON EXECUTIVE DIRECTOR

Lorenzo is an Operational Managing Director at TFCP. He has had a wide-ranging career encompassing sales management and corporate development for companies such as IBM and Nortel Networks, to strategy for management consultants, Bain & Co. He now puts these skills and expertise to good use at Terra Firma. In addition to due diligence work on transactions, Lorenzo also handles post-acquisition operational challenges which differ greatly. At Terra Firma, in the cinema investment his role includes driving acquisitions across Europe, while his work in the aircraft leasing business has included managing the integration of the two acquired companies.

NILS STEINMEYER
NON EXECUTIVE DIRECTOR

Nils is a Finance Director at TFCP. He joined TFCP in 2003 with a remit to align the financial management and reporting standards across the portfolio businesses. Prior to TFCP, Nils spent 11 years with General Electric Co. (USA) in a wide range of finance roles across various divisions of the company, including 5 years in businesses where General Electric was a minority shareholder.

SIR GERRY LOUGHRAN KCB
NON EXECUTIVE DIRECTOR

As Chairman of Phoenix Energy Holdings, Sir Gerry Loughran brings a wealth of experience and expertise in the public and private sectors. He has served as Permanent Secretary of the Industry Department (Department of Economic Development) in Northern Ireland and subsequently was appointed Head of the Northern Ireland Civil Service and Secretary to the Northern Ireland Executive. In this role he led 29,000 members of the Northern Ireland Civil Service until his retirement from the Service in 2002. Since then he has held a number of appointments in the private sector. He is currently Chairman of Blackstaff Press, Director of Allied Irish Banks (UK) PLC, the Baird Group and Forward Emphasis International. He also serves on several Boards in the education and training sectors.

PETER DIXON
GROUP CHIEF EXECUTIVE

Peter has spent his entire career in the gas industry, acquiring over 34 years' experience. He started out as an Engineer in 1976 with North West Gas and went on to play a key role in the break-up of what was then the old British Gas. Peter joined Phoenix Natural Gas as Commercial Director in February 1997. He was appointed Chief Executive in July 2000. He is currently Chairman of the Energy for Children Charitable Trust, as well as Chairman of Arena Network - the environmental arm of Business in the Community of which he is also a Board member. In 2008 he was appointed a Belfast Harbour Commissioner.

MICHAEL MCKINSTRY
GROUP FINANCE DIRECTOR

Michael has been with Phoenix from its earliest days, joining the fledgling company in 1996 as Finance Director. He took his place on the Group Board in January 2006 following the acquisition of Phoenix by Kellen. Because Michael has been at the financial helm of Phoenix throughout its history, overseeing the various changes to its ownership, corporate, financial and regulatory structures, as well as developing its strategies, he has a comprehensive knowledge and understanding of the business. Prior to joining Phoenix, Michael gained extensive financial management experience across a broad range of business sectors, starting in heavy engineering with GEC, in the textiles industry with Ulster Weavers and in the energy industry with Premier Power following its purchase by British Gas.

FINANCIAL REVIEW

2010 was another year of strong performance across the Group. Despite the difficult economic climate, the constraints arising within financial markets and uncertainty created by reduced public sector spending, each of its businesses have delivered results ahead of expectations. In addition the extremely cold weather experienced in the year has increased gas throughput and thereby boosted income levels in both the gas distribution and supply businesses in the year.

2010 was the first full year for Phoenix Natural Gas (PNG), the gas distribution business, to operate under the terms of its investment grade rating and to report to debt investors on its financial covenants. Its strong operating performance has supported its ratios being calculated ahead of expectations and therefore, well within required levels.

The Group has sought to enhance performance of its distribution business in the year through further investment in its network and growth in customer connections. It has also continued to focus on improving efficiency and managing costs in line with its licence obligations and regulatory assumed levels. In addition it has sought to improve its operating performance within supply and energy services businesses through the growth of its customer base in new markets as opportunities open up and retention of as high a market share as possible in its existing markets – it has achieved this through management of trading risks, enhancing customer service and controlling costs.

TURNOVER

Group turnover of £111.0m in 2010 is £2.6m higher than in 2009.

Distribution income in Phoenix Natural Gas (PNG) has risen by £2.2m to £39.5m as a result of a significant rise in gas throughput in the year.

Distribution prices are set in advance of each year on the basis of forecasts of gas throughput and RPI. As a result actual income generated will be higher or lower than the maximum allowed level as a consequence of the utilisation of such forecasting estimates. The difference arising (either surplus or deficit) is thereby accumulated at the end of the year as a 'Z balance', to be adjusted in charges in future years.

Distribution income was £1.7m higher than allowed levels within its price control in 2010 and £2.7m higher than the level allowed in 2009. As a consequence the level of accumulated over-recovered income has grown to £5m at the end of 2010. This balance increased rather than decreased in the year as a result of the extremely cold weather experienced at either end of the calendar year which pushed up gas throughput and the income generated therefrom.

	TURNOVER £ 2010	2009
Distribution (PNG)	39.5m	37.3m
Supply (PSL)	101.1m	106.4m
Energy Limited (PEL)	5.4m	-
Energy Services (PES)	3.5m	2.9m
Intra Group Sales	(38.5m)	(38.2m)
Total	111.0m	108.4m

Income in Phoenix Supply (PSL) has fallen by £5.3m despite an increase in throughput compared to the previous year. This was driven by lower average selling prices as the company passed through the lower wholesale gas costs to customers.

Phoenix Energy (PEL) has generated £5.4m of income during its first full year of trading as a result of its initial customer acquisitions whilst Phoenix Energy Services' (PES) income has risen by £0.6m primarily as a result of an increase in activity provided to its core distribution business in the year.

Further detail behind movements in turnover is provided within the divisional reports on pages 14 to 23, but a summary is outlined below:

OPERATING PROFIT

Group operating profit reduced by £2.7m to £17.9m in 2010 predominantly as a result of lower operating profits generated in PSL.

Operating profit within PNG of £15.7m (2009: £15.9m) is primarily driven by the income levels allowed for within its current 5-year price control issued by NIAUR less the respective costs involved in operating the business.

It should be noted that PNG operating profits in both 2009 and 2010 benefited from income generated being higher than that allowed in the price control. Future operating profits will therefore be impacted by the £5m of over recovered income being returned to customers in discounted charges.

Operating profit within PSL in 2010 of £0.6m (2009: £3.5m) reflects a return to tariff customers of a proportion of gas cost savings generated in previous years in line with the terms of its tariff price control, whereby differences in actual gas costs incurred compared to forecast included

in tariff assumptions are incorporated into future tariff reviews.

PSL is subject to a price control with regard to the prices it charges to its tariff customers (domestic & small commercial). Under its price control profit is currently capped at 1.5% of turnover and actual gas costs are allowed to be 'passed through' to customers in charges over time. Whilst the contract market has been open for some time, the tariff market has opened up to competition from November 2010 and Phoenix is now competing directly with other suppliers for tariff customers. The impact of loss of tariff customers, whilst fairly limited at the end of 2010, is expected to grow through 2011 as tariff competition is fully established. Therefore its market share is likely to move towards levels experienced in other liberated gas supply markets.

As a result of significant rises in gas costs being experienced post year-end in 2011, together with the rise in gas costs normally experienced during the winter months, the majority of any gas cost savings carried forward are expected to have been passed back to customers during the early part of 2011. However the impact of the current rising cost of gas in the wholesale market was only experienced by customers when PSL reviewed its selling prices post year-end in April 2011.

PEL generated a profit of £0.1m in its first full year of trading, with customer acquisition activities continuing as the business seeks to establish a strong position in the gas supply market in ROI.

	OPERATING PROFIT £ 2010	2009
Distribution (PNG)	15.7m	15.9m
Supply (PSL)	0.6m	3.5m
Energy Limited (PEL)	0.1m	(0.1m)
Energy Services (PES)	0.6m	0.4m
Other	0.9m	0.9m
Total	17.9m	20.6m

Operating profit within PES has increased by £0.2m as a result of a significant rise in the amount of work provided to its main customer PNG, both as a result of an increase in planned maintenance activities and also metering and emergency response activities associated with the extremely cold weather.

OPERATING CASH FLOWS

During the year, net cash inflow of £33.0m was generated from operations compared to £32.3m in the previous year.

Included within operating cash-flows is £4.0m of cash held as collateral against outstanding guarantees (mainly as part of credit arrangements to suppliers) under bank facilities. This is £24.0m lower than cash collateralised in the previous year partially as a result of credit obligations to a previous supplier now being retired and partially through provision of credit arrangements by an alternative means.

A further £12.9m (2009: £12.1m) was re-invested in the Group to fund expansion to the distribution network and connect new customers, while £17.7m (2009: £30.5m) was used to meet interest obligations and other financing costs in respect to the Group's bank borrowings and bond providers. However it should be noted that comparable costs for 2009 included £16.9m towards one-off 'swap break' costs arising as a result of refinancing.

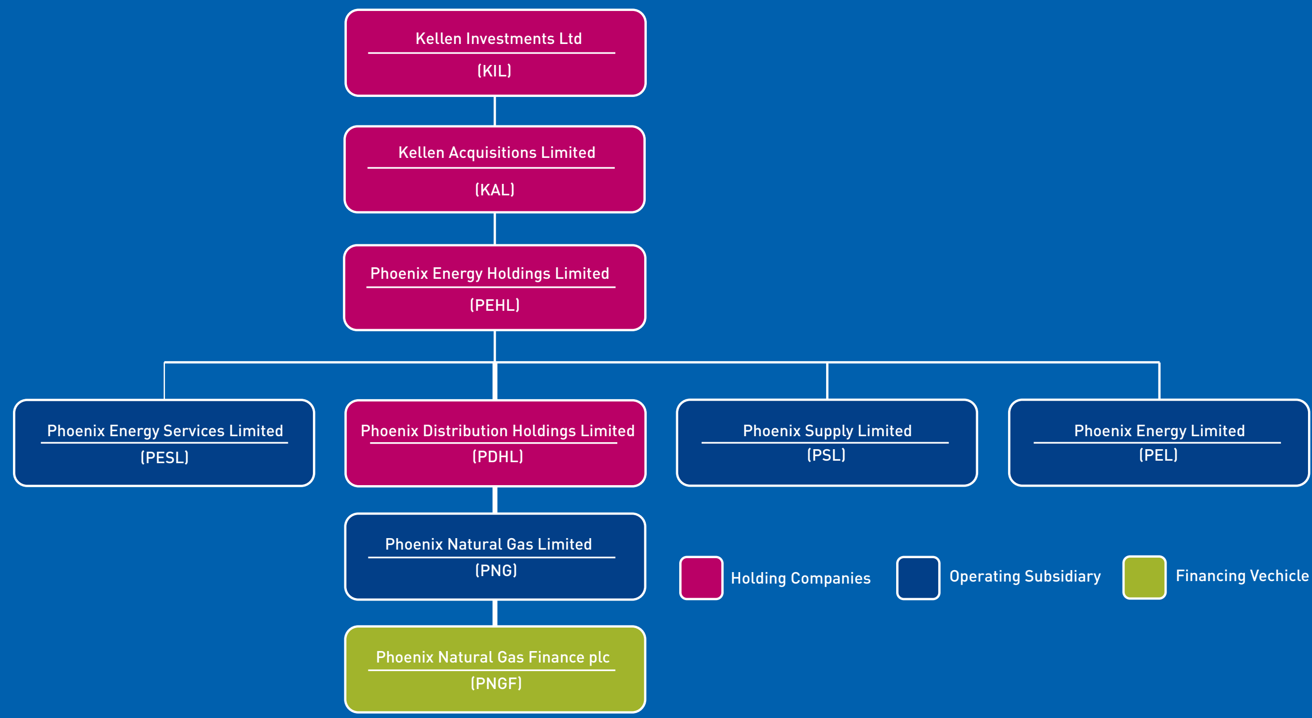
In addition the £5m drawn previously by PNG under its revolving bank facilities was repaid in the year out of the surplus of cash resources available.

The net result of these cash flow movements was that cash held at bank or in hand at the end of 2010 has reduced by £2.6m from the balance at the end of the previous year.

BANK BORROWINGS

At the end of 2010, net debt decreased to £233.4m compared to £258.7m at the end of 2009.

Bank balances at the end of 2010 increased by £21.4m to £34.9m whilst the £5m drawn under PNG's 3-year £80m bank facilities was repaid during the year, with business



cash-flows benefiting from £24.0m of cash released from collateral in the year.

In addition the balance outstanding to bondholders (net of capitalised fees) increased by £1.1m to £268.3m at the end of 2010 as a result of the amortisation of fees.

The Group is principally involved in the development of long-term infrastructure assets, owned by PNG, with underlying income growing over time in line with growth in connections.

The Group's principle sources of debt finance is through the issue by Phoenix Natural Gas Finance plc, a 100% subsidiary of PNG, of £275m bonds at a rate of 5.5%, guaranteed by PNG and PDHL (the holding company of PNG) repayable in 2017. These bonds were rated Baa2 by Moody's and BBB+ by Fitch.

In addition PNG entered into a £80m 3-year facilities agreement with Barclays Capital and The Royal Bank of Scotland plc in 2009 made up of a £50m revolving credit facility to support continued investment in capital expenditure within the distribution division, and a £30m working capital facility to finance working capital requirements within PNG. As part of this working capital facility PNG can lend up to £20m to PSL to finance its working facilities.

The debt facilities require the "financing group" (PDHL, PNG & PNGF) to comply with certain financial and non-financial covenants. The covenants include a limit in borrowings linked to the regulatory asset value of our assets (TRV & DAV) and ratios linking earnings to net interest paid.

In addition at the end of 2010, £2.2m of contingent liabilities associated with guarantees granted to loan note holders under a previous bank facility remain outstanding together with £1.8m under a new letter of credit arrangement entered into by PSL and The Royal Bank of Scotland plc.

BUSINESS GROWTH

The principles underpinning the growth of PNG are defined within the 5-year price control for 2007 - 2011. Plans include: network extension to make gas available to new industrial, commercial and domestic developments, taking gas mains into areas where customers have a strong propensity to convert from their existing fuel to natural gas, and meeting our obligations to NIHE to make gas available to tenants in line with its refurbishment programme.

During the year, the Group invested a further £12.9m in capital expenditure. Investments included construction of 73km additional distribution mains and connection of a further 8,081 new customers in 2010.

While the licence under which PNG operates requires investment in a network to make gas available to a minimum number of customers, PNG has reached the point where its obligations with respect to availability have been fulfilled. Therefore a growing proportion of future investment will be directed at connecting customers to the existing network. In support of this, PNG continues to invest in an extensive sales and marketing programme to all potential new customers and manages customers up until the date they are connected and using gas. PNG charges all gas suppliers, including PSL, for utilisation of its network in line with the terms of its network code.

PRINCIPAL RISKS AND RISK MANAGEMENT

The Group's management structures, coupled with appropriate policies and procedures on how the respective businesses function, are designed to enable the achievement of business objectives while controlling the risks associated with the environment within which it operates.

The key business risks and uncertainties affecting the Group, together with the means by which we manage them, are outlined below:

REGULATORY RISK

PNG, PSL and PEL operate under licences issued by government. As a result, the Group devotes a considerable amount of time to the management of regulatory matters with both NIAUR and DETI (Department of Enterprise, Trade and Investment) in Northern Ireland and CER (Commission for Energy Regulation) in the Republic of Ireland. Compliance with the ongoing requirements of these licences, changes arising from the evolving regulatory environment, (including those associated with the agreement reached with NIAUR in November 2006), EU obligations, the full introduction of supply competition, and the implications of price controls, mean that significant attention has been and will continue to be dedicated to regulatory compliance. Indeed the Group allocates a specialist resource to this task.

The Group manages the relationship with NIAUR, DETI and CER at senior management level in each of the regulated businesses, supported by a dedicated resource within common services in PNG.

HEALTH & SAFETY RISK

As a provider of an essential service to the public, the Group works in an environment where health and safety must take top priority within the operating businesses. At the heart of the Group's safety culture, the 'ASHES' system ensures all employees understand the rigorous policies and procedures in place to deliver a safe operating environment. Through a dedicated manager within PNG, by stringently controlling health and safety performance from company board level through to field operations, and with the strategic support of The British Safety Council audits and ISO accreditations, the Group is able to manage any health and safety risks that may arise.

BUSINESS CONTINUITY RISK

The Group has measures in place to mitigate the risks associated with managing the business in the event of a gas supply emergency, or any other occurrence which could affect the ability of all or part of the Group to function normally, potentially affecting financial performance.

As a rule, gas supply emergency risks are managed through the contractual relationships that exist in the Transmission Network Codes and the agreements between the Transmission System Operator and the Distribution System Operator. In addition, general operational risks are controlled through the establishment of prudent and safe operational processes and through a structured and highly focused approach to capital expenditure in conjunction with robust maintenance procedures. Regular emergency exercises involving all gas operators and selected local essential service providers in Northern Ireland are simulated to test and further develop the processes in place. The Group also maintains a comprehensive business continuity plan which includes details of our IT recovery plan and is updated, reviewed and tested on a regular basis.

GAS PRICE COMMODITY RISK

PSL & PEL are exposed to the wholesale cost of gas, which they must acquire. To minimise exposure, hedging instruments and forward exchange contracts are used to try and match the price charged to customers with the costs incurred by the Group.

In addition, in the tariff sector it is necessary to forecast gas costs forward for the tariff year. Therefore PSL is exposed in the short term to the actual costs incurred being different to the price being charged to customers. PSL has agreed a mechanism with NIAUR within its price control, so that differences between actual and forecast are reflected in future tariff price reviews. PSL has a dedicated gas trading manager who monitors the gas cost daily and ensures, wherever possible, that supply contracts are matched with purchase arrangements on behalf of both PEL and PSL. A purchasing strategy is agreed by the Group board which sets levels for buying gas forward, especially across times when gas costs are expected to be more volatile, with the balance of any requirements being purchased on a within day basis.

FINANCIAL RISK MANAGEMENT

Group operations bring exposure to a variety of financial risks, including the effects of changes in liquidity and interest rates. The Group exercises strong financial and management accounting controls through the consolidation of all financial and treasury requirements within the finance function within common services in PNG.

ANNUAL REPORT & ACCOUNTS 2010 KELLEN GROUP
SECTION 2 : BUSINESS REVIEW

Long-term business plans and shorter term budgets and forecasts are tracked monthly against actual performance at both a company and consolidated group level in line with obligations under financing agreements, thereby enabling financial requirements to be monitored against the cash resources available to both the Group as a whole and its constituent parts.

A mixture of long-term debt, raised through the issue of fixed rate bonds, and short-term debt available within our banking facility, are used to ensure that there are sufficient resources available for operational requirements. The Group does not use derivative financial instruments for speculative purposes.

The Group has delegated the responsibility of monitoring financial risk management to the Finance Committee, a sub-committee of the Board. The policies set by this committee are directly implemented by the finance function.

EXCHANGE RATE RISK

The Group operates through its subsidiary, PEL in the Republic of Ireland and as such has to deal with exchange rate risks associated with the purchase of goods and raw materials in a currency which may be different to the currency in which it receives its income.

Where such exposure exists, PEL limits the impact of such exchange rate fluctuations by the use of hedging instruments such as forward exchange rate contracts to limit the effect on its performance.

CREDIT RISK

The Group's principal current assets are bank balances, cash, trade and other receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of these cash flows.

PNG is exposed to credit risk arising mainly from the risk that gas suppliers are unable to pay distribution charges as they fall due. The risk is partially mitigated by the requirement for all suppliers to comply with credit arrangements within the PNG Distribution Network Code to evidence their ability to pay for distribution charges when they fall due, thereby reducing the risk of payment default by a supplier.

In 2010 89% of all distribution revenue was received from the Group's own supply business PSL. In addition at the end of 2010 99.9% of all annual distribution income generated was provided on the basis of prepayment of monthly charges by the supplier in advance of the month.

Revenues within PSL and PES have no significant concentration of credit risk with a specific customer. Credit exposure is spread over a large number of individual customers.

Michael McKinstry
Group Finance Director

BUSINESS AWARDS

WINNER
Best Business Award:
Best Customer Focus
2010

WINNER
Chartered Accountants Ireland:
Spirit of Enterprise Award
2010

WINNER
CIPR Pride Award
for Public Relations
2010

WINNER
Institution of Gas Engineers &
Managers Award for Business Skills
2010

WINNER
Big Tick Award
for Corporate Social Reponsibility
2010

WINNER
Sunday Times Top Track
100 Companies
2010

WINNER
Corgi Northern Ireland
Installer of the Year
2010

WINNER
BVCA:
Portfolio Company Awards
2011

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2010.

PRINCIPAL ACTIVITY

The principal activity of the Group is the development and operation of the distribution gas networks together with the supply of gas and other energy services.

The principal activity of the Company is that of an intermediate holding company and is the highest EU parent company for which Group accounts will be drawn up.

BUSINESS AND FINANCIAL REVIEW

The Chairman's statement, CEO Review and Financial Review, together with the Divisional Reports, can be viewed on pages 3 to 32.

These provide a comprehensive picture and analysis of the Group's business and performance during the year including the primary KPIs used by the Group in its operations.

EMPLOYEES
EQUAL OPPORTUNITIES

The Group is committed to a proactive approach in promoting equality of opportunity. Kellen Group ensures that it operates fairly and equitably in its dealings with employees and prospective staff members.

The Group is opposed to all forms of unlawful and unfair discrimination, ensuring through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the Kellen Group provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Race or ethnic origin
- Nationality
- Sexual orientation
- Age

DISABILITY

The Group has taken active steps to implement the Disability Discrimination (Northern Ireland) Order 2006. It is corporate policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

EMPLOYEE PARTICIPATION

Within the bounds of commercial confidentiality, information is communicated to staff at every level about matters that affect the progress of the Group and are of interest and concern to them as employees. This encourages staff participation in our performance.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry. Trade creditors at year end represented 20 days (2009:25 days) of purchases. It is the Group's policy regarding all suppliers to agree payment terms in advance of the supply of goods and to adhere to these terms.

PRINCIPAL RISKS AND FINANCIAL RISK MANAGEMENT

This section is considered in detail within the Group Finance Director's review on pages 26 to 32.

RESULTS AND DIVIDENDS

The loss for the financial year is £0.03m (2009: loss of £7.5m). No dividends were paid during the year.

POLITICAL AND CHARITABLE DONATIONS

The Group made charitable donations amounting to £21,177 in 2010 (2009: £16,244). No donations for political purposes were made during the year (2009: £Nil).

DIRECTORS AND THEIR INTERESTS

Details of the directors who served through 2010 are provided below:

Q R Stewart - Resigned 23 February 2010
J Williamson - Appointed 23 February 2010
- Resigned 29 March 2011
S Kassam - Appointed 23 February 2010
N Steinmeyer
L Levi
P V Dixon
G P Greener
G Loughran
W F M McKinstry

DISCLOSURE OF INFORMATION TO AUDITORS

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 Group's auditors are aware of that information.

AUDITORS

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

By order of the Board

W F M McKinstry
Director
23rd June 2011

CORPORATE GOVERNANCE REPORT

The Kellen Group's corporate governance structure is set by the Board of directors of Kellen Investments Limited. The Kellen Group is committed to the highest standards of corporate governance as set out in the Combined Code on Corporate Governance.

The Board of directors of Kellen Investments Limited (the "Kellen Board") believes that effective corporate governance is a fundamental aspect of a well-run business and is committed to achieving the highest standards of corporate governance, corporate responsibility and risk management in directing and controlling the business.

The following paragraphs describe the key governance structures and internal controls operating within the group. Through these mechanisms, the Kellen Group aims to apply the highest standards of corporate governance and to conform to the spirit of the 'Combined Code'.

BOARD CONSTITUTION AND PROCEDURES

The Kellen Board comprises seven members; a non-executive Chairman, two executive directors and four non-executive directors. Biographies of the Kellen Board members are shown on pages 24 to 25.

The Chairman is responsible for the effective running of the Kellen Board and for communications with all directors and shareholders. He ensures the Kellen Board receives sufficient information on financial trading and corporate issues prior to board meetings.

The executive directors are responsible for day-to-day operations and the development of strategic plans for consideration by the Kellen Board as a whole.

The Kellen Board meets regularly during the year. During 2010, four main board meetings were held, plus a number of specific meetings to deal with strategic developments and particular authority issues. All members of the Kellen Board receive detailed financial information and regular presentations from executives on the business performance, in addition to items for decision and minutes of board committees, in advance of every meeting, whether they are able to attend or not. This enables the directors to make informed decisions on corporate and business issues under consideration.

The principles for the corporate governance of the Group were adopted by the Kellen Board on 9th December 2005. These determine the internal policies by which the Group should operate.

To ensure that key policy and strategic decisions are made by Kellen Board, certain matters must be brought to Kellen Board for approval, including but not limited to: final approval of the annual accounts and budget, major acquisitions and disposals and any changes to the Group's financing arrangements and financial policies. Where urgent decisions are required on matters specifically reserved for the board between meetings, there is a process in place to enable discussion and decision-making. Directors also have access to the advice and services of the Company Secretary.

Board Committees

The Kellen Board has established three committees, each with clearly defined terms of reference, procedures, responsibilities and powers.

AUDIT COMMITTEE

The Audit Committee is chaired by Nils Steinmeyer and consists of three of the independent non-executive directors. Each member brings relevant financial experience at a senior executive level. The expertise and experience of these members is summarised on pages 24 and 25.

Audit Committee members are expected to have an understanding of the following areas:

- the principles of, contents of and developments in financial reporting, including the applicable accounting standards and statements of recommended practice, and in particular, the appropriateness of the Group's accounting policies;
- the Group's wider corporate policies and its financing;
- systems of internal control and matters that require the use of judgment in the presentation of accounts and key figures, as well as the role of internal and external auditors.

The Group Chief Executive, Group Finance Director and external auditors are normally invited to attend the committee meetings. The committee holds a minimum of two meetings during the financial year at appropriate times in the audit reporting cycle.

The committee oversees the relationship with the external auditors, reviews their audit plan and discusses findings with them. In addition, the committee reviews the effectiveness of the Group's internal controls and risk management systems and also ensures there is proportionate and independent investigation of any matter brought to their attention.

Further, this committee is required to assist the Kellen Board to fulfil its responsibilities relating to external financial reporting and associated announcements. During the year, members reviewed, either as a committee, or as part of the Board:

- interim and annual financial statements, including requirements for financial reporting;
- Group trading statements and, where practicable, all proposed announcements to be made by Kellen Group to the extent that they contain material financial information;
- changes proposed to policies and practices;
- significant accounting issues;
- the risk management process.

The committee is also responsible for the development, implementation and monitoring of Kellen Group's policy on external audit and reserves oversight responsibility for monitoring independence, objectivity and compliance with ethical and regulatory requirements. Additional functions include: recommending the appointment and re-appointment of the company's external auditors and annually reviewing a formal letter provided by the external auditors confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards.

With regard to audits, the committee also reviews:

- the terms, areas of responsibility and scope as set out in the external auditor's engagement letter;
- the overall work plan for the forthcoming year, together with the cost-effectiveness of the audit and the auditors' remuneration and performance;
- any major issues which arose during the course of the audit and their resolution;
- key accounting and audit judgements;
- the level of errors identified during the audit including schedules of unadjusted errors and representation letters;
- and lastly, the recommendations made to management by the auditors and the Group response.

REMUNERATION AND NOMINATIONS COMMITTEE

The Remuneration and Nominations Committee is chaired by Lorenzo Levi (previously Quentin Stewart) and consists of three non-executive directors. This committee meets at least once a year and at such other times as the Kellen Board requires.

The committee's specific duties and responsibilities are as follows:

- establish the criteria to be used in selecting directors and ensure the remuneration package is designed to attract, motivate and retain staff of the highest calibre;
- approve the remuneration of the executive directors and management to provide independent and objective assessment of any benefits granted to directors and management;
- ensure that the pension arrangements throughout the Group are appropriate, well supervised and conform to applicable law.

The committee also reviews the design of incentive and performance related pay plans for approval by the Board, together with remuneration policies as a whole and trends across the Group.

FINANCE COMMITTEE

The Finance Committee is chaired by Nils Steinmeyer (previously Julie Williamson) and consists of three non-executive directors. In addition, the Group Chief Executive and the Group Finance Director are normally invited to attend the meeting.

This committee is responsible for making recommendations to the Kellen Board on financing and investment policy, including the capital structure of the Group, management of financial risks such as interest rates and foreign exchange, management of credit risk, communication with financial institutions, and the acquisition and divestment of material corporate premises.

Further, the committee is also responsible for making recommendations to the Kellen Board based on proposals by the Group Chief Executive (beyond authority levels so delegated) with regard to the creation or disposal of new subsidiaries, the raising of external finance, approval or divestments within the Group and the granting of securities, guarantees and indemnities.

In certain specific circumstances, the Kellen Board has delegated authority to the committee to make decisions in these areas.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

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 year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and parent 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 parent 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 on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

W F M McKinstry
Director
23rd June 2011

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KELLEN INVESTMENTS LTD

We have audited the financial statements of Kellen Investments Limited for the year ended 31 December 2010, which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated balance sheet, the company balance sheet, the consolidated cashflow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 38, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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 ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2010 and of the group's loss for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared 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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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
23rd June 2011

FINANCIALS

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	2010 £'m	2009 £'m
Turnover	2	**111.0**	**108.4**
Cost of sales		(67.0)	(64.3)
Gross profit		**44.0**	**44.1**
Net operating expenses	3	(26.1)	(23.5)
Operating profit	4	**17.9**	**20.6**
Loss on sale of fixed assets		0.0	(0.1)
Interest payable and similar charges	7	(17.9)	(32.2)
Interest receivable and similar income	8	0.2	0.4
Profit/(loss) on ordinary activities before taxation		**0.2**	**(11.3)**
Taxation	9	(0.2)	3.8
Loss for the financial year	**21**	**(0.0)**	**(7.5)**

A statement of movements on reserves is given in Note 21.

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

All the results of the Group derive from continuing operations.

The notes on pages 46 to 60 form part of these financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2010 £'m	2009 £'m
Loss for the financial year	(0.0)	(7.5)
Total recognised Loss since last report	**(0.0)**	**(7.5)**

The notes on pages 46 to 60 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

	Note	2010 £'m	2009 £'m
FIXED ASSETS			
Tangible assets	11	196.5	189.4
Intangible assets	13	109.0	112.2
		305.5	**301.6**
CURRENT ASSETS			
Stocks	15	1.2	0.9
Debtors: Amounts falling due within one year	16	84.1	67.8
Cash at bank and in hand	27	38.9	41.5
Total current assets		**124.2**	**110.2**
Creditors: Amounts falling due within one year	17	(109.3)	(87.7)
Net current assets		**14.9**	**22.5**
Total assets less current liabilities		**320.4**	**324.1**
Creditors: Amounts falling due after one year	17	(268.3)	(272.2)
Provisions for liabilities and charges	18	(15.8)	(15.6)
Deferred income	19	(2.5)	(2.5)
Net assets		**33.8**	**33.8**
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	(36.0)	(36.0)
Shareholders' funds	**22**	**33.8**	**33.8**

The financial statements were approved by the Board of Directors on 23 June 2011 and are signed on its behalf by:

W F M McKinstry
Director
23 June 2011

The notes on pages 46 to 60 form part of these financial statements.

COMPANY BALANCE SHEET

	Note	2010 £'m	2009 £'m
FIXED ASSETS			
Tangible assets	12	0.0	0.0
Investments	14	67.2	67.2
		67.2	**67.2**
CURRENT ASSETS			
Debtors: Amounts falling due within one year	16	31.1	28.4
Cash at bank and in hand		0.0	0.0
Total current assets		**31.1**	**28.4**
Creditors: Amounts falling due within one year	17	(24.9)	(23.6)
Net current assets		**6.2**	**4.8**
Total assets less current liabilities		**73.4**	**72.0**
Creditors: Amounts falling due after one year	17	0.0	0.0
Net assets		**73.4**	**72.0**
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	3.6	2.2
Shareholders' funds	**22**	**73.4**	**72.0**

The financial statements were approved by the Board of Directors on 23 June 2011 and are signed on its behalf by:

W F M McKinstry
Director
23 June 2011

Company registration number: 05366077

The notes on pages 46 to 60 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

	Note	2010 £'m	2009 £'m
NET CASH FLOW FROM OPERATING ACTIVITIES	23	33.0	32.3
RETURNS ON INVESTMENT AND SERVICING OF FINANCE			
Interest paid		(17.9)	(31.0)
Interest received		0.2	0.5
Preference share dividends paid		0.0	(4.1)
Dividends received		0.0	0.0
		(17.7)	**(34.6)**
Taxation		**0.0**	**0.0**
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Purchase of tangible fixed assets		(12.9)	(12.1)
		(12.9)	**(12.1)**
Net cash flow before financing		**2.4**	**(14.4)**
FINANCING			
Redemption of equity shares		0.0	(10.2)
Repayment of loan from parent		0.0	(37.2)
Issue of bond (net of issue costs)		0.0	267.0
Repayment of loan to bank		(5.0)	(210.5)
		(5.0)	**9.1**
Decrease in cash in period	24	(2.6)	(5.3)

The notes on pages 46 to 60 form part of these financial statements.

NOTES FORMING PART OF THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

BASIS OF PREPARATION

The consolidated financial statements incorporate the financial statements of Kellen Investments Limited, Kellen Acquisitions Limited, Phoenix Energy Holdings Limited, Phoenix Distribution Holdings Limited, Phoenix Natural Gas Limited, Phoenix Supply Limited, Phoenix Energy Services Limited, Phoenix Natural Gas Finance plc and Phoenix Energy Limited for the year ended 31 December 2010.

All subsidiaries are accounted for using the acquisition method of accounting and the profit and loss account and statement of cash flows of the Group included the results and cash flows of subsidiaries from the date of acquisition to the period end. All transactions between the businesses of the Group have been eliminated in the preparation of the consolidated financial statements.

GOING CONCERN

As highlighted in note 17 to the financial statements, the Group is financed through bank debt loan facilities and bond finance to support continued investment in its infrastructure assets and to meet its general working capital requirements. This debt facility is due for renewal in November 2012 and the bond due for redemption in 2017.

The Group's forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that the Group is capable of operating well within the level of its current facilities and also able to meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

REVENUE RECOGNITION

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of energy and transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

DEFERRED TAXATION

Deferred tax is recognised in respect of:

1) Material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date, and

2) Tax losses not group relieved in the current period. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements.

Deferred tax assets and liabilities recognised have not been discounted.

INVESTMENTS

Investments held by the Company in subsidiary undertakings are stated at cost less amounts written off.

TANGIBLE FIXED ASSETS

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.

The economic lives used are as follows:

	Years
Distribution mains	60
Distribution services	35
Distribution meters	20
Office equipment and fixtures & fittings	5

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

INTANGIBLE FIXED ASSETS

Intangible fixed assets comprise the value attributed to the various licences acquired with Phoenix Natural Gas Limited. These are being amortised over the distribution licence recovery period of 40 years.

DEBTORS

Debtors are stated after provision has been made against all debts considered doubtful of collection.

PENSIONS

The Group operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the Group will benefit from the employee's services.

INTEREST BEARING BORROWINGS

Immediately after issue, the debt is stated at the fair value of the consideration received on the issue of the capital instrument after deduction of finance costs. These costs are allocated to the debt over the term of the debt at a constant rate of the carrying amount.

STOCKS

Stock has been valued at the lower of cost and net realisable value.

GOVERNMENT GRANTS

The European Regional Development Grant relates specifically to capital expenditure on the high pressure distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

OPERATING LEASES

Costs in respect of operating leases are charged on a straight line basis over the lease term.

CLASSIFICATION OF FINANCIAL INSTRUMENTS ISSUED BY THE GROUP

Financial instruments issued by the Group are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

a) they include no contractual obligations upon the company (or Group as the case may be) to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the company (or Group); and

b) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes a legal form of the company's own shares, the amounts presented in these financial statements are called up share capital and share premium account exclude amounts in relation to those shares.

Where a financial instrument that contains both an equity and a financial liability component exists these components are separated and accounted for individually under the above policy. The finance cost on the financial liability component is correspondingly higher over the life of the instrument.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholder fund (see dividends policy), are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

CASH LONG TERM INCENTIVE PLAN

The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

DIVIDENDS ON SHARES PRESENTED WITHIN SHAREHOLDERS' FUNDS

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

are appropriately authorised and are no longer at the discretion of the company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

2. ANALYSIS OF TURNOVER

The Group's turnover, profits and net assets all relate to the business of gas distribution in Northern Ireland and gas supply in both Northern Ireland and the Republic of Ireland together with the provision of energy services predominantly for the gas industry.

Details of each of its separate business activities are provided with the Financial and Divisional Reviews on pages 14 to 32.

3. NET OPERATING EXPENSES

Net operating expenses were all considered to be administrative expenses.

4. OPERATING PROFIT

This is stated after charging/(crediting):

	Group 2010 £'m	Group 2009 £'m
Depreciation – owned assets	5.8	5.4
Amortisation of intangible assets	3.2	3.2
European Regional Development Grant release	0.0	(0.1)
Operating lease rentals	1.0	1.0
Auditors' remuneration	0.1	0.1

The auditors' remuneration in respect of the individual Company accounts amounted to £8k, (2009: £8k). KPMG Belfast were paid £6k for non-audit related services to the Group during the year, (2009: £112k). KPMG London were paid £nil for non-audit related services to the Group during the year, (2009: £118k).

NOTES (CONTINUED)

5. EMPLOYEE INFORMATION

The average number of persons employed by the Group (including executive directors) analysed by category during the period was as follows:

	Group 2010 No	Group 2009 No
Operational	122	108
Administration	84	82
	206	**190**

The aggregate staff costs of these persons were as follows:

	Group 2010 £'m	Group 2009 £'m
Wages and salaries	6.1	5.5
Social security costs	0.7	0.6
Other pension costs	0.6	0.6
	7.4	**6.7**

6. DIRECTORS' REMUNERATION

	Group 2010 £'m	Group 2009 £'m
Emoluments	0.9	0.8
Amount receivable under long term incentive schemes	0.2	0.1
Company pension contributions	0.1	0.1
	1.2	**1.0**

Details in respect of the highest paid director are as follows:

	Group 2010 £'m	Group 2009 £'m
Emoluments	0.5	0.5
Amount receivable under long term incentive schemes	0.2	0.1
Company pension contributions	0.0	0.0
	0.7	**0.6**

Retirement benefits are accruing to one executive director under a group defined contributon scheme.

The Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

NOTES (CONTINUED)

7. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2010 £'m	Group 2009 £'m
Amounts payable on bank loans and overdrafts	17.2	26.5
Amounts payable on loan notes	0.0	4.4
Other	0.7	1.3
	17.9	**32.2**

8. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2010 £'m	Group 2009 £'m
Bank interest	0.2	0.4
	0.2	**0.4**

NOTES (CONTINUED)

9. TAXATION

	Group 2010 £'m	Group 2000 £'m
Current tax		
UK corporation tax for the year	0.0	(2.2)
Adjustments relating to earlier years	0.0	2.1
Total current tax (credit)/charge	**0.0**	**(0.1)**
Deferred tax		
Origination/reversal of timing differences	0.8	(1.6)
Effect in reduction in tax rate	(0.6)	0.0
Adjustments relating to earlier years	0.0	(2.1)
Total deferred tax charge/(credit)	**0.2**	**(3.7)**
Total tax charge/(credit)	**0.2**	**(3.8)**

The current tax charge for the period is the same as (2009 higher than) the standard rate of corporation tax in the UK. The differences are explained below:

	2010 £'m	2000 £'m
Current tax reconciliation		
Profit/(Loss) on ordinary activities before tax	0.0	(11.3)
Current tax at 28% (2009: 28%)	0.0	(3.2)
Effects of:		
Adjustment relating to earlier years	0.0	2.2
Expenses not deductible for tax purposes	(0.3)	1.3
Excess capital allowances	(0.8)	1.5
Deferred tax asset not recognised	(0.1)	(4.8)
Other permanent differences	1.2	2.9
Total current tax (credit)/charge	**0.0**	**(0.1)**

Factors affecting future tax charge

A phased reduction in the main rate of corporation tax from 28% to 24% was announced in the emergency budget on 22 June 2010. It is expected that this fall in the main corporation tax rate will result in a reduction of the group's deferred tax liability and future current tax charge.

NOTES (CONTINUED)

10. PROFIT FOR THE FINANCIAL YEAR

As permitted by Section 408 of the Companies Act 2006, the parent company's profit and loss account has not been included in these financial statements. The parent company's profit for the financial period was £1,443k.

11. TANGIBLE FIXED ASSETS (GROUP)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Total £'m
Cost				
At 1 January 2010	1.9	3.1	223.3	**228.3**
Additions	0.1	0.1	12.7	**12.9**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2010	2.0	3.2	236.0	**241.2**
Depreciation				
At 1 January 2010	1.8	1.5	35.6	**38.9**
Charge for the year	0.1	0.1	5.6	**5.8**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2010	1.9	1.6	41.2	**44.7**
Net book value				
At 31 December 2009	0.1	1.6	187.7	**189.4**
At 31 December 2010	0.1	1.6	194.8	**196.5**

NOTES (CONTINUED)

12. TANGIBLE FIXED ASSETS (COMPANY)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Total £'m
Cost				
At 1 January 2010	0.0	0.0	0.0	**0.0**
Additions	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2010	0.0	0.0	0.0	**0.0**
Depreciation				
At 1 January 2010	0.0	0.0	0.0	**0.0**
Charge for the year	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2010	0.0	0.0	0.0	**0.0**
Net book value				
At 31 December 2009	0.0	0.0	0.0	**0.0**
At 31 December 2010	0.0	0.0	0.0	**0.0**

13. INTANGIBLE FIXED ASSETS (GROUP)

	Licence £'m	Total £'m
Cost		
At 1 January 2010	127.3	**127.3**
Additions	0.0	**0.0**
Disposals	0.0	**0.0**
At 31 December 2010	127.3	**127.3**
Amortisation		
At 1 January 2010	15.1	**15.1**
Charge for the year	3.2	**3.2**
Disposals	0.0	**0.0**
At 31 December 2010	18.3	**18.3**
Net book value		
At 31 December 2009	112.2	**112.2**
At 31 December 2010	109.0	**109.0**

NOTES (CONTINUED)

14. FIXED ASSET INVESTMENTS

	Group 2010	Company 2010	Group 2009	Company 2009
Shares in subsidiary undertakings	£'m	£'m	£'m	£'m
Cost at 1 January	0.0	67.2	0.0	76.4
Preference shares redeemed	0.0	0.0	0.0	(9.2)
Cost at 31 December	**0.0**	**67.2**	**0.0**	**67.2**
Net Book Value	**0.0**	**67.2**	**0.0**	**67.2**

During 2009 Kellen Acquisitions Limited, a direct subsidiary of Kellen Investments Limited, redeemed 9.2m preference shares of £1 each as part of the refinancing of the Group.

The Company has ordinary share investments in the following companies at 31 Dec 2010

Company name	Holding	Holding %	Country of incorporation	Activity
Kellen Acquisitions Ltd	Direct	100%	Great Britain	note (iv)
Phoenix Energy Holdings Ltd	Indirect	100%	Great Britain	note (iv)
Phoenix Distribution Holdings Ltd	Indirect	100%	Great Britain	note (iv)
Phoenix Energy Limited	Indirect	100%	Republic of Ireland	note (v)
Phoenix Natural Gas Ltd	Indirect	100%	Northern Ireland	note (i)
Phoenix Supply Ltd	Indirect	100%	Northern Ireland	note (ii)
Phoenix Energy Services Ltd	Indirect	100%	Northern Ireland	note (iii)
Phoenix Natural Gas Finance plc	Indirect	100%	Northern Ireland	note (vi)
Belfast Energy Ltd	Indirect	100%	Northern Ireland	Dormant
Belfast Natural Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Power Ltd	Indirect	100%	Northern Ireland	Dormant
PNG Storage Ltd	Indirect	100%	Northern Ireland	Dormant

Note (i) Phoenix Natural Gas Ltd distributes natural gas to the Greater Belfast area.
Note (ii) Phoenix Supply Ltd supplies natural gas to customers in the Greater Belfast area.
Note (iii) Phoenix Energy Services Ltd provides services to Phoenix Natural Gas Ltd and Phoenix Supply Ltd as well as boiler and appliance maintenance services to energy consumers.
Note (iv) Kellen Acquisitions Ltd, Phoenix Energy Holdings Ltd and Phoenix Distribution Holdings Ltd are intermediate holding companies.
Note (v) Phoenix Energy Ltd supplies natural gas to customers under licence in the Republic of Ireland.
Note (vi) Phoenix Natural Gas Finance plc holds a bond listed on the LSE.

All other companies are dormant within the meaning of the Companies Act 2006.

NOTES (CONTINUED)

15. STOCKS

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Stock of spares and meters	1.2	0.0	0.9	0.0
	1.2	**0.0**	**0.9**	**0.0**

16. DEBTORS

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Amounts falling due within one year				
Trade	13.8	0.0	12.4	0.0
Amounts owed by subsidiary undertaking	0.0	24.1	0.0	24.1
Other	2.4	0.0	0.3	0.0
Prepayments and accrued income	67.9	7.0	55.1	4.3
	84.1	**31.1**	**67.8**	**28.4**
Amounts falling due after one year				
Amounts owed by subsidiary undertaking	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
	0.0	**0.0**	**0.0**	**0.0**

NOTES (CONTINUED)

17. CREDITORS

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Amounts falling due within one year				
Trade	1.9	0.0	2.7	0.0
Payments in advance	37.6	0.0	43.2	0.0
Amounts owed to subsidiary undertaking	0.0	24.1	0.0	23.5
Other creditors	14.1	0.0	4.1	0.0
Accruals and deferred income	55.7	0.8	37.7	0.1
	109.3	**24.9**	**87.7**	**23.6**
Amounts falling due after one year				
Bank loans	0.0	0.0	5.0	0.0
Bond	268.3	0.0	267.2	0.0
	268.3	**0.0**	**272.2**	**0.0**
Amounts falling due after one year: analysis				
Amounts falling due between one and two years				
Bank loans	0.0	0.0	0.0	0.0
	0.0	**0.0**	**0.0**	**0.0**
Amounts falling due between two and five years				
Bank loans	0.0	0.0	5.0	0.0
	0.0	**0.0**	**5.0**	**0.0**
Amounts falling due after five years				
Bond	268.3	0.0	267.2	0.0
	268.3	**0.0**	**267.2**	**0.0**

- There were no committed undrawn bank facilities.
- The Group's borrowings are denominated in sterling.
- The Bonds issued by its subsidiary, Phoenix Natural Gas Finance plc,. are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.
- The bond issued is repayable in 2017 and carries a fixed coupon rate of 5.5% per annum payable quarterly. The £268.3m repayable after 5 years is stated after deducting issue costs of £8m and the addition of amortised loan issue costs of £1.3m.

NOTES (CONTINUED)

18. PROVISIONS FOR LIABILITIES AND CHARGES

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Deferred taxation				
Accelerated capital allowances	(16.8)	0.0	(16.6)	0.0
Short term timing differences	1.0	0.0	1.0	0.0
	(15.8)	**0.0**	**(15.6)**	**0.0**
Deferred tax liability				
At 1 January 2010	**(15.6)**	**0.0**	**(19.3)**	**0.0**
(Charged)/credited to profit and loss account	(0.2)	0.0	3.7	0.0
At 31 December 2010	**(15.8)**	**0.0**	**(15.6)**	**0.0**

19. DEFERRED INCOME

	Group £'m	Company £'m
ERD grant received		
At 1 January 2010	2.5	0.0
Credit to profit and loss account	0.0	0.0
At 31 December 2010	**2.5**	**0.0**

20. CALLED UP SHARE CAPITAL

	2010 £	2009 £
Allotted and fully paid:		
Ordinary shares of £1 each	49,752,705	49,752,705
A Ordinary shares of £1 each	20,076,752	20,076,752

Ordinary shares each carry one vote. A ordinary shares are non voting.

During 2009 the Company redeemed 10,157,605 ordinary shares of £1 each as part of the refinancing of the group.

NOTES (CONTINUED)

21. RECONCILIATION OF MOVEMENTS IN RESERVES

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Revenue reserves brought forward	(36.0)	2.2	(28.5)	(3.4)
(Loss)/profit for the financial year	(0.0)	1.4	(7.5)	5.6
Revenue reserves carried forward	**(36.0)**	**3.6**	**(36.0)**	**2.2**

22. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Opening shareholders' funds	33.8	72.0	51.5	76.6
Equity share capital redeemed	0.0	0.0	(10.2)	(10.2)
(Loss)/profit for the financial year	(0.0)	1.4	(7.5)	5.6
Closing shareholders' funds	**33.8**	**73.4**	**33.8**	**72.0**

23. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Group 2010 £'m	Group 2009 £'m
Operating profit	**17.9**	**20.6**
Release of ERDF Grant	0.0	(0.1)
Depreciation	5.8	5.4
Goodwill amortisation	3.2	3.2
(Increase) in stocks	(0.3)	(0.1)
(Increase)/decrease in debtors	(16.3)	9.6
Increase/(decrease) in creditors	22.7	(6.3)
Net cash flow from operating activities	**33.0**	**32.3**

NOTES (CONTINUED)

24. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	Group 2010 £'m	Group 2009 £'m
Decrease in cash in period	**(2.6)**	**(5.3)**
Increase in loan from Parent	0.0	38.5
Issue of bond	0.0	(267.0)
Decrease in bank loan	5.0	210.5
Movement in net debt resulting from cashflows	**2.4**	**(23.3)**
Non cash adjustment - amortisation of bond issue costs	(1.1)	(0.2)
Non cash adjustment - collateralised cash security	24.0	(28.0)
Movement in net debt during the year	**25.3**	**(51.5)**
Opening net debt	(258.7)	(207.2)
Closing net debt	**(233.4)**	**(258.7)**
Analysed as follows		
Bank loans > 1 year	0.0	(5.0)
Bond	(268.3)	(267.2)
Loan from parent	0.0	0.0
Cash at bank and in hand*	34.9	13.5
Closing net debt	**(233.4)**	**(258.7)**

*Cash at bank and in hand does not include £4.0m which is held in collateral as it does not meet the definition of cash within FRS1 (Cash Flow Statements)

25. PENSION COMMITMENTS

The group operates two pension schemes:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £0.6m (2009: £0.6m).

NOTES (CONTINUED)

26. CAPITAL COMMITMENTS

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Capital expenditure				
Contracted but not provided for	3.0	0.0	4.6	0.0

27. CONTINGENT LIABILITIES

At 31 December 2010 the Group and Company had no contingent liabilities (31 December 2009: £Nil). At the year end bank and cash balances totalling £4.0m were collateralised in respect of ongoing contractual obligations.

28. FINANCIAL COMMITMENTS

At 31 December 2010 the Group and Company had annual commitments under non-cancellable operating leases expiring as follows:

	Group 2010 £'m	Company 2010 £'m	Group 2009 £'m	Company 2009 £'m
Motor Vehicles				
Within one year	0.1	0.0	0.1	0.0
Within two to five years	0.4	0.0	0.4	0.0
After five years	0.0	0.0	0.0	0.0
	0.5	**0.0**	**0.5**	**0.0**
Property				
Within one year	0.0	0.0	0.0	0.0
Within two to five years	0.5	0.0	0.5	0.0
After five years	0.0	0.0	0.0	0.0
	0.5	**0.0**	**0.5**	**0.0**

29. RELATED PARTY DISCLOSURES

As at 31 December 2010 the company owed its immediate parent and controlling company, Carmel Capital II Sarl, £nil (2009: £nil). Interest payable on the loan note during the year was £nil (2009: £3.9m).
Advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the consolidated Group.

30. ULTIMATE CONTROLLING PARTY

The immediate parent company and controlling company is Carmel Capital II Sarl, a company incorporated in Luxemburg, with registered office address 41 Boulevard du Prince Henri, L-1724 Luxembourg. Group accounts are not prepared at this level.
The directors regard TFCP Holdings Limited, a company registered in Guernsey, to be the ultimate parent company and controlling party.

OTHER INFORMATION

Directors
G P Greener - Chairman
P V Dixon - Group Chief Executive Officer
W F M McKinstry - Group Finance Director
L Levi
G Loughran
S Kassam
N O Steinmeyer

Secretary
Taylor Wessing Secretaries Limited

Auditors
KPMG
17/25 College Square East
Belfast
BT1 6DH

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

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

Registered office
5 New Street Square
London
EC4A 3TW

Kellen Investments Limited
Registered in England and Wales
Company Registration Number: 05366077

KELLEN GROUP

Kellen Investments Limited

197 Airport Road West

Belfast

BT3 9ED

Telephone: 08454 55 55 55

Fax: (028) 9055 5500

Email: info@phoenixgroupni.com

Web: www.phoenixgroupni.com

KG KELLEN GROUP

ANNUAL REPORT & ACCOUNTS 2011

Business in the Community AWARDS 2011
Big Tick re-accreditation

PHOENIX

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KELLEN GROUP HISTORY

1996	**Launch of Phoenix Natural Gas by British Gas plc in September.** At the time of its launch, the Phoenix development was one of the largest 'greenfield' private sector-led integrated gas transmission, distribution and supply investments in the world. This first year saw a licence being granted, construction commencing and the first customer connected.
1997	**Purchase of a 24.5% stake in Phoenix by Keyspan.** February marked an Anglo-American link-up, with the owners of The Brooklyn Union Gas Company.
2001	**Purchase of a 24.5% stake in Phoenix by ESH plc.** East Surrey Holdings (ESH) plc (a GB based water and gas utility) took a 24.5% in Phoenix reducing the BG holding to 51%.
2001	**Established Phoenix Energy Services Limited** as a provider of downstream services into the Northern Ireland energy market.
2003	**Purchase of remaining 75.5% stake by ESH plc.** ESH raised the finance to complete a buy-out of other partners, becoming sole owner of Phoenix.
2005	**Purchase of ESH plc by Terra Firma.** Through its Kellen vehicle, Terra Firma secured the purchase of East Surrey Holdings plc by the end of 2005.
2006	**Sale of Sutton and East Surrey Water (SESW) plus subsidiaries.** In spring, the sale of the SESW to Deutsche Bank was completed. In summer that same year, ESP (East Surrey Pipelines) was sold to ABN AMRO Infrastructure.
2007	**Separation of Phoenix Supply Division.** In line with the requirements of the Second EU Gas Directive 2003/55/EC, Phoenix legally separated its gas trading and supply division from its transmission and distribution business on 1st January 2007.
2008	**Separation of Phoenix Natural Gas.** On 1st January 2008 Phoenix completed the separation of its distribution division from that of transmission.
2008	**Sale of Transmission Division.** Phoenix completed the sale of its transmission assets to Northern Ireland Energy Holdings (NIEH) on 31st March 2008.
2009	**Issue of £275m of Bonds due 2017 at rate of 5.5% by Phoenix Natural Gas Finance plc,** guaranteed by Phoenix Natural Gas Limited and Phoenix Distribution Holdings Limited, with the proceeds being used as part of a restructuring process to refinance Group activities. These Bonds received a rating of Baa2 by Moody's and BBB+ by Fitch.
2009	**Phoenix extends its supply operations** into the Republic of Ireland as its new subsidiary Phoenix Energy Limited commences trading.

THE KELLEN GROUP

The Kellen Group, trading under the Phoenix banner, is the pre-eminent natural gas business in Northern Ireland. Since 1996 Phoenix has been successful in introducing natural gas to a new market and establishing a strong and vibrant supporting industry. In the process, Phoenix has gained a strong international reputation for its innovative, commercial infrastructural development in a 'greenfield' environment. Coupled with its significant operational achievements, Phoenix has also been recognised for its outstanding performance within the arena of safety and corporate social responsibility culminating in the award of its second British Safety Council 'Sword of Honour' in recognition of world-class health, safety and environmental practices. In addition, the Group received Business in the Community's 'Big Tick Award' for a seventh consecutive year, celebrating excellence in the delivery of leading edge corporate social responsibility programmes. This award underlines its commitment to both its staff and the community it serves.

FINANCIAL HIGHLIGHTS

- Increase in Group turnover of £16.5m (14.9%), from £111.0m in 2010 to £127.5m in 2011. This has been driven both by an increase in the volume of gas supplied across our supply businesses together with the application of increased selling prices to customers as a result of a higher forecast cost of gas.
- Group Operating profit of £20.1m, an increase of £2.2m from £17.9m in 2010. This has been driven mainly by an increase in profits generated in the regulated part of our supply business in the year. This has resulted in an over recovery of gas costs in the year which will be returned to customers in future years as part of principles of its regulated price control.
- An operating cash-flow of £26.7m was generated in 2011 compared to £33.0m in the previous year.

OPERATIONAL HIGHLIGHTS

- Transported 117.3 million therms of gas to users in 2011 through its gas distribution network in Northern Ireland, 10.7 million therms less than 2010 with throughput significantly affected year on year by warmer average temperatures.
- Invested a further £12.3m in 2011, extending the gas network by a further 57 kilometres and connecting an additional 9,719 customers. This brings the total network coverage to 3,148 kilometres and customer connections to circa 148,000.
- The Group's Health, Safety and Environmental performance (HSE) was once again recognised as being 1 of only 10 organisations throughout Northern Ireland to be awarded Platinum accreditation through the Arena Network Annual Environmental Awards.
- The Group was accredited with a 'Big Tick Award' from Business in the Community for excellence in its Corporate Social Responsibility (CSR) activity in Greater Belfast. This was the seventh consecutive year that the Group had received such acclaim.

KELLEN GROUP AT A GLANCE

DISTRIBUTION

Owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. The distribution business is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The Phoenix network currently extends to 3,148 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 50% of the population of Northern Ireland. Phoenix Natural Gas manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast; already some 148,000 customers have been connected to the natural gas network in the 15 years since natural gas first became available in Northern Ireland.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

SUPPLY NI

Phoenix Supply is the market leader in gas supply in Northern Ireland delivering natural gas to customers using the Phoenix Natural Gas distribution network. The supply business competes directly with other gas suppliers in its licence area, which mirrors the Group's distribution business in Greater Belfast and Larne. At the end of 2011 the company supplied 91% of all customers connected with gas. In addition, Phoenix Supply trades gas on the wholesale market and provides billing services for its expanding customer base, together with that of its affiliate, Phoenix Energy, from its offices in Belfast.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

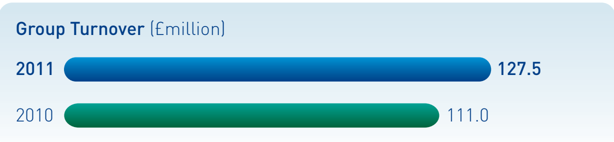
SUPPLY ROI

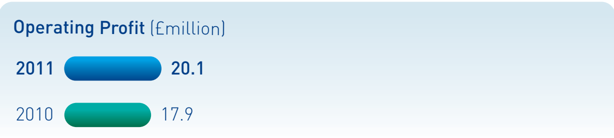
Phoenix Energy commenced supplying natural gas in the Republic of Ireland towards the end of 2009, expanding the service offering of Phoenix Supply Limited across the island of Ireland. Based on the combined volumes of Phoenix Supply Limited and Phoenix Energy Limited, Phoenix has become the second largest supplier of natural gas to homes and businesses on the island of Ireland.

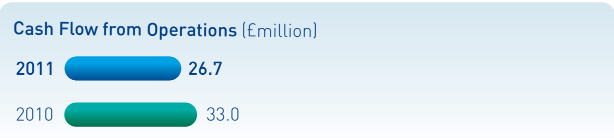
The company operates in a separate regulatory environment within the Republic of Ireland under a licence issued by the Commission for Energy Regulation (CER) in Dublin.

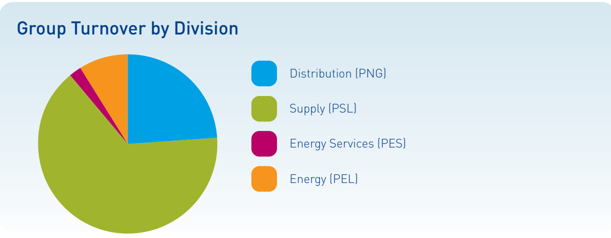
ENERGY SERVICES

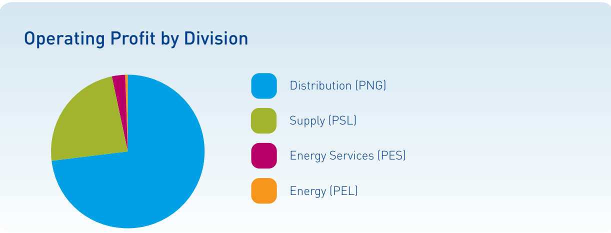
A specialist provider of downstream services into the Northern Ireland energy market, Energy Services' remit includes the provision of a 24/7 emergency response to Phoenix Natural Gas, together with metering and meter reading services across the natural gas industry in Greater Belfast and Larne. In addition, the company delivers a range of other services to energy users on a demand and contract basis.











CHAIRMAN'S STATEMENT

During 2011, the Group operated through four main revenue-generating divisions. All four divisions have delivered trading results ahead of expectations, despite the challenging market conditions.

Demand for gas during the year was impacted by the warmer than average weather. This, alongside homes and businesses looking to continue to reduce their consumption due to environmental initiatives and economic pressures, saw volumes subdued. In contrast, turnover has benefitted from a rise in wholesale energy prices in 2011, with as a result, gas prices increasing significantly to reflect these higher costs during the year.

The Group continues to maintain a strong focus on delivering the efficiency and cost savings required to meet the regulatory price control targets placed upon both it's gas distribution and supply businesses in Northern Ireland. Our relatively low operating costs has maintained our competitive edge against other fuels and assisted our trading business in the Republic of Ireland to grow ahead of expectations. Phoenix Natural Gas (PNG), our gas distribution business in Northern Ireland, successfully refinanced its bank facilities during the year. The Group is in a strong position to continue developing its businesses in 2012.

In August 2011, PNG received a determination from NIAUR with respect to its periodic price control for the two year period beginning on 1 January 2012. Whilst this determination assessed allowable operating and capital costs broadly in line with expectations, NIAUR unexpectedly included measures to modify PNG's licence to retrospectively remove value from the company's regulated asset base, previously agreed with the company as part of negotiations to move to a 40 year 'RAV based' licence in 2006. As a result the Board has rejected the determination and proposed licence modifications and subsequently NIAUR have referred the matter to the Competition Commission to adjudicate upon. An outcome to this process is expected to be concluded by the end of September 2012.

Phoenix Supply Limited (PSL) received its new price control towards the end of 2011, this being broadly in line with the principles contained within its previous control which ended on 31 December 2011.

Despite the distractions from NIAUR's actions and the economic pressures facing our customers, PNG has performed well operationally, with new customer connections up on 2010 levels. With all of our operating subsidiaries firmly established, the Board believes that the long-term prospects remain good and with demand for natural gas forecast to continue to increase in Phoenix's current licence area and beyond, the Group is in a strong position to make the most of its future growth opportunities.

Despite increased competition in the Irish energy market Phoenix remains the second largest natural gas supplier

(excluding power generation volumes) on the island of Ireland; second only to the state-owned monopoly, Bord Gas Eireann (BGE). The expansion of the Group's activities into the Republic of Ireland has proven to be a successful step in realising further growth potential.

On 16th May 2012, the Group announced that it had reached agreement with SSE plc (Airtricity) to sell its supply businesses in both NI and ROI subject to the necessary approvals. The activities undertaken by our gas supply businesses involve the buying of gas and billing customers for its use; these have been a separate stand-alone operation within the Phoenix Group for several years. This growth clearly prompted SSE plc (Airtricity), one of the biggest energy suppliers in the UK and Ireland, to extend its current activities in Northern Ireland and the Republic through the acquisition of Phoenix's gas supply businesses.

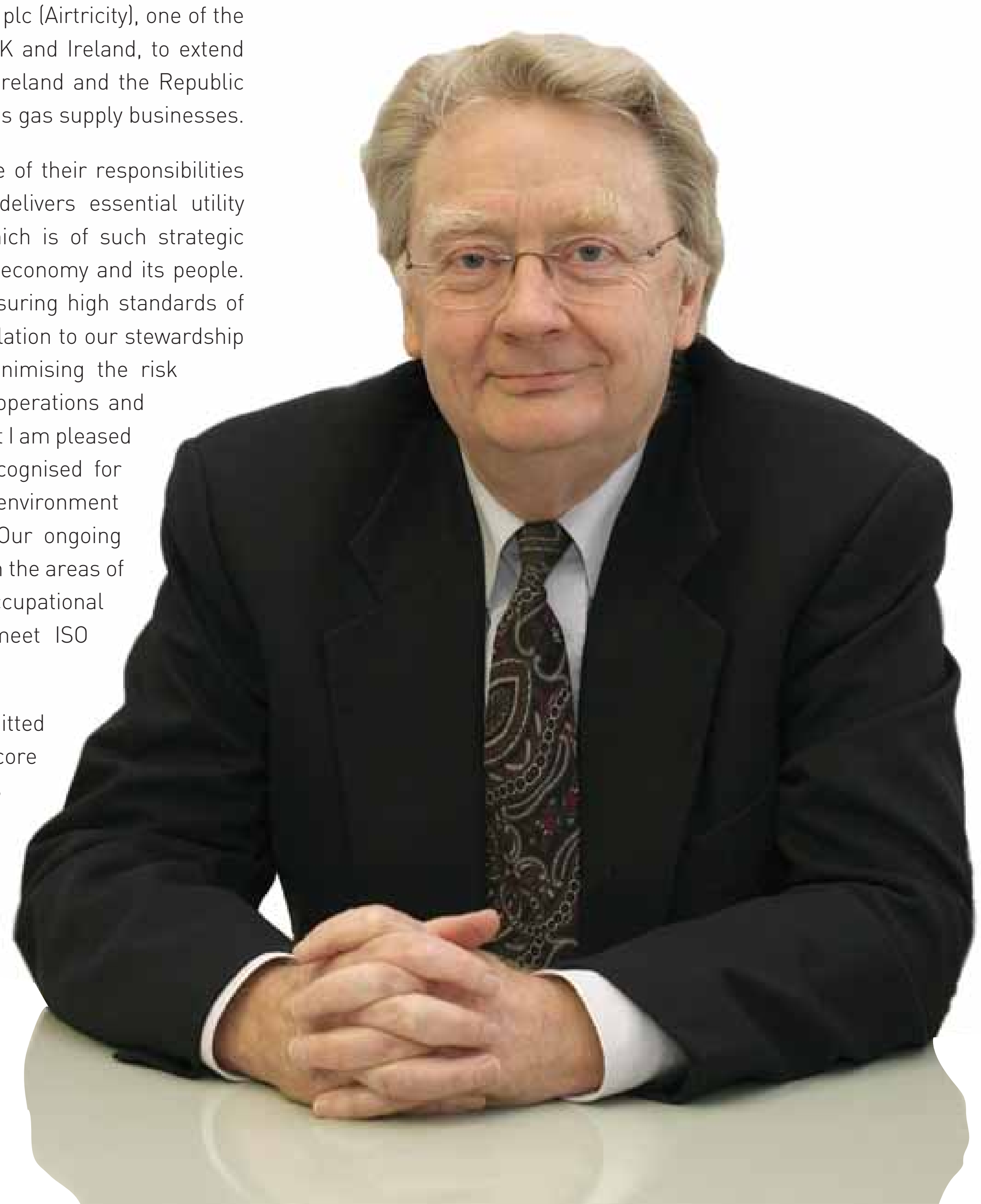
Board members are keenly aware of their responsibilities as directors of a Group which delivers essential utility services on a 24/7 basis and which is of such strategic importance to Northern Ireland's economy and its people. We remain fully committed to ensuring high standards of performance and monitoring in relation to our stewardship of our responsibilities and in minimising the risk to the public from our extensive operations and construction activity. In this respect I am pleased to report that the Group was recognised for its positive contribution to the environment by Business in the Community. Our ongoing strategic operational procedures in the areas of environmental performance and occupational health and safety continue to meet ISO 14001 and 18001 accreditations.

As a Group, Kellen remain committed to growth and development of our core distribution and service businesses across the island of Ireland into the future. Phoenix Natural Gas is Northern Ireland's leading gas distribution provider with continued responsibility for the marketing of natural gas across the Province.

Despite the uncertainty arising from the current regulatory dispute associated with our distribution business, the Board are fully committed to support the Competition Commission process with which PNG is engaged and welcomes the possibility of a more stable and transparent regulatory regime that such a process might provide.

We look beyond the current impasse with confidence and with a grateful acknowledgment of all our people who have made the past twelve months so successful despite the challenges we have faced.

Dr George Greener CBE
Chairman



ANNUAL REPORT & ACCOUNTS 2011
KELLEN GROUP
SECTION 1 : OVERVIEW

CHIEF EXECUTIVE'S REVIEW

I am pleased to report that the Kellen Group delivered an operating profit of £20.1m in 2011. The underlying value of the Group was greatly enhanced by a strong operating performance across our businesses together with sustained development of our gas network and growth of our customer base. Despite the weakening economic conditions, we continued to grow by ensuring that our product offering met the needs of our growing potential customer base. Our 2011 performance was ahead of expectations in most areas across the Group. This underlines the robustness of our business plan and strength of our management and staff. I remain confident that, despite the regulatory and economic challenges, the Group is well placed to deliver on its plan and thereby to build upon past success.

THE MARKET

Despite the warmer than average temperatures and subdued economic activity, gas costs rose during the year in line with the rising price of oil – this was due in part to political instability in the Middle East and fears about nuclear power arising in Japan. This resulted in our supply business having to significantly increase its tariff selling price at the beginning of May 2011.

Natural gas remains a relatively new option in the Greater Belfast energy market, having only become available since 1996 to a growing potential customer base. Given the progressive nature of the development of the network across that period, gas on average has been available at the doorstep of approximately 292,000 homes and businesses for up to eleven years.

Kellen, under the Phoenix brand, holds licences for the distribution and supply of natural gas in the Greater Belfast area and more recently within the Republic of Ireland. The Phoenix Group operates through four separate businesses: Phoenix Natural Gas Limited (PNG), Phoenix Supply Limited (PSL), Phoenix Energy Services Limited (PES) in Northern Ireland and Phoenix Energy Limited (PEL) in the Republic of Ireland. All of these businesses, in the context of the market they operate, are significant in their own right with circa 375 staff employed directly, or through operating and alliance partnerships. Phoenix is the largest natural gas distributor and supplier in Northern Ireland and the second largest in the island of Ireland. The growth to date has all been organically driven.

PNG's primary objective is to make natural gas available to around 90% of all households and businesses in the

Greater Belfast area by 2016, connecting circa 60% of these potential customers to the gas network by this date. This entails ensuring that new properties and developments are built with gas heating incorporated and that existing properties are converted to gas, either when existing heating equipment needs to be replaced or as a result of marketing aimed at accelerating customer conversion. The principal challenge for natural gas is to displace oil as the main energy source for homes and businesses. Oil is still the dominant fuel for domestic heating and an embedded 'oil culture' remains very strong across Northern Ireland given that the natural gas market has only recently been developed and indeed there is limited availability of natural gas outside the PNG licence area. Oil prices remained volatile and high throughout 2011, reminding those homeowners and businesses who have not yet converted to natural gas of the high cost of oil, both in terms of the commodity price and the low efficiency of typical indigenous oil boilers. However cost is not the only driver, as many people making the decision to change to gas, do so in recognition of its convenience, reliability and efficiency. These considerations, together with the cost of conversion, remain key factors in the speed of switchover to gas.

THE BUSINESS

The Group continues to build on its success to date and 2011 was yet another year of solid growth. The four operating businesses within the Group have robust plans to maximise their potential and they remain on course to deliver their key objectives.

PNG continues to expand its network coverage and connections to homes and businesses. The supply divisions (PSL and PEL) continue to enhance their service offering to customers and deliver gas at highly competitive but sustainable rates, underpinned by key market fundamentals in relation to costs. Meanwhile PES continues to grow its share of the downstream after-sales market with repeat business and new product offerings underpinning the growth of this business, alongside its key role in supporting the metering, maintenance and emergency response activities to its sister companies.

During the year, PNG invested a further 12.3m in extending its network by a further 57 kilometres to establish gas in new developing areas such as Comber and to enable the connection of new customers to gas across the network for the first time. The Group continues to seek new opportunities to expand PNG's current licence areas in relation to both its distribution and supply activities.

Gas on gas competition in the Greater Belfast intensified in 2011. New suppliers are actively investing in encouraging customers to switch across all sectors of the market, particularly domestic and small commercial sectors. Currently PSL's cost base, potential margin and tariff price are all subject to a price control. As the only regulated gas supplier PSL still retains a significant market share, however, as its market share falls the need for a regulated market also changes. As at the end of 2011 around 9% of customers have switched from PSL to other suppliers with 91% of all gas users in Greater Belfast now being supplied by PSL.

THE FUTURE

The difficult economic climate currently presents major challenges to PNG's ability to grow its connected customer base and thereby maximise utilisation of its gas distribution network. PNG has already connected 51% of all the connectable homes and businesses to its network. Despite the challenges its plan remains to connect c.60% of properties by 2016. This requires on average PNG to connect a further 8,000 properties per year for the next five years – it is worth noting that this is below the level of connections it has achieved in each of the last five years.

PNG's periodic price control consultation concluded in 2011. Unlike past price controls this was a mini-price control for a two year period, at the request of NIAUR in order to align natural gas price control regimes across Northern Ireland. However late in the process NIAUR's unexpectedly proposed to amend PNG's TRV retrospectively via a licence modification. PNG does not accept the proposed licence modification and as such has asked NIAUR to dis-apply its determination. NIAUR have as a result referred the matter to the Competition Commission. There is a clearly defined process when such disagreements arise and on this basis a clear outcome is expected at the end of September 2012. PSL completed their supply price control process with NIAUR during 2011 – this runs for a further 5-year period commencing on 1 January 2012, and the company is currently operating within the principles of this control.

The gas market outside of Belfast in the so called 'ten towns', currently being solely developed by Bord Gas Eireann's subsidiary, firmus energy, is open to competition in October 2012. This will provide further opportunities for the Group's supply companies to compete fully across the island of Ireland. This provides the opportunity to offset potential losses of load expected by our supply business in Greater Belfast, as a result of competition, with loads gained both in the Republic of Ireland and elsewhere in Northern Ireland as the market outside opens fully in the forthcoming years.

On 16th May 2012, the Group announced that it had reached agreement with SSE plc (Airtricity) to sell its supply businesses in both NI and ROI with the sale subject to the necessary approvals completing on 22nd June 2012.

Kellen Group will continue to focus on investing and growing its core business, Phoenix Natural Gas, which operates the Greater Belfast natural gas network and is responsible for making gas available to around half the population of Northern Ireland. Phoenix remains one of the largest private sector investors in Northern Ireland, connecting over 8,000 homes and businesses to its natural gas network every year.

Phoenix established the natural gas industry in Northern Ireland in 1996 and due to its success there are now over 300,000 homes and businesses that have access to cheaper, cleaner fuel. The scale of the gas network has attracted three other gas suppliers to the Greater Belfast area. This growth has now prompted SSE plc (Airtricity), one of the biggest energy suppliers in the UK and Ireland, to extend its current activities in Northern Ireland and the Republic through the acquisition of Phoenix's gas supply businesses.

Our long term ambition is to grow our distribution business. Our past successes were built by our outstanding people and their 'can do' mentality. The same will be true of those working on our future direction with great attention to detail and a willingness to adopt to change.

Peter Dixon
Group Chief Executive

CORPORATE SOCIAL RESPONSIBILITY

Kellen Group's award-winning integrated Corporate Social Responsibility programme is called LIFE and stands for Leadership in the marketplace, Investing in our people, Fostering our community and Environmental responsibility. LIFE was developed to provide an overarching framework for the range of ongoing initiatives carried out by the Group that positively impact our marketplace, workplace, environment and community. We are delighted to have, for the seventh year running, received national recognition for our efforts by collecting a Business In The Community 'Big Tick' award for CSR excellence. Phoenix is amongst a small number of companies within the UK to have won the Big Tick award on so many occasions.

LEADERSHIP IN THE MARKETPLACE

During 2011 the Group has continued to improve upon, evaluate and show leadership in every area of Phoenix LIFE. The Group continues to be a strong supporter and corporate member of Business In The Community, sitting on its Northern Ireland board and chairing its environmental arm – Arena Network.

Education Outreach

Phoenix has a long history of supporting young people and providing them with as much help as possible in meeting their goals and ambitions. One of the key relationships Phoenix has developed in the last year has been with Cinemagic.

Cinemagic is an award-winning organisation that uses the power of film and all forms of moving image to entertain, educate, motivate and inspire young people. Designed for and by young people, Cinemagic caters for those aged 4 to 25 who have just about every level of interest in film, whether wanting to watch and enjoy, create their own work or take things a stage further and find out more about a career in the film or television industry. Phoenix is currently supporting a variety of projects in partnership with Cinemagic in the Greater Belfast area.

The most recent initiative, known as the 'Reel Issues for Youth project', successfully brought the power of film, guest speakers and debate to a number of local schools.

Impressed with the ongoing partnership between Phoenix and Cinemagic, Arts & Business NI provided further funding for a bespoke film project to focus on what Phoenix does to promote STEM subjects. Science, Technology, Engineering and Maths (STEM) are disciplines that the Government has highlighted as being key to the nation's future economic success. Phoenix has always been a strong supporter of the STEM agenda and were a key contributor in the setting up of Northern Ireland's first ever gas sector skills qualification at Belfast Metropolitan College.

The Group also has long-standing relationships with many schools as well as with Queen's University and the University of Ulster.

Since the development of a local STEM strategy in 2010, there has been a an increasing level of collaboration between industry and the Northern Ireland Executive aimed at encouraging more people to study these subjects and choose careers in these important areas of the economy. Private sector organisations like Phoenix have been at the forefront of this promotion. The Phoenix/Cinemagic STEM film was created by a talented group of young people and largely includes interviews with members of Phoenix staff as well as footage taken at gas installations and at engineering site works. The edited footage has already received much attention from a number of stakeholders and it was shown at the NI Assembly's 'STEM – One Year On' event that was attended by Government Ministers, including the Minister for Employment and Learning and the Minister for Education.

INVESTING IN OUR PEOPLE

The Group continues to invest in its most important asset – its people. Increasingly, there is evidence that Phoenix's reputation as a socially responsible organisation is helping to attract job candidates who recognise Phoenix as a company with a strong focus on people and developing them. Furthermore Phoenix's staff turnover, which is already low, fell by a further 7% in the past year keeping HR recruitment spend relatively low. Staff satisfaction surveys suggest that CSR activities are a key reason for people staying with Phoenix. According to recent surveys 98% of staff believe the Group's monthly Phoenix Fifteen information sessions organised for staff are an "excellent" part of Phoenix LIFE.

Another key staff initiative involves volunteers working with pupils of primary school age right up to students who are involved in further education at universities and colleges. One of the most recent initiatives has seen members of staff agree to mentor two groups of eight year old children from two different schools as part of Business In The Community's national 'Time to Read' and 'Time to Count' programmes. This involves a commitment to attend the local schools once a week for a full year

playing a key role in helping to improve the literacy and numeracy levels of children by reading books with them and developing learning based scenarios.

Feedback from Phoenix staff indicates that they view their time spent volunteering as beneficial – even beyond the sense of fulfilment that they gain from the experience. 82% of staff have indicated that volunteering has enhanced a number of their job-related skills. In 2011 over 170 Phoenix staff participated in one or more voluntary activities, amounting to more than 2,500 hours.

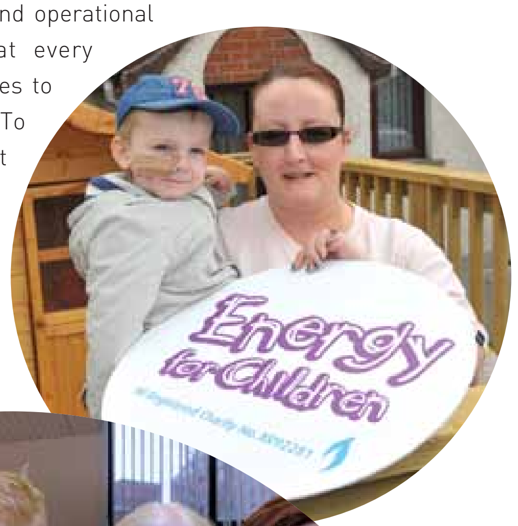
In the past year Phoenix has also partnered with Queen's University Belfast, which led to the establishment of Riddel Hall – a £15 million purpose built Postgraduate and Executive Education Centre. Phoenix are one of fifty Founder's Club members, all of whom have the opportunity to work with the Centre's management experts from across the world in order to shape the content of what is delivered at the Centre. Phoenix management now have access to relevant business tutorials, programmes and training in a number of different areas.

FOSTERING OUR COMMUNITY

Phoenix has established a track-record of supporting young people and providing them with as much help as possible in meeting their potential goals in life. Over the past year we have continued with our commitment to support the Ulster Rugby Academy, which is known as the Phoenix Ulster Rugby Academy. It is designed to nurture, develop and prepare the next generation of Ulster and Ireland rugby stars and it has been doing this with great success. In the past three years, with Phoenix's support, 30 academy trainees have gone on to secure professional rugby contracts – many of them now full international players. The success of the Academy makes it one of the best of its kind in European rugby.

However in terms of our community work it is Phoenix and the wider gas industry's Energy for Children Charitable Trust that continues to have the greatest impact in terms of changing young people's lives in Northern Ireland for the better.

The Trust was founded with the objective to break new ground and reach deeper into the heart of local communities in order to help improve the lives of disadvantaged children. Focusing on individuals and groups who may have slipped through the net of the more established charity network, Phoenix provides all administrative and operational support so that every penny raised goes to needy causes. To date the Trust has helped over 5,000 individual children throughout Greater Belfast and beyond.



ENVIRONMENTAL RESPONSIBILITY

Around 2.6 million tonnes of carbon dioxide (CO_2) has already been prevented from entering the local atmosphere by consumers switching to gas in the Phoenix Natural Gas area, with continued savings of around 250,000 tonnes of CO_2 per annum (the equivalent of removing around 80,000 cars from Northern Ireland's roads each year).

Phoenix energy advisors have in the last year on average visited 200 homes every week to provide essential energy awareness and savings advice tailored to each individual home (over 10,000 homes a year). Through these audits Phoenix encourages people to switch to what is a lower carbon fuel, to use more energy efficient appliances, to protect their homes from heat loss, to add insulation measures and thereby to reduce overall energy consumption.

To add to this energy advice work Phoenix showed real leadership last year by, in the absence of government funds, setting up a wide-ranging and privately funded boiler scrappage scheme for householders who needed that little bit of extra help in order to alleviate their dependency on inefficient boilers and get connected to natural gas and in many cases move out of fuel poverty. The scheme saw the local gas industry contribute £400 cash back for any consumers wishing to upgrade from an old inefficient domestic oil boiler over a certain age to a high efficiency A-rated natural gas boiler.

Phoenix continues to actively promote environmental awareness both internally and externally, through its in-house environmental team, involvement with local award schemes and through publicity campaigns. In 2011 Phoenix was assessed to be in the platinum quintile by ARENA Network in terms of environmental performance, meaning that the Group scored 80%+ in their environmental benchmarking survey.

Phoenix's investment in CSR is a long-term one, put in place strategically to benefit both the organisation and the local communities that we serve. The financial resources attributed to Phoenix LIFE are far outweighed by the voluntary effort, commitment and time given by staff to maximise the impact of all initiatives pursued.

DIVISIONAL REVIEW

PHOENIX NATURAL GAS

DISTRIBUTION

Phoenix Natural Gas (PNG) is the owner and operator of 3,148km of distribution network within its licence area, in the Greater Belfast and Larne areas of Northern Ireland, and has already made gas available to 292,000 premises and connected circa 148,000 customers to its network. The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

The business is partially funded by £275m of 5.5% bonds issued in 2009 and repayable in 2017 by its subsidiary Phoenix Natural Gas Finance plc, guaranteed by both 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. In addition the company took the opportunity to re-finance its £60m bank facilities, during the year, in order finance its future capital expenditure and working capital requirements over the next three years.

GROWTH AND INVESTMENT

Distribution income of £39.2m in 2011 was £0.3m lower than that in 2010, generated mainly through the application of published conveyance charges to all gas distribution system users based on the volume of gas conveyed in the year. Charges are set annually in advance of the year (inclusive of an estimate of any surplus/deficit from the previous year) in order to recover the maximum allowed income for each year as detailed within PNG's five year Price Control ending on 31st December 2011, as previously determined by NIAUR.

PNG's allowable regulated income is profiled to 2046 so as to provide a flat real price per therm to customers in line with expected growth in the business across that period and deliver a return on allowable costs of 7.5% real to 2016 with return beyond 2016 being subject to review by NIAUR as part of future price controls. In addition any differences between allowable regulated income and actual income is carried forward as a 'Z' balance at the end of each year and allowable regulated income adjusted as appropriate in subsequent years.

Actual income generated was lower than the regulatory 'determined' level for 2011 however this reflected the return of a proportion of over-recovered income (Z) to customers from previous years. Consequently the level of 'Z' brought forward into 2011 of £5.0m has reduced to £2.4m by the end of the year. The balance remaining will be carried forward and returned to all system users through lower conveyance charges in subsequent years.

117.3 million therms (mt) of natural gas was transported through the network, 10.7mt less than 2010. Volumes are estimated to have been lower than forecast by 7.2mt because average temperatures across the year were 0.4 degrees centigrade warmer than the five year average, most notably in the final quarter. This compares to 2010 when volumes were an estimated 14.4mt higher than forecast as a result of temperatures being exceptionally cold relative to historic averages.

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) fell by 2.4mt, largely due to reduced consumption in temperature sensitive sites. Otherwise demand continues to be influenced by the economic pressures on business customers and the continued focus on energy efficiency and environmental initiatives. Elsewhere, throughput in the domestic and smaller industrial & commercial sectors fell by 8.3mt, with lower demand driven by warmer weather relative to 2010 offset to some extent b a 7% a increase in the number of customers connected to the network and some load growth within existing users.

Operating profits of £14.0m were £1.7m lower than in 2010 as a result of a slight reduction in distribution income together with an expected increase in operating costs, which is reflective of the growth in the size of the network. Actual operating costs in PNG are monitored closely in real terms against the levels determined by NIAUR during the price control reviews. Whilst the implication of growth in the business is that costs will increase each year, this has been partially offset in 2011 by the business delivering ongoing efficiency improvements.

PNG invested a further £12.3m in capital expenditure during 2011, constructing 57km of new network and connecting 9,719 new customers. By year-end, PNG had 3,148km of network in operation, making gas available to 291,855 premises in its licence area, with a total of 148,474 (51%) already connected.

OPERATIONS AND REGULATION

The company met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending "Public Reported Escapes", targets were exceeded.

During 2011, the distribution network continued to operate without major incident. No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2011.

A 'peak day' for demand of 19.9 GWH was recorded on 20th January 2011, which compares to the 2010 'peak day' of 24.4 GWH. However it should be noted that in 2010 throughput on this peak day was driven by exceptionally low temperatures (-10.1 degrees centigrade) compared to the temperatures during the 2011 peak day of -1.9 degrees centigrade.

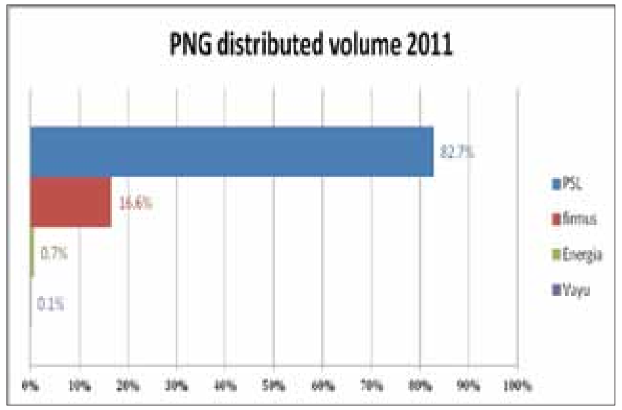
PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is recognised as exemplary when benchmarked against other organisations throughout Northern Ireland. PNG's ongoing operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO 14001 and 18001.

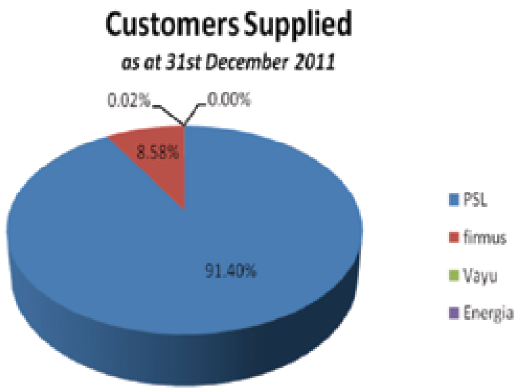
During 2011 the company progressed with its price control review with NIAUR, which is required in order to determine the allowable capital, operating expenditure and income for the period 2012 to 2013 inclusive. In August 2011 NIAUR issued its draft proposals which, as well as indicating their view on allowable costs, also unexpectedly included a proposal to retrospectively remove a proportion of the company's regulated asset base referred to within its licence as Total Regulatory Value (TRV). NIAUR proposed that although the two parties had reached a comprehensive value sharing agreement for the benefit of customers in 2006 and subsequently included as part of 2007 licence amendments, they were now looking to share further value with customers through a retrospective reopening of the Agreement and a retrospective adjustment to the TRV which was codified within the Licence in 2007. The company responded to NIAUR's statutory public consultation of its draft position by registering its strong opposition to such proposals, clearly laying its rationale for taking such a position and confirming that it would be unable to accept such proposals if issued as a final determination. In January 2012 NIAUR issued its final price control review determination and also a proposed licence modification to implement the adjustment to the TRV. On the 6th February 2012 the company rejected the price control review determination and the TRV licence modification issued by the NIAUR. As no agreement could be reached between the company and NIAUR over the Price Control proposals NIAUR made a reference to the Competition Commission on the 28th March 2012. The Competition Commission has a period of six months (which could be extended if required by a further six months) to issue its decision in respect to the Price Control determination that should apply to the company.

GAS ON GAS COMPETITION

PNG has been instrumental in ensuring the necessary systems and processes are in place to ensure that competition for the supply of natural gas to customers across all market sectors in Greater Belfast is now in place, with the project to facilitate competition within the 'Pay As you Go' metering sector coming on-stream as planned in August 2011.

Currently six suppliers hold licences for the supply of natural gas in Phoenix Licence area however only four actually supplied gas to customers during 2011, with only firmus energy and Phoenix Supply Limited actually engaged in competition within the domestic tariff market at present.



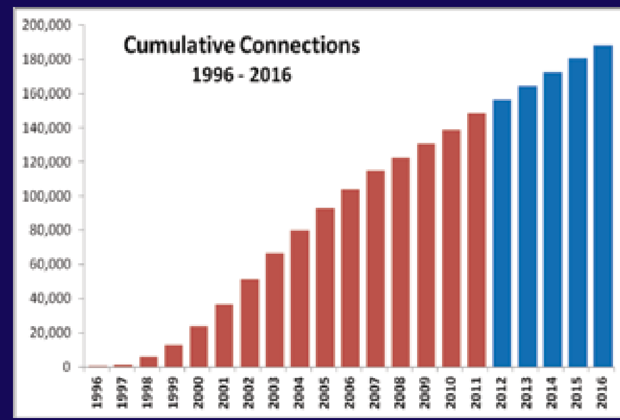


PNG has developed its market into four distinct sectors (NIHE, New Build, Owner Occupied and I&C) each with its own dynamic.

The Northern Ireland Housing Executive (NIHE) is the body responsible for all of Northern Ireland's public housing. Over the last sixteen years PNG has been involved in assisting NIHE to develop heating replacement programs which were aligned to the development of the natural gas infrastructure. With a high proportion of available NIHE properties having already connected to natural gas, the number of new connections in this sector is expected to reduce somewhat in forthcoming years from historic levels.

Within the new build housing market, gas is now invariably the fuel of choice and therefore PNG's activity is highly dependent on the state of the housing market. 2011 saw a continued slowdown in activity, both in terms of house sales as well as new housing schemes starting up, with the majority of schemes that were completed being developed on the back of public sector funding by Housing Associations. Whilst a large number of private sector developers have ceased trading in recent years, PNG has seen a more hopeful build-up in 2011 of reworked planning applications coming forward for design. Some of these are due to commence in 2012 with developers approaching these construction projects on a much more conservative basis than in the past to reduce cash flow implications. PNG is well positioned to provide natural gas to all new housing projects in Greater Belfast during 2012 and beyond, once the market conditions become more favourable.

In the owner occupied sector PNG has met its licence obligations in respect to its' network development plan' and therefore further investment in established private residential areas is likely to be more limited going forward. Connections in 2011 have significantly benefitted from the accumulated effect of a number of factors such as: the cold weather at the end of 2010 which forced many customers into replacing their existing boilers and converting to gas in early 2011; the sustained high cost of oil relative to gas particularly in the first half of 2011, the increase in gas marketing activities both directly by PNG and also indirectly from new gas suppliers entering the market thereby stimulating demand throughout the past year. In addition weak house sales has provided an added stimulus to the home improvement market, with upgrading of central heating systems recognised as providing both immediate lifestyle and other benefits as well as adding value to a home in the longer term.



In 2012 PNG plans to invest in a further 55km of new distribution network to bring the opportunity of natural gas to a further 5,400 potential new customers across all sectors as well as extending our network in the south east of our licence area to Millisle.

PNG has established a wide network of gas related businesses such as manufacturers, distributors, merchants, retailers, and installers, throughout its licence area. This network focuses on meeting the needs of new gas users and developing incentives and offers to encourage customers to switch to natural gas. Through our ongoing relationship with Government agencies, PNG will maximise consumer opportunities provided by Government funded schemes, such as 'Warm Homes', "Cosy Homes", "Healthy Homes", "Snug Plus" – which are designed to lift households out of fuel poverty by supplying a modern and efficient natural gas heating system. PNG continues to lobby the Northern Ireland Assembly to introduce a government funded 'Boiler Scrappage' scheme similar to the scheme which has been made available within other parts of UK.

DIVISIONAL REVIEW

PHOENIX NATURAL GAS SUPPLY

SUPPLY (NI)

Phoenix Supply Limited (PSL) is the largest natural gas supplier in Northern Ireland supplying c91% of all customers connected to the Phoenix Natural Gas (PNG) network in Greater Belfast and Larne with natural gas at the end of 2011.

OPERATING PERFORMANCE

Turnover for the year of £106.4 million was £5.3 million higher than in 2010 due to increasing gas prices. The increase in turnover was despite a reduction in consumption both as a result of warmer weather and also a reduction in the volume of gas supplied relative to other suppliers.

From 1st May 2011 published selling prices in the tariff sector were increased by 39.1% as a result of a forecast rise in gas costs for the tariff year to March 2012. Within the large industrial and commercial sector, pricing arrangements are more directly linked to the wholesale gas market actually incurred each month, therefore selling prices directly reflect the increase in actual monthly wholesale gas costs applicable to this sector.

The rise in turnover as a result of higher selling prices was partially offset by a lower volume of gas supplied to customers during the year. This was driven largely by the impact on customer consumption of much warmer weather relative to 2010. Otherwise the reduction in throughput associated with customers transferring to other gas suppliers was partially offset by new customers connecting to the PNG network and thereby being supplied by PSL for the first time.

Operating profits of £4.5 million were £3.9 million above the level reported in 2010. This was due in part to lower gas costs being delivered relative to assumptions within the revised tariff especially as the year progressed. Ultimately this has resulted in an increase in the level of gas costs savings generated within the regulated tariff sector brought forward into 2012, which under the terms of PSL's price control mechanism, will be returned to customers in future years.

Under the terms of PSL's regulatory supply price control, all gas cost savings are required to be returned to customers at the subsequent tariff review. This principle provides significant protection to customers as demonstrated by the scale of the price reduction applied by PSL on 1st April 2012, in contrast to the response by other suppliers across the UK where no such arrangement is in place.

GROWTH AND DEVELOPMENT

The company continued to benefit from the growth of new connections to the PNG network during the year with 9,719 new customers being supplied by PSL following their connection for the first time. Despite the intensification of competition from other gas suppliers, PSL still supplied c83% of the total gas volume supplied to customers within the PNG distribution licence area in 2011.

PSL continues to invest in training and efficiency measures in order to deliver a level of service which exceeds customer expectations. Throughout the year the company continued to promote the Energy Care Scheme which delivers a range of additional benefits to vulnerable customers, underpinning the strong customer focused ethos of the business. There are now a record number of customers registered on this scheme and participation from customers compares favourably to similar schemes across the energy industry.

MARKET OVERVIEW AND OUTLOOK

WHOLESALE GAS MARKET OVERVIEW

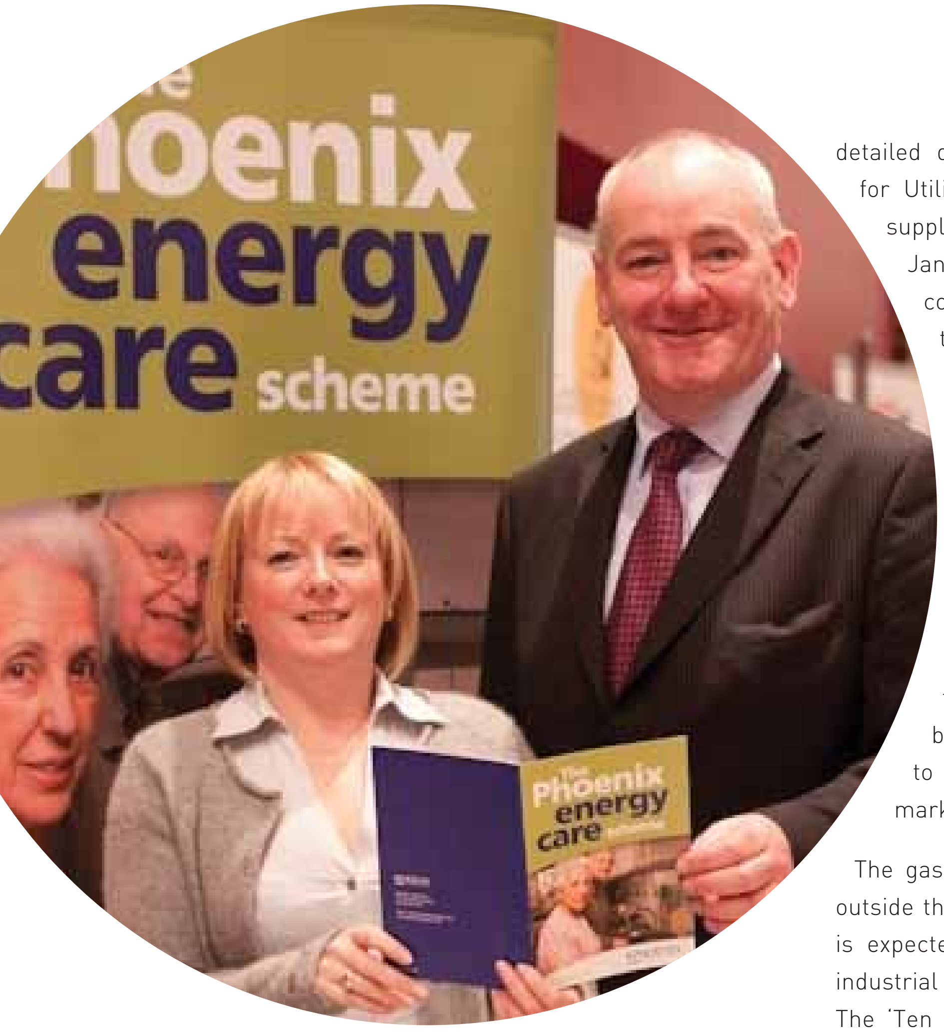
The wholesale gas market in the United Kingdom (UK) continues to be influenced by global factors. This is due to the decline of indigenous natural gas reserves and increasing reliance on natural gas imports, particularly Liquefied Natural Gas (LNG).

Natural gas prices rose sharply at the end of the first quarter after an earthquake and tsunami struck Japan on 11th March 2011 resulting in a devastating reduction in the country's nuclear power generation capacity. This led to fears that demand for LNG in Japan would increase causing UK gas prices to rise. Prices for the following winter period had increased to almost 75 pence per therm by mid-March compared to 60 pence per therm a month earlier.

After having increased in response to the Japanese earthquake natural gas prices remained at this higher level for much of the year. Throughout the summer prices for gas to be delivered in the forthcoming winter period traded in a relatively tight range broadly between 69 – 73 pence per therm. Prices were supported as traders were concerned over the level of future LNG deliveries to the UK. Visibility in respect of the number of LNG cargos reaching UK LNG import facilities is limited which adds to a sense of nervousness in the market.

However, as the winter period commenced weather was milder than normal and record levels of LNG reached the UK which provided a healthy supply/demand balance. This reduced the need to withdraw gas from storage in the early part of the winter period and resulted in storage levels at the end of 2011 being close to 90% full compared to around half that level a year earlier. As a consequence, natural gas prices in the UK fell quite sharply.

Since the year end wholesale gas costs have continued to decrease largely as a result of plentiful supplies of natural gas in the UK and lower demand as a result of higher than seasonal normal temperatures. As a direct result of this decrease in wholesale gas costs, PSL decreased its tariff prices by 8.5% with effect from 1st April 2012.



detailed discussions, the Northern Ireland Authority for Utility Regulation issued a determination on a supply price control covering the period from 1st January 2012 to 31st December 2016. This price control, which largely follows the principles in the previous control, sets a framework for the treatment of PSL's costs over this new period.

PSL is the market leader in gas supply in Northern Ireland. During the year the company provided, on a daily and weekly basis, key wholesale gas market information to its key industrial and commercial customers. PSL's dedicated gas purchasing team, based in Belfast, continues to provide bespoke gas purchasing solutions and advice to customers in the industrial and commercial market sector.

The gas retail market in the so called 'Ten Towns' outside the PNG network in Greater Belfast and Larne is expected to open up to competition for the large industrial and commercial sector from 1st October 2012. The 'Ten Towns' include Antrim, Armagh, Ballymena, Ballymoney, Banbridge, Coleraine, Craigavon, Limavady, Londonderry and Newry. To date this market has been supplied solely by Firmus Energy. The company looks forward to this market opening during 2012 and expects that this will provide an area of growth into the future. However whilst market opening provides an opportunity for large industrial and commercial customers to choose another supplier, those customers consuming less than 25,000 therms per annum will not be able to choose their supplier until 1 April 2015.

GAS ON GAS COMPETITION

PSL is expected to continue to face competition from other gas suppliers during 2012. Given the fact that until the beginning of 2011, PSL supplied c99% of all customers with gas, the company has really only experienced active competition within the wider domestic market for the first time in 2011.

The company will continue to focus on providing customer service which exceeds customer expectations which is the foundation of its customer retention strategy. However, whilst it retains a significant market share, PSL will continue to be subject to regulatory controls on its tariff prices.

In 2011 PSL operated under the terms of a supply price control which covered the period 1st January 2009 to 31st December 2011. During the year, after

DIVISIONAL REVIEW

PHOENIX ENERGY LIMITED

SUPPLY (ROI)

This was the second full year of trading for Phoenix Energy Limited (PEL), after the company commenced supplying natural gas in the Republic of Ireland (ROI) towards the end of 2009. In 2011, when combined with supply activities in Northern Ireland, Phoenix' gas supply divisions further consolidated their position as the second largest on the island of Ireland, excluding gas volumes supplied to power generators.

OPERATING PERFORMANCE

Turnover in 2011 of £14.1 million was £8.7 million above 2010 levels, representing an 161% increase over the prior year. The increase in turnover arose both as a result of our success in acquiring new customers throughout the year thereby increasing throughput by 78% (20.1mt) and also from a rise in average selling prices relative to the previous year, as a result of a higher wholesale cost of gas being passed on to customers.

The company supplies customers in the large industrial and commercial sectors in the ROI on an individual contract basis with pricing arrangements directly linked to the wholesale gas market and relevant published conveyance charges. Therefore, average selling prices across the year directly reflect monthly movements in the wholesale gas market.

Customers continued to switch to PEL throughout the year as the company consolidated its position in the gas supply market in the ROI. PEL's customer base now extends across manufacturing, pharmaceutical, agrifood, hospitality and public sectors and includes one of the largest industrial users ever to switch from the incumbent supplier, BG Energy, (owned by Bord Gas Eireann) in ROI.

The company generated an operating profit of £0.15 million during the year which represents a £0.08 million increase in performance compared to 2010. The increase in margin is driven primarily by margin on increased throughput and also the fact that the company has progressed from its initial start-up phase.

While the company operates under a licence granted by the Commission for Energy Regulation (CER), it is not subject to price regulation, allowing PEL to compete

directly with other licensed gas suppliers in the ROI.

GROWTH AND DEVELOPMENT

The success of PEL is testament to the outstanding service offered to its customers and to competitively priced and flexible gas supply contracts on offer. PEL provides one of the most comprehensive range of flexible gas purchasing options in the Irish marketplace including fixed and variable pricing options. The company also provides innovative and bespoke capacity management products tailored to individual customer requirements, procurement strategies and risk appetite.

Competition in the ROI is more established than in NI with a total of eight licensed natural gas suppliers active in the market. PEL's initial entry into the market was to compete in the above regulated tariff formula (RTF) sector, which contains the largest industrial and commercial users in Ireland. During 2011 PEL supplied around 23% market share in this sector, with BG Energy supplying the remainder.

PEL has also grown its market share within the RTF sector and this market is expected to grow further during 2012.

During the year the company achieved recognition for its impressive growth and development by being awarded a Global Business Excellence Award for Outstanding Fast-Growth.

OUTLOOK

The scope for the further growth of PEL is significant as the natural gas market in the ROI is over four times larger than in NI. PEL expects to record further growth in 2012 and the company has established a platform, brand and team to continue to deliver strong growth by winning new customers across the industrial and commercial sectors in which it operates and by consolidating its position in the Irish market.

DIVISIONAL REVIEW

PHOENIX ENERGY SERVICES

ENERGY SERVICES

Phoenix Energy Services (PES) is the leading provider of natural gas boiler and appliance servicing, emergency response, gas metering and meter reading services in Northern Ireland. From a business start-up position in 2001, the company now undertakes more than 50,000 service engineering and 276,000 meter reading visits annually, using a professional team of Gas Safe Registered engineers and other multi-skilled staff.

BUSINESS REVIEW

Turnover of £3.7m in PES was £0.2m higher than in 2010, in line with the continued expansion of the business, both internally to PNG and PSL and externally through growth in services to home owners and businesses. It should further be noted that activity levels in 2010 had benefitted from extremely cold weather, which increased the level of emergency response and maintenance activities whereas weather was much milder than normal in 2011. Operating profits were £0.1m lower than 2010 levels at £0.5m.

Phoenix Energy Services is now a well established brand in Northern Ireland's growing natural gas market. Along with the proven capability of delivering a world-class emergency service to gas consumers, the business also provides professional support to the Group's distribution and supply businesses through a range of other business-critical activities, including gas asset installation, maintenance and meter reading.

The achievements of the company of the gas apprenticeship scheme over the past year have been recognised within the industry with the presentation of the PMST "Apprentice of the Year " award.

24/7 Emergency Response Service

PES continues to deliver a professional downstream emergency response service to the core distribution division, ahead of agreed industry standards. This area of operations currently accounts for 31% of the service engineering visits undertaken, with activity growing alongside the expanding natural gas infrastructure in Northern Ireland.

Asset Installation and Maintenance

This arm of the business delivers a range of meter installation and maintenance services to the distribution division and constitutes a further 50% of downstream service engineering activity. While minimising unnecessary activity in this area will obviously be a focus for the distribution business, activities will grow in line with the increasing customer base, competition in the supply market and the changing age profile of the network.

Customer Support Services

PES provides a one-stop-shop for boiler and appliance maintenance, repair, landlord inspection, commercial planned maintenance and boiler insurance breakdown protection. This work constitutes 19% of the downstream service engineering activity and continued to deliver significant revenue into the business in 2011 despite the general economic downturn. This workload reflects continued success in this developing market and is the result of building customer loyalty through excellent service delivery and the innovative marketing of products such as the boiler insurance breakdown package "Phoenix ServiceCare". A series of focused marketing campaigns has also delivered growth in the boiler service area.

Meter Reading and Related Activities

Meter reading activities continued to focus, in 2011, on increasing productivity through better use of technology. A total of 276,000 reads were completed in support of the billing programme of its main meter reading customer, Phoenix Supply.

MARKET OVERVIEW AND OUTLOOK

Trading conditions remain buoyant in the customer support services sector, due to ongoing targeted marketing supported by continued repeat business despite the challenging economic conditions. Customer awareness of increased energy efficiency across all areas of the economy has been a strong driver for proactive maintenance of all appliances. With volatility in the cost of fuel and other domestic expenditure, the benefits of fixed price boiler insurance packages such as 'Phoenix ServiceCare' remain attractive.

Emergency services and asset maintenance activities will continue to grow in tandem with the expanding natural gas market in Northern Ireland. The increasing age of installed plant and equipment will also be an ongoing source of work in this safety critical area. Meter reading services will continue to focus on increasing productivity in order to support the efficiency targets placed upon the regulated supply business.

Overall, the future growth prospects of PES are looking extremely healthy, thanks to anticipated further growth of the Northern Ireland gas infrastructure and consumer market

BOARD OF DIRECTORS

DR GEORGE GREENER CBE
CHAIRMAN

George Greener brings to Kellen significant and varied experience at directorship level, most recently as Chairman of the National Health Service in London. Before joining the Kellen Board, he was Senior Independent Director of Reckitt Benckiser plc, as well as Chairman of the British Waterways Board, The Big Food Group plc, Swallow Hotels plc, Allied Dunbar Assurance plc, Eagle Star Holdings plc and Threadneedle Asset Management plc. In addition, George held the posts of Chief Executive Officer of BAT Financial Services and Director of BAT Industries plc. George has also served as Group Chief Executive Officer of Hillsdown Holdings plc.

SAMI KASSAM
NON EXECUTIVE DIRECTOR

Sami is a Director at TFCP. Sami brings with him significant transaction experience, having been on the investment team at TFCP since 2006. Whilst at TFCP, Sami has been primarily focused on the energy and infrastructure space, with recent notable transactions including the refinancing of Infinis, the take private of Novera Energy and the acquisition of Consolidated Pastoral Company. Prior to joining TFCP, Sami worked as an Investment Banker within Citigroup's M&A team.

LORENZO LEVI
NON EXECUTIVE DIRECTOR

Lorenzo is an Operational Managing Director at TFCP. He has had a wide-ranging career encompassing sales management and corporate development for companies such as IBM and Nortel Networks, to strategy for management consultants, Bain & Co. He now puts these skills and expertise to good use at Terra Firma. In addition to due diligence work on transactions, Lorenzo also handles post-acquisition operational challenges which differ greatly. At Terra Firma, in the cinema investment his role includes driving acquisitions across Europe, while his work in the aircraft leasing business has included managing the integration of the two acquired companies.

LORCAN WOODS
NON EXECUTIVE DIRECTOR

Lorcan joined Terra Firma in London as Finance Director, Portfolio Businesses with current board responsibility for Everpower Wind Holdings and Phoenix Natural Gas. He was brought up in N.Ireland joining Unilever as a graduate trainee and working in a variety of finance roles for 21 years in Foods and Personal Care. His final two roles were as Finance Director, Unilever Mexico and Vice President, M&A where he led a number of transactions including the disposal of Bertolli Olive Oil and the acquisition of the Sara Lee Personal Care business.

SIR GERRY LOUGHRAN KCB
NON EXECUTIVE DIRECTOR

As Chairman of Phoenix Energy Holdings, Sir Gerry Loughran brings a wealth of experience and expertise in the public and private sectors. He has served as Permanent Secretary of the Industry Department (Department of Economic Development) in Northern Ireland and subsequently was appointed Head of the Northern Ireland Civil Service and Secretary to the Northern Ireland Executive. In this role he led 29,000 members of the Northern Ireland Civil Service until his retirement from the Service in 2002. Since then he has held a number of appointments in the private sector. He is currently Chairman of Blackstaff Press, Director of Allied Irish Banks (UK) PLC, the Baird Group and Forward Emphasis International. He also serves on several Boards in the education and training sectors.

PETER DIXON
GROUP CHIEF EXECUTIVE

Peter has spent his entire career in the gas industry, acquiring over 34 years' experience. He started out as an Engineer in 1976 with North West Gas and went on to play a key role in the break-up of what was then the old British Gas. Peter joined Phoenix Natural Gas as Commercial Director in February 1997. He was appointed Chief Executive in July 2000. He is currently Chairman of the Energy for Children Charitable Trust, as well as Chairman of Arena Network - the environmental arm of Business in the Community of which he is also a Board member. In 2008 he was appointed a Belfast Harbour Commissioner and he is also a Board member of the Winston Churchill Memorial Trust.

MICHAEL MCKINSTRY
GROUP FINANCE DIRECTOR

Michael has been with Phoenix from its earliest days, joining the fledgling company in 1996 as Finance Director. He took his place on the Group Board in January 2006 following the acquisition of Phoenix by Kellen. Because Michael has been at the financial helm of Phoenix throughout its history, overseeing the various changes to its ownership, corporate, financial and regulatory structures, as well as developing its strategies, he has a comprehensive knowledge and understanding of the business. Prior to joining Phoenix, Michael gained extensive financial management experience across a broad range of business sectors, starting in heavy engineering with GEC, in the textiles industry with Ulster Weavers and in the energy industry with Premier Power following its purchase by British Gas.

FINANCIAL REVIEW

2011 was another year of strong performance, with all operating businesses within the Group exceeding expectations despite the challenging economic conditions. Despite the warmer weather, the rising cost of its natural gas and financial constraints on consumer spending, the business was able to outperform by highlighting the good value of its offering relative to its competitors, continuing to achieve operating efficiencies and maintaining a tight control over its costs.

Operating performance within Phoenix Natural Gas (PNG), the gas distribution business, has been positive with relative value offering that natural gas provides over other energy sources being magnified in 2011 and helping to boost connections in the year. In addition PNG took the opportunity in the summer to re-finance its bank debt for a further three years at preferential terms

Our gas supply operations in both NI & ROI have continued to perform well in highly competitive markets – the focus on management of gas trading risks, enhancing customer offering and where applicable operating within the terms of its licence and respective price controls continue to serve these businesses well.

Our energy service business continues to deliver the efficiencies required to support the regulated businesses within the Group and also seeks to add value to consumer offering where appropriate.

TURNOVER

Group turnover of £127.5m in 2011 is £16.5m higher than in 2010.

	TURNOVER £ 2011	2010
Distribution (PNG)	39.2m	39.5m
Supply (PSL)	106.4m	101.1m
Energy Limited (PEL)	14.1m	5.4m
Energy Services (PES)	3.7m	3.5m
Intra Group Sales	(35.9m)	(38.5m)
Total	127.5m	111.0m

Distribution income in Phoenix Natural Gas (PNG) has fallen by £0.3m to £39.2m, with lower gas throughput year on year being offset by an 8% increase in average distribution charges.

Distribution prices are set in advance of each year on the basis of forecasts of gas throughput and RPI for both the year in question and the preceding year. As a result actual income generated will be higher or lower than the maximum allowed level as a consequence of the utilisation of such forecasting estimates. The difference arising (either surplus or deficit) is thereby accumulated at the end of the year as a 'Z balance', to be adjusted in charges in future years - in this manner NIAUR regulate rate of return allowed to Phoenix.

Whilst distribution income was £2.9m lower than allowed levels within its price control in 2011 (2010: £1.7m higher than the level allowed), a balance of £2.4m of over-recovered income still remains to be returned to customers at end of 2011. This arose as a result of the surplus brought forward into 2011 being greater than expected when prices were set and thereby more than offsetting any reduction in income in 2011 as a result of warmer weather.

	2011	2010	Inc/(Dec)
Allowable Income	41.8m	37.5m	4.3m
Under/Over Recovery	(2.9m)	1.7m	(4.6m)
Other Income	0.3m	0.3m	-
Distribution Turnover	39.2m	39.5m	(0.3m)

Income in Phoenix Supply (PSL) has risen by £5.3m (5%) despite a 14% fall in throughput compared to the previous year. This was driven mainly by higher average selling prices agreed with the NIAUR at the beginning of May 2011, which was implemented as a result of an expected rise in gas costs.

Income in Phoenix Energy (PEL) has risen by £8.7m during the year driven both by a 78% increase in throughput and a 46% increase in average selling prices, as a result of the impact of higher average cost of gas in the year.

Phoenix Energy Services' (PES) income has risen by £0.2m primarily as a result of an increase in activity provided to its core distribution business in the year.

Further detail behind movements in turnover is provided within the divisional reports on pages (14 to 24), but a summary is outlined in the previous page:

OPERATING PROFIT

Group operating profit increased by £2.2m to £20.1m in 2011 predominantly as a result of an higher operating profits generated in PSL.

	OPERATING PROFIT £ 2011	2010
Distribution (PNG)	14.0m	15.7m
Supply (PSL)	4.5m	0.6m
Energy Limited (PEL)	0.1m	0.1m
Energy Services (PES)	0.5m	0.6m
Other	1.0m	0.9m
Total	20.1m	17.9m

Operating profit within PNG of £14.0m (2010: £15.7m) is primarily driven by the income levels allowed for within its current 5-year price control issued by NIAUR less the respective costs involved in operating the business.

It should be noted that PNG's operating profits were reduced by £4.6m relative to 2010 by a movement in the over-recovered Z (surplus of actual income over allowed income). The value of Z carried forward at the end of 2011 to be returned to customers in discounted charges in the future amounted to £2.4m.

Operating profit within PSL in 2011 of £4.5m (2010: £0.6m) has benefitted from an increase in the level of gas cost savings generated in the year, to be returned to tariff customers in lower prices in future years. This is in line with the terms of its regulated tariff price control, whereby any differences in actual gas costs incurred compared to the forecast of such cost included in its tariff setting assumptions are carried forward and adjusted in future tariff reviews.

PSL is subject to a price control with regard to the prices it charges to its tariff customers (domestic & small commercial). In addition to the pass through treatment of gas costs, PSL's tariff prices are capped so as to provide for an allowable level of operating cost and a profit margin of 1.5% on turnover.

Whilst the contract market has been open to competition from other gas suppliers for some time, the tariff market opened up on a phased basis from November 2010 with full competition across all tariff market sectors being in place from August 2011. Therefore PSL is now competing directly with other suppliers for customers in all sectors of the market in it's gas supply area (which mirrors that of PNG). By the end of 2011, 9% of it's customers had switched to other gas suppliers.

As a result of a fall in gas costs experienced in the latter part of 2011 compared to that assumed when increasing its tariff prices on 1 May 2011, PSL has taken forward into 2012 a greater level of savings than forecast. This together with an updated view of future gas costs has resulted in PSL reducing its tariff prices by 8.5% post year-end on 1 April 2012.

PEL generated a profit of £0.1m in the year as it continues to develop its customer base in its gas supply market in ROI following on from starting to trade at the end of 2009.

Operating profit within PES has decreased by £0.1m as a result of a slight change in the mix of its workload compared to the previous year. PES continues to be reliant on workload from its main customer PNG, both as a result of an increase in planned maintenance activities but also from on-demand metering and emergency response activities which can be influenced by weather conditions.

OPERATING CASH FLOWS

During the year, net cash inflow of £26.7m was generated from operations compared to £33.0m in the previous year.

A further £12.3m (2010: £12.9m) was re-invested in the Group to fund expansion to the distribution network and connect new customers, while £16.8m (2010: £17.7m) was used to meet interest obligations and other financing costs in respect to the Group's bank borrowings and bond providers.

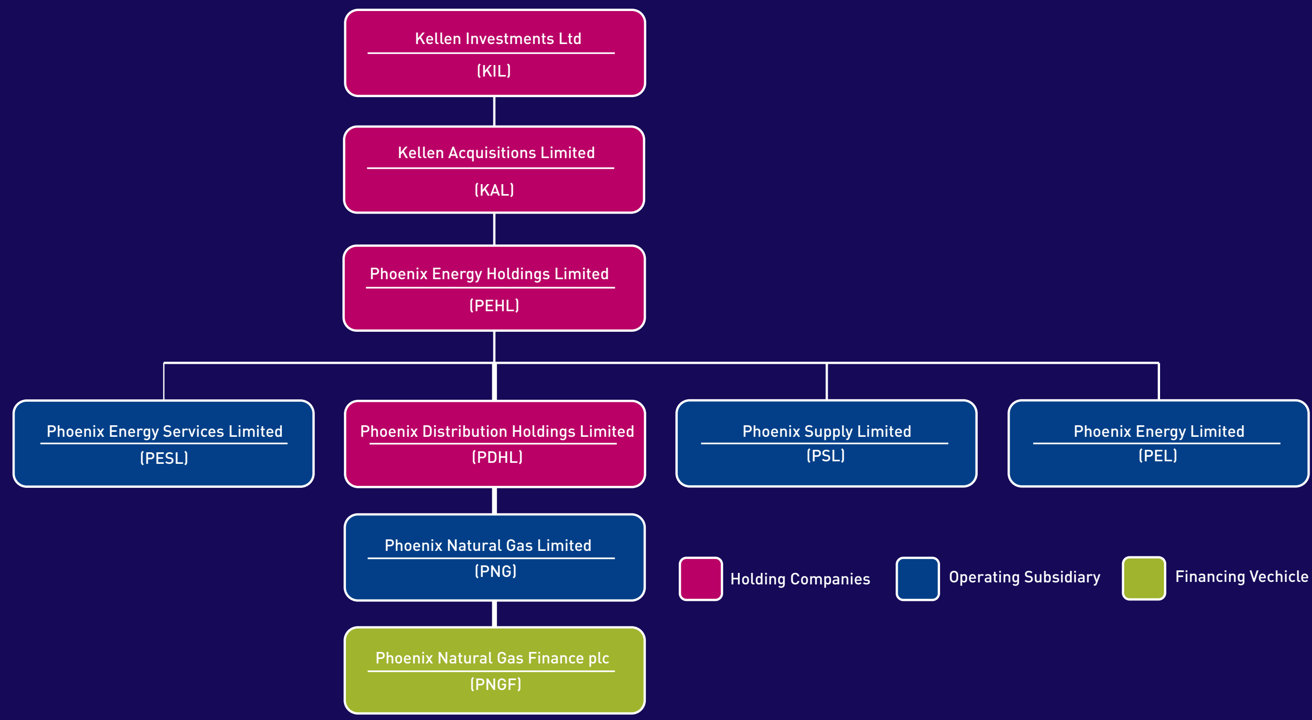
£10m was drawn by PNG under its revolving bank facilities in the year to support financing requirements across the Group.

The net result of these cash flow movements was that cash held at bank or in hand at the end of 2011 has increased by £7.6m from the balance at the end of the previous year.

BANK BORROWINGS

The Group is principally involved in the development of long-term infrastructure assets, owned by PNG, with underlying income growing over time in line with growth in connections.

ANNUAL REPORT & ACCOUNTS 2011
KELLEN GROUP
SECTION 2 : BUSINESS REVIEW



The Group's principle source of debt finance has been generated from the issue in 2009 of £275m of bonds by Phoenix Natural Gas Finance plc, a 100% subsidiary of PNG, of £275m which pay a coupon rate of 5.5. These bonds are guaranteed by PNG and PDHL (the holding company of PNG), were rated Baa2 by Moody's and BBB+ by Fitch and are repayable in 2017.

In addition PNG re-financed its bank facilities in August 2011 exclusively with The Royal Bank of Scotland plc for a further 3 year term, reducing the value of its facilities to £60m. These facilities are made up of a £30m revolving credit facility to support continued investment in capital expenditure within the distribution division, and a £30m working capital facility to finance working capital requirements within PNG. As part of this working capital facility PNG can lend up to 5% of the value of PNG's Total Regulated Value (TRV) to PSL in order to finance its working facilities.

At the end of 2011, net debt increased to £234.5m (excluding cash held as collateral) compared to £233.4m at the end of 2010.

Bank balances at the end of 2011 increased by £9.9m to £44.8m whilst the £10m was drawn under PNG's 3-year £60m bank facilities.

Included within bank balances is £1.7m of cash held as collateral against outstanding guarantees, as part of credit arrangements to suppliers and other service providers under bank facilities. This is £2.3m lower than cash collateralised in the previous year mainly as a result of obligations to ESH loan note holders now being settled in full.

In addition the balance outstanding to bondholders (net of capitalised fees) increased by £1.0m to £269.3m at the end of 2011 as a result of the amortisation of fees.

The debt facilities require the "financing group" (PDHL, PNG & PNGF) to comply with certain financial and non-financial covenants. The covenants include a limit in borrowings linked to the regulatory asset value of our assets (TRV & DAV) and ratios linking earnings to net interest paid.

BUSINESS GROWTH

The principles underpinning the growth of PNG are defined within its current price control, currently the five year price control for period 2007 to 2011, with subsequent plans subject to review as part of the normal price control process. Plans include: network extension to make gas available to new industrial, commercial and domestic developments, taking gas mains into areas where customers have a strong propensity to convert from their existing fuel to natural gas and meeting our obligations to NIHE to where possible make gas available to tenants in line with its refurbishment programme.

During the year, the Group invested a further £12.3m in capital expenditure. Investments included construction of 57km additional distribution mains and connection of a further 9,719 new customers in 2011.

While the licence under which PNG operates requires investment in a network to make gas available to a minimum number of customers, PNG has reached the point where its obligations with respect to this network development plan which is contained within its licence have been fulfilled. Therefore a growing proportion of future investment will be directed at connecting customers to the existing network. In support of this, PNG continues to invest in an extensive sales and marketing programme to all potential new customers and manages customers up until the date they are connected and using gas. PNG charges all gas suppliers, including PSL, on an equal basis, for utilisation of its network in line with the terms of its network code.

KELLEN ANNOUNCE SALE OF SUPPLY BUSINESSES

On 16th May 2012, Kellen Group announced that it had entered into an agreement to sell 100% of the share capital of both Phoenix Supply Limited and Phoenix Energy Limited, to SSE plc, through its subsidiaries Airtricity (Energy Supply) Northern Ireland Limited & its Republic of Ireland-registered subsidiary Airtricity Limited for £19.1m excluding working capital adjustments.

With the necessary approval by the Irish Competition Authority having been granted the sale was completed on Friday 22nd June 2012.

As part of the sale, the existing loan arrangement between Phoenix Natural Gas Limited and Phoenix Supply Limited was repaid in full.

For details of the turnover and operating profit of Phoenix Supply Limited and Phoenix Energy Limited see the divisional review on pages 21 and 22 and the financial review on pages 25 and 29. This will provide the users of the financial statments with a indication of the future financial effect of the disposal.

PRINCIPAL RISKS AND RISK MANAGEMENT

The Group's management structures, coupled with appropriate policies and procedures on how the respective businesses function, are designed to enable the achievement of business objectives while controlling the risks associated with the environment within which it operates.

The key business risks and uncertainties affecting the Group, together with the means by which we manage them, are outlined below:

REGULATORY RISK

PNG, PSL and PEL operate under licences issued by government. As a result, the Group devotes a considerable amount of time to the management of regulatory matters with both NIAUR and DETI (Department of Enterprise, Trade and Investment) in Northern Ireland and CER (Commission for Energy Regulation) in the Republic of Ireland. Compliance with the ongoing requirements of these licences, changes arising from the evolving regulatory environment, (including those associated with the agreement reached with NIAUR in November 2006), EU obligations, the full introduction of supply competition, and the implications of price controls, mean that significant attention has been and will continue to be dedicated to regulatory compliance. Indeed the Group allocates a specialist resource to this task.

The Group manages the relationship with NIAUR, DETI and CER at senior management level in each of the regulated businesses, supported by a dedicated resource within common services in PNG.

HEALTH & SAFETY RISK

As a provider of an essential service to the public, the Group works in an environment where health and safety must take top priority within the operating businesses. At the heart of the Group's safety culture, the 'ASHES' system ensures all employees understand the rigorous policies and procedures in place to deliver a safe operating environment. Through a dedicated manager within PNG, by stringently controlling health and safety performance from company board level through to field operations, and with the strategic support of The British Safety Council audits and ISO accreditations, the Group is able to manage any health and safety risks that may arise.

BUSINESS CONTINUITY RISK

The Group has measures in place to mitigate the risks associated with managing the business in the event of a gas supply emergency, or any other occurrence which could affect the ability of all or part of the Group to function normally, potentially affecting financial performance.

As a rule, gas supply emergency risks are managed through the contractual relationships that exist in the Transmission Network Codes and the agreements between the Transmission System Operator and the Distribution System Operator. In addition, general operational risks are controlled through the establishment of prudent and safe operational processes and through a structured and highly focused approach to capital expenditure in conjunction with robust maintenance procedures. Regular emergency exercises involving all gas operators and selected local essential service providers in Northern Ireland are simulated to test and further develop the processes in place. The Group also maintains a comprehensive business continuity plan which includes details of our IT recovery plan and is updated, reviewed and tested on a regular basis.

GAS PRICE COMMODITY RISK

PSL & PEL are exposed to the wholesale cost of gas, which they must acquire. To minimise exposure, hedging instruments and forward exchange contracts are used to try and match the price charged to customers with the costs incurred by the Group.

In addition, in the tariff sector it is necessary to forecast gas costs forward for the tariff year. Therefore PSL is

exposed in the short term to the actual costs incurred being different to the price being charged to customers. PSL has agreed a mechanism with NIAUR within its price control, so that differences between actual and forecast are reflected in future tariff price reviews. PSL has a dedicated gas trading manager who monitors the gas cost daily and ensures, wherever possible, that supply contracts are matched with purchase arrangements on behalf of both PEL and PSL. A purchasing strategy is agreed by the Group board which sets levels for buying gas forward, especially across times when gas costs are expected to be more volatile, with the balance of any requirements being purchased on a within day basis.

FINANCIAL RISK MANAGEMENT

Group operations bring exposure to a variety of financial risks, including the effects of changes in liquidity and interest rates. The Group exercises strong financial and management accounting controls through the consolidation of all financial and treasury requirements within the finance function within common services in PNG.

Long-term business plans and shorter term budgets and forecasts are tracked monthly against actual performance at both a company and consolidated group level in line with obligations under financing agreements, thereby enabling financial requirements to be monitored against the cash resources available to both the Group as a whole and its constituent parts.

A mixture of long-term debt, raised through the issue of fixed rate bonds, and short-term debt available within our banking facility, are used to ensure that there are sufficient resources available for operational requirements. The Group does not use derivative financial instruments for speculative purposes.

The Group has delegated the responsibility of monitoring financial risk management to the Finance Committee, a sub-committee of the Board. The policies set by this committee are directly implemented by the finance function.

EXCHANGE RATE RISK

The Group operates through its subsidiary, PEL in the Republic of Ireland and as such has to deal with exchange rate risks associated with the purchase of goods and raw materials in a currency which may be different to the currency in which it receives its income.

Where such exposure exists, PEL limits the impact of such exchange rate fluctuations by the use of hedging instruments such as forward exchange rate contracts to limit the effect on its performance.

CREDIT RISK

The Group's principal current assets are bank balances, cash, trade and other receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of these cash flows.

PNG is exposed to credit risk arising mainly from the risk that gas suppliers are unable to pay distribution charges as they fall due. The risk is partially mitigated by the requirement for all suppliers to comply with credit arrangements within the PNG Distribution Network Code to evidence their ability to pay for distribution charges when they fall due, thereby reducing the risk of payment default by a supplier.

In 2011 85% of all distribution revenue was received from the Group's own supply business PSL. In addition at the end of 2011 99.9% of all annual distribution income generated was provided on the basis of prepayment of monthly charges by the supplier in advance of the month.

Revenues within PSL and PES have no significant concentration of credit risk with a specific customer. Credit exposure is spread over a large number of individual customers.

Michael McKinstry
Group Finance Director

BUSINESS AWARDS

WINNER
Big Tick Award
for Corporate Social Reponsibility
2011

WINNER
BVCA:
Portfolio Company Awards
2011

WINNER
Energy Supplier
Customer Service Award
2011

WINNER
Arena Network
Platinum Quintile Award
2011

WINNER
Institution of Gas Engineers & Managers
Young Person's Paper Prize
2011

WINNER
Global Business Excellence Award
for Rapid Growth
2011

WINNER
PMST Adult Apprentice
of the Year
2011

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2011.

PRINCIPAL ACTIVITY

The principal activity of the Group is the development and operation of the distribution gas networks together with the supply of gas and other energy services.

The principal activity of the Company is that of an intermediate holding company and is the highest EU parent company for which Group accounts will be drawn up.

BUSINESS AND FINANCIAL REVIEW

The Chairman's statement, CEO Review and Financial Review, together with the Divisional Reports, can be viewed on pages 3 to 34.

These provide a comprehensive picture and analysis of the Group's business and performance during the year including the primary KPIs used by the Group in its operations.

EMPLOYEES
EQUAL OPPORTUNITIES

The Group is committed to a proactive approach in promoting equality of opportunity. Kellen Group ensures that it operates fairly and equitably in its dealings with employees and prospective staff members.

The Group is opposed to all forms of unlawful and unfair discrimination, ensuring through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the Kellen Group provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Race or ethnic origin
- Nationality
- Sexual orientation
- Age

DISABILITY

The Group has taken active steps to implement the Disability Discrimination (Northern Ireland) Order 2006. It is corporate policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

EMPLOYEE PARTICIPATION

Within the bounds of commercial confidentiality, information is communicated to staff at every level about matters that affect the progress of the Group and are of interest and concern to them as employees. This encourages staff participation in our performance.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry. Trade creditors at year end represented 20 days (2010:20 days) of purchases. It is the Group's policy regarding all suppliers to agree payment terms in advance of the supply of goods and to adhere to these terms.

PRINCIPAL RISKS AND FINANCIAL RISK MANAGEMENT

This section is considered in detail within the Group Finance Director's review on pages 28 to 34.

RESULTS AND DIVIDENDS

The profit for the financial year is £2.7m (2010: loss of £0.03m). No dividends were paid during the year.

POLITICAL AND CHARITABLE DONATIONS

The Group made charitable donations amounting to [£28,218] in 2011 (2010: £21,177). No donations for political purposes were made during the year (2010: £Nil).

DIRECTORS AND THEIR INTERESTS

Details of the directors who served through 2011 are provided below:

J Williamson - Resigned 29 March 2011
N Steinmeyer - Resigned 14 December 2011
L Woods - Appointed 14 December 2011
S Kassam
L Levi
P V Dixon
G P Greener
G Loughran
W F M McKinstry

DISCLOSURE OF INFORMATION TO AUDITORS

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 Group's auditors are aware of that information.

AUDITORS

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

By order of the Board

W F M McKinstry
Director
25th June 2012

CORPORATE GOVERNANCE REPORT

The Kellen Group's corporate governance structure is set by the Board of directors of Kellen Investments Limited. The Kellen Group is committed to the highest standards of corporate governance as set out in the Combined Code on Corporate Governance.

The Board of directors of Kellen Investments Limited (the "Kellen Board") believes that effective corporate governance is a fundamental aspect of a well-run business and is committed to achieving the highest standards of corporate governance, corporate responsibility and risk management in directing and controlling the business.

The following paragraphs describe the key governance structures and internal controls operating within the group. Through these mechanisms, the Kellen Group aims to apply the highest standards of corporate governance and to conform to the spirit of the 'Combined Code'.

BOARD CONSTITUTION AND PROCEDURES

The Kellen Board comprises seven members; a non-executive Chairman, two executive directors and four non-executive directors. Biographies of the Kellen Board members are shown on pages 26 and 27.

The Chairman is responsible for the effective running of the Kellen Board and for communications with all directors and shareholders. He ensures the Kellen Board receives sufficient information on financial trading and corporate issues prior to board meetings.

The executive directors are responsible for day-to-day operations and the development of strategic plans for consideration by the Kellen Board as a whole.

The Kellen Board meets regularly during the year. During 2011, four main board meetings were held, plus a number of specific meetings to deal with strategic developments and particular authority issues. All members of the Kellen Board receive detailed financial information and regular presentations from executives on the business performance, in addition to items for decision and minutes of board committees, in advance of every meeting, whether they are able to attend or not. This enables the directors to make informed decisions on corporate and business issues under consideration.

The principles for the corporate governance of the Group were adopted by the Kellen Board on 9th December 2005. These determine the internal policies by which the Group should operate.

To ensure that key policy and strategic decisions are made by Kellen Board, certain matters must be brought to Kellen Board for approval, including but not limited to: final approval of the annual accounts and budget, major acquisitions and disposals and any changes to the Group's financing arrangements and financial policies. Where urgent decisions are required on matters specifically reserved for the board between meetings, there is a process in place to enable discussion and decision-making. Directors also have access to the advice and services of the Company Secretary.

Board Committees

The Kellen Board has established three committees, each with clearly defined terms of reference, procedures, responsibilities and powers.

AUDIT COMMITTEE

The Audit Committee is chaired by Lorcan Woods (previously Nils Steinmeyer) and consists of three of the independent non-executive directors. Each member brings relevant financial experience at a senior executive level. The expertise and experience of these members is summarised on pages 26 and 27.

Audit Committee members are expected to have an understanding of the following areas:

- the principles of, contents of and developments in financial reporting, including the applicable accounting standards and statements of recommended practice, and in particular, the appropriateness of the Group's accounting policies;
- the Group's wider corporate policies and its financing;
- systems of internal control and matters that require the use of judgment in the presentation of accounts and key figures, as well as the role of internal and external auditors.

The Group Chief Executive, Group Finance Director and external auditors are normally invited to attend the committee meetings. The committee holds a minimum of two meetings during the financial year at appropriate times in the audit reporting cycle.

The committee oversees the relationship with the external auditors, reviews their audit plan and discusses findings with them. In addition, the committee reviews the effectiveness of the Group's internal controls and risk management systems and also ensures there is proportionate and independent investigation of any matter brought to their attention.

Further, this committee is required to assist the Kellen Board to fulfil its responsibilities relating to external financial reporting and associated announcements. During the year, members reviewed, either as a committee, or as part of the Board:

- interim and annual financial statements, including requirements for financial reporting;
- Group trading statements and, where practicable, all proposed announcements to be made by Kellen Group to the extent that they contain material financial information;
- changes proposed to policies and practices;
- significant accounting issues;
- the risk management process.

The committee is also responsible for the development, implementation and monitoring of Kellen Group's policy on external audit and reserves oversight responsibility for monitoring independence, objectivity and compliance with ethical and regulatory requirements. Additional functions include: recommending the appointment and re-appointment of the company's external auditors and annually reviewing a formal letter provided by the external auditors confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards.

With regard to audits, the committee also reviews:

- the terms, areas of responsibility and scope as set out in the external auditor's engagement letter;
- the overall work plan for the forthcoming year, together with the cost-effectiveness of the audit and the auditors' remuneration and performance;
- any major issues which arose during the course of the audit and their resolution;
- key accounting and audit judgements;
- the level of errors identified during the audit including schedules of unadjusted errors and representation letters;
- and lastly, the recommendations made to management by the auditors and the Group response.

REMUNERATION AND NOMINATIONS COMMITTEE

The Remuneration and Nominations Committee is chaired by Lorenzo Levi and consists of three non-executive directors. This committee meets at least once a year and at such other times as the Kellen Board requires.

The committee's specific duties and responsibilities are as follows:

- establish the criteria to be used in selecting directors and ensure the remuneration package is designed to attract, motivate and retain staff of the highest calibre;
- approve the remuneration of the executive directors and management to provide independent and objective assessment of any benefits granted to directors and management;
- ensure that the pension arrangements throughout the Group are appropriate, well supervised and conform to applicable law.

The committee also reviews the design of incentive and performance related pay plans for approval by the Board, together with remuneration policies as a whole and trends across the Group.

FINANCE COMMITTEE

The Finance Committee is chaired by Lorcan Woods (previously Nils Steinmeyer) and consists of three non-executive directors. In addition, the Group Chief Executive and the Group Finance Director are normally invited to attend the meeting.

This committee is responsible for making recommendations to the Kellen Board on financing and investment policy, including the capital structure of the Group, management of financial risks such as interest rates and foreign exchange, management of credit risk, communication with financial institutions, and the acquisition and divestment of material corporate premises.

Further, the committee is also responsible for making recommendations to the Kellen Board based on proposals by the Group Chief Executive (beyond authority levels so delegated) with regard to the creation or disposal of new subsidiaries, the raising of external finance, approval or divestments within the Group and the granting of securities, guarantees and indemnities.

In certain specific circumstances, the Kellen Board has delegated authority to the committee to make decisions in these areas.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

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 year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and parent 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 parent 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 on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

W F M McKinstry
Director
25th June 2012

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KELLEN INVESTMENTS LTD

We have audited the financial statements of Kellen Investments Limited for the year ended 31 December 2011, which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated balance sheet, the company balance sheet, the consolidated cashflow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 40, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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 ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2011 and of the group's profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared 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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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
25th June 2012

FINANCIALS

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	2011 £'m	2010 £'m
Turnover	2	**127.5**	**111.0**
Cost of sales		(81.2)	(67.0)
Gross profit		**46.3**	**44.0**
Net operating expenses	3	(26.2)	(26.1)
Operating profit	4	**20.1**	**17.9**
Loss on sale of fixed assets		(0.1)	0.0
Interest payable and similar charges	7	(17.1)	(17.9)
Interest receivable and similar income	8	0.3	0.2
Profit/(loss) on ordinary activities before taxation		**3.2**	**0.2**
Taxation	9	(0.5)	(0.2)
Profit/(loss) for the financial year	**21**	**2.7**	**0.0**

A statement of movements on reserves is given in Note 21.

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

All the results of the group derive from continuing operations.

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2011 £'m	2010 £'m
Profit/(Loss) for the financial year	2.7	(0.0)
Total recognised Profit since last report	**2.7**	**(0.0)**

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

	Note	2011 £'m	2010 £'m
FIXED ASSETS			
Tangible assets	11	202.5	196.5
Intangible assets	13	105.8	109.0
		308.3	**305.5**
CURRENT ASSETS			
Stocks	15	1.2	1.2
Debtors: Amounts falling due within one year	16	72.7	76.5
Cash at bank and in hand	27	46.5	38.9
Total current assets		**120.4**	**116.6**
Creditors: Amounts falling due within one year	17	(94.1)	(101.7)
Net current assets		**26.3**	**14.9**
Total assets less current liabilities		**334.6**	**320.4**
Creditors: Amounts falling due after one year	17	(279.3)	(268.3)
Provisions for liabilities and charges	18	(16.3)	(15.8)
Deferred income	19	(2.5)	(2.5)
Net assets		**36.5**	**33.8**
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	(33.3)	(36.0)
Shareholders' funds	**22**	**36.5**	**33.8**

The financial statements were approved by the Board of Directors on 25 June 2012 and are signed on its behalf by:

W F M McKinstry
Director
25 June 2012

The notes on pages 48 to 62 form part of these financial statements.

COMPANY BALANCE SHEET

	Note	2011 £'m	2010 £'m
FIXED ASSETS			
Tangible assets	12	0.0	0.0
Investments	14	67.2	67.2
		67.2	**67.2**
CURRENT ASSETS			
Debtors: Amounts falling due within one year	16	33.9	31.1
Cash at bank and in hand		0.0	0.0
Total current assets		**33.9**	**31.1**
Creditors: Amounts falling due within one year	17	(26.1)	(24.9)
Net current assets		**7.8**	**6.2**
Total assets less current liabilities		**75.0**	**73.4**
Creditors: Amounts falling due after one year	17	0.0	0.0
Net assets		**75.0**	**73.4**
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	5.2	3.6
Shareholders' funds	**22**	**75.0**	**73.4**

The financial statements were approved by the Board of Directors on 25 June 2012 and are signed on its behalf by:

W F M McKinstry
Director
25 June 2012

Company registration number: 05366077

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

	Note	2011 £'m	2010 £'m
NET CASH FLOW FROM OPERATING ACTIVITIES	23	**26.7**	**33.0**
RETURNS ON INVESTMENT AND SERVICING OF FINANCE			
Interest paid		(17.1)	(17.9)
Interest received		0.3	0.2
		(16.8)	**(17.7)**
Taxation		**0.0**	**0.0**
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Purchase of tangible fixed assets		(12.3)	(12.9)
		(12.3)	**(12.9)**
Net cash (out)/in flow before financing		**(2.4)**	**2.4**
FINANCING			
Receipt/(Repayment) of loan from /(to) bank		10.0	(5.0)
		10.0	**(5.0)**
Increase/(Decrease) in cash in period	24	**7.6**	**(2.6)**

The notes on pages 48 to 62 form part of these financial statements.

NOTES FORMING PART OF THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

BASIS OF PREPARATION

The consolidated financial statements incorporate the financial statements of Kellen Investments Limited, Kellen Acquisitions Limited, Phoenix Energy Holdings Limited, Phoenix Distribution Holdings Limited, Phoenix Natural Gas Limited, Phoenix Supply Limited, Phoenix Energy Services Limited, Phoenix Natural Gas Finance plc and Phoenix Energy Limited for the year ended 31 December 2011.

All subsidiaries are accounted for using the acquisition method of accounting and the profit and loss account and statement of cash flows of the Group included the results and cash flows of subsidiaries from the date of acquisition to the period end. All transactions between the businesses of the Group have been eliminated in the preparation of the consolidated financial statements.

GOING CONCERN

As highlighted in note 17 to the financial statements, the Group is financed through bank debt loan facilities and bond finance to support continued investment in its infrastructure assets and to meet its general working capital requirements. This debt facility is due for renewal in August 2014 and the bond due for redemption in 2017.

The Group's forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that the Group is capable of operating well within the level of its current facilities and also able to meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

REVENUE RECOGNITION

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of energy and transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

DEFERRED TAXATION

Deferred tax is recognised in respect of:

1) Material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date, and

2) Tax losses not group relieved in the current period. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements.

Deferred tax assets and liabilities recognised have not been discounted.

INVESTMENTS

Investments held by the company in subsidiary undertakings are stated at cost less amounts written off.

TANGIBLE FIXED ASSETS

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.

The economic lives used are as follows:

	Years
Distribution mains	60
Distribution services	35
Distribution meters	20
Office equipment and fixtures & fittings	5

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

INTANGIBLE FIXED ASSETS

Intangible fixed assets comprise the value attributed to the various licences acquired with Phoenix Natural Gas Limited. These are being amortised over the distribution licence recovery period of 40 years.

DEBTORS

Debtors are stated after provision has been made against all debts considered doubtful of collection.

PENSIONS

The Group operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the Group will benefit from the employee's services.

INTEREST BEARING BORROWINGS

Immediately after issue, the debt is stated at the fair value of the consideration received on the issue of the capital instrument after deduction of finance costs. These costs are allocated to the debt over the term of the debt at a constant rate of the carrying amount.

STOCKS

Stock has been valued at the lower of cost and net realisable value.

GOVERNMENT GRANTS

The European Regional Development Grant relates specifically to capital expenditure on the high pressure distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

OPERATING LEASES

Costs in respect of operating leases are charged on a straight line basis over the lease term.

CLASSIFICATION OF FINANCIAL INSTRUMENTS ISSUED BY THE GROUP

Financial instruments issued by the Group are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

a) they include no contractual obligations upon the company (or Group as the case may be) to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the company (or Group); and

b) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes a legal form of the company's own shares, the amounts presented in these financial statements are called up share capital and share premium account exclude amounts in relation to those shares.

Where a financial instrument that contains both an equity and a financial liability component exists these components are separated and accounted for individually under the above policy. The finance cost on the financial liability component is correspondingly higher over the life of the instrument.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholder fund (see dividends policy), are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

CASH LONG TERM INCENTIVE PLAN

The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

DIVIDENDS ON SHARES PRESENTED WITHIN SHAREHOLDERS' FUNDS

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

are appropriately authorised and are no longer at the discretion of the company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

2. ANALYSIS OF TURNOVER

The Group's turnover, profits and net assets all relate to the business of gas distribution in Northern Ireland and gas supply in both Northern Ireland and the Republic of Ireland together with the provision of energy services predominantly for the gas industry.

Details of each of its separate business activities are provided with the Financial and Divisional Reviews on pages 14 to 34.

3. NET OPERATING EXPENSES

Net operating expenses were all considered to be administrative expenses.

4. OPERATING PROFIT

This is stated after charging/(crediting):

	Group 2011 £'m	Group 2010 £'m
Depreciation – owned assets	6.2	5.8
Amortisation of intangible assets	3.2	3.2
European Regional Development Grant release	0.0	0.0
Operating lease rentals	0.9	1.0
Auditors' remuneration	0.1	0.1

The auditors' remuneration in respect of the individual Company accounts amounted to £4k, (2010: £8k). KPMG Belfast were paid £13k for non-audit related services to the Group during the year, (2010: £6k).

NOTES (CONTINUED)

5. EMPLOYEE INFORMATION

The average number of persons employed by the Group (including executive directors) analysed by category during the period was as follows:

	Group 2011 No	Group 2010 No
Operational	125	122
Administration	92	84
	217	**206**

The aggregate staff costs of these persons were as follows:

	Group 2011 £'m	Group 2010 £'m
Wages and salaries	6.7	6.1
Social security costs	0.8	0.7
Other pension costs	0.6	0.6
	8.1	**7.4**

6. DIRECTORS' REMUNERATION

	Group 2011 £'m	Group 2010 £'m
Emoluments	1.0	0.9
Amount receivable under long term incentive schemes	0.2	0.2
Company pension contributions	0.1	0.1
	1.3	**1.2**

Details in respect of the highest paid director are as follows:

	Group 2011 £'m	Group 2010 £'m
Emoluments	0.5	0.5
Amount receivable under long term incentive schemes	0.2	0.2
Company pension contributions	0.0	0.0
	0.7	**0.7**

Retirement benefits are accruing to one executive director under a group defined contributon scheme.

The Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

NOTES (CONTINUED)

7. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2011 £'m	Group 2010 £'m
Amounts payable on bank loans and overdrafts	16.5	17.2
Other	0.6	0.7
	17.1	**17.9**

8. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2011 £'m	Group 2010 £'m
Bank interest	0.3	0.2
	0.3	**0.2**

NOTES (CONTINUED)

9. TAXATION

	Group 2011 £'m	Group 2010 £'m
Current tax		
UK corporation tax for the year	0.0	0.0
Adjustments relating to earlier years	0.0	0.0
Total current tax	**0.0**	**0.0**
Deferred tax		
Origination/reversal of timing differences	1.7	0.8
Effect in reduction in tax rate	(1.2)	(0.6)
Adjustments relating to earlier years	0.0	0.0
Total deferred tax charge	**0.5**	**0.2**
Total tax charge	**0.5**	**0.2**

The current tax charge for the period is less than (2010: less than) the standard rate of corporation tax in the UK. The differences are explained below:

	2011 £'m	2010 £'m
Current tax reconciliation		
Profit/(Loss) on ordinary activities before tax	3.2	0.2
Current tax at 26.5% (2010: 28%)	0.8	0.1
Effects of:		
Adjustment relating to earlier years	0.0	(0.1)
Expenses not deductible for tax purposes	(0.2)	(0.3)
Excess capital allowances	(1.7)	(0.8)
Deferred tax asset not recognised	0.0	(0.1)
Other permanent differences	1.1	1.2
Total current tax (credit)/charge	**0.0**	**0.0**

Factors affecting future tax charges:

Finance Act 2011 provided for the reduction in the main rate of corporation tax from 26% to 25% with effect from 1 April 2012.

On 22 March 2012, the Government announced its intention to further reduce the main rate of corporation tax to 24% with effect from 1 April 2012 with future reductions of 1% each year with the rate reducing to 22% by 1 April 2014. The reduction in the rate of corporation tax to 24% was enacted on 26 March 2012.

The deferred tax balances as at 31 December 2011 have been determined with reference to the enacted corporation tax rate at that date of 25%.

NOTES (CONTINUED)

10. PROFIT FOR THE FINANCIAL YEAR

As permitted by Section 408 of the Companies Act 2006, the parent company's profit and loss account has not been included in these financial statements. The parent company's profit for the financial period was £1,596k.

11. TANGIBLE FIXED ASSETS (GROUP)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Transmission pipeline £'m	Total £'m
Cost					
At 1 January 2011	2.0	3.2	236.0	0.0	**241.2**
Additions	0.1	0.0	12.2	0.0	**12.3**
Disposals	0.0	0.0	(0.2)	0.0	**(0.2)**
At 31 December 2011	2.1	3.2	248.0	0.0	**253.3**
Depreciation					
At 1 January 2011	1.9	1.6	41.2	0.0	**44.7**
Charge for the year	0.1	0.2	5.9	0.0	**6.2**
Disposals	0.0	0.0	(0.1)	0.0	**(0.1)**
At 31 December 2011	2.0	1.8	47.0	0.0	**50.8**
Net book value					
At 31 December 2010	0.1	1.6	194.8	0.0	**196.5**
At 31 December 2011	0.1	1.4	201.0	0.0	**202.5**

NOTES (CONTINUED)

12. TANGIBLE FIXED ASSETS (COMPANY)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Total £'m
Cost				
At 1 January 2011	0.0	0.0	0.0	**0.0**
Additions	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2011	0.0	0.0	0.0	**0.0**
Depreciation				
At 1 January 2011	0.0	0.0	0.0	**0.0**
Charge for the year	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2011	0.0	0.0	0.0	**0.0**
Net book value				
At 31 December 2010	0.0	0.0	0.0	**0.0**
At 31 December 2011	0.0	0.0	0.0	**0.0**

13. INTANGIBLE FIXED ASSETS (GROUP)

	Licence £'m	Total £'m
Cost		
At 1 January 2011	127.3	**127.3**
Additions	0.0	**0.0**
Disposals	0.0	**0.0**
At 31 December 2011	127.3	**127.3**
Amortisation		
At 1 January 2011	18.3	**18.3**
Charge for the year	3.2	**3.2**
Disposals	0.0	**0.0**
At 31 December 2011	21.5	**21.5**
Net book value		
At 31 December 2010	109.0	**109.0**
At 31 December 2011	105.8	**105.8**

NOTES (CONTINUED)

14. FIXED ASSET INVESTMENTS

Shares in subsidiary undertakings	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Cost at 1 January	0.0	67.2	0.0	67.2
Preference shares redeemed	0.0	0.0	0.0	0.0
Cost at 31 December	**0.0**	**67.2**	**0.0**	**67.2**
Net Book Value	**0.0**	**67.2**	**0.0**	**67.2**

The Company has ordinary share investments in the following companies at 31 Dec 2011

Company name	Holding	Holding %	Country of incorporation	Activity
Kellen Acquisitions Ltd	Direct	100%	Great Britain	note (iv)
Phoenix Energy Holdings Ltd	Indirect	100%	Great Britain	note (iv)
Phoenix Distribution Holdings Ltd	Indirect	100%	Great Britain	note (iv)
Phoenix Energy Limited	Indirect	100%	Republic of Ireland	note (v)
Phoenix Natural Gas Ltd	Indirect	100%	Northern Ireland	note (i)
Phoenix Supply Ltd	Indirect	100%	Northern Ireland	note (ii)
Phoenix Energy Services Ltd	Indirect	100%	Northern Ireland	note (iii)
Phoenix Natural Gas Finance plc	Indirect	100%	Northern Ireland	note (vi)
Belfast Energy Ltd	Indirect	100%	Northern Ireland	Dormant
Belfast Natural Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Power Ltd	Indirect	100%	Northern Ireland	Dormant
PNG Storage Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Energy Supply Ltd	Indirect	100%	Northern Ireland	Dormant

Note (i) Phoenix Natural Gas Ltd distributes natural gas to the Greater Belfast area.
Note (ii) Phoenix Supply Ltd supplies natural gas to customers in the Greater Belfast area.
Note (iii) Phoenix Energy Services Ltd provides services to Phoenix Natural Gas Ltd and Phoenix Supply Ltd as well as boiler and appliance maintenance services to energy consumers.
Note (iv) Kellen Acquisitions Ltd, Phoenix Energy Holdings Ltd and Phoenix Distribution Holdings Ltd are intermediate holding companies.
Note (v) Phoenix Energy Ltd supplies natural gas to customers under licence in the Republic of Ireland.
Note (vi) Phoenix Natural Gas Finance plc holds a bond listed on the LSE.

All other companies are dormant within the meaning of the Companies Act 2006.

On 16th May 2012, Phoenix Energy Holdings Limited (PEHL) announced that it had entered into an agreement to sell 100% of the share capital of Phoenix Supply Limited, its gas supply business in Northern Ireland and 100% of the share capital of Phoenix Energy Limited, its separate gas supply company operating in the Republic of Ireland, to SSE plc, through its subsidiaries Airtricity (Energy Supply) Northern Ireland Limited & its Republic of Ireland-registered subsidiary Airtricity Limited for £19.1m.

With the necessary approval being granted by the Irish Competition Authority, the sale was completed on 22nd June 2012.

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NOTES (CONTINUED)

15. STOCKS

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Stock of spares and meters	1.2	0.0	1.2	0.0
	1.2	**0.0**	**1.2**	**0.0**

16. DEBTORS

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Amounts falling due within one year				
Trade	5.1	0.0	6.2	0.0
Amounts owed by subsidiary undertaking	0.0	24.3	0.0	24.1
Other	3.7	0.0	2.4	0.0
Prepayments and accrued income	63.9	9.6	67.9	7.0
	72.7	**33.9**	**76.5**	**31.1**
Amounts falling due after one year				
Amounts owed by subsidiary undertaking	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
	0.0	**0.0**	**0.0**	**0.0**

NOTES (CONTINUED)

17. CREDITORS

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Amounts falling due within one year				
Trade	2.2	0.0	1.9	0.0
Payments in advance	31.4	0.0	30.0	0.0
Amounts owed to subsidiary undertaking	0.0	26.0	0.0	24.1
Other creditors	12.3	0.0	14.1	0.0
Accruals and deferred income	48.2	0.1	55.7	0.8
	94.1	**26.1**	**101.7**	**24.9**
Amounts falling due after one year				
Bank loans	10.0	0.0	0.0	0.0
Bond	269.3	0.0	268.3	0.0
	279.3	**0.0**	**268.3**	**0.0**
Amounts falling due after one year: analysis				
Amounts falling due between one and two years				
Bank loans	0.0	0.0	0.0	0.0
	0.0	**0.0**	**0.0**	**0.0**
Amounts falling due between two and five years				
Bank loans	10.0	0.0	0.0	0.0
	10.0	**0.0**	**0.0**	**0.0**
Amounts falling due after five years				
Bond	269.3	0.0	268.3	0.0
	269.3	**0.0**	**268.3**	**0.0**

- There were no committed undrawn borrowing facilities.
- The Group's borrowings are denominated in sterling.
- The Bonds issued by its subsidiary, Phoenix Natural Gas Finance plc,. are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.
- The bond issued is repayable in 2017 and carries a fixed coupon rate of 5.5% per annum payable quarterly. The £269.3m repayable after 5 years is stated after deducting issue costs of £8m and the addition of amortised loan issue costs of £2.3m.

NOTES (CONTINUED)

18. PROVISIONS FOR LIABILITIES AND CHARGES

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Deferred taxation				
Accelerated capital allowances	(17.4)	0.0	(16.8)	0.0
Short term timing differences	1.1	0.0	1.0	0.0
	(16.3)	**0.0**	**(15.8)**	**0.0**
Deferred tax liability				
At 1 January 2011	**(15.8)**	**0.0**	**(15.6)**	**0.0**
(Charged)/credited to profit and loss account	(0.5)	0.0	(0.2)	0.0
At 31 December 2011	**(16.3)**	**0.0**	**(15.8)**	**0.0**

19. DEFERRED INCOME

	Group £'m	Company £'m
ERD grant received		
At 1 January 2011	2.5	0.0
Credit to profit and loss account	0.0	0.0
At 31 December 2011	**2.5**	**0.0**

20. CALLED UP SHARE CAPITAL

	2011 £	2010 £
Allotted and fully paid:		
Ordinary shares of £1 each	49,752,705	49,752,705
A Ordinary shares of £1 each	20,076,752	20,076,752

Ordinary shares each carry one vote. A ordinary shares are non voting.

NOTES (CONTINUED)

21. RECONCILIATION OF MOVEMENTS IN RESERVES

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Revenue reserves brought forward	(36.0)	3.6	(36.0)	2.2
Loss/(profit) for the financial year	2.7	1.6	0.0	1.4
Revenue reserves carried forward	**(33.3)**	**5.2**	**(36.0)**	**3.6**

22. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Opening shareholders' funds	33.8	73.4	33.8	72.0
Profit/(loss) for the financial year	2.7	1.6	0.0	1.4
Closing shareholders' funds	**36.5**	**75.0**	**33.8**	**73.4**

23. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Group 2011 £'m	Group 2010 £'m
Operating profit/(loss)	**20.1**	**17.9**
Release of ERDF Grant	0.0	0.0
Depreciation	6.2	5.8
Goodwill amortisation	3.2	3.2
(Increase)/decrease in stocks	0.0	(0.3)
Decrease/(increase) in debtors	3.8	(16.3)
Decrease/(increase) in creditors	(6.6)	22.7
Net cash flow from operating activities	**26.7**	**33.0**

NOTES (CONTINUED)

24. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	Group 2011 £'m	Group 2010 £'m
(Decrease)/increase in cash in period	**7.6**	**(2.6)**
Decrease/(increase) in loan from Parent	0.0	0.0
Increase in bond debt	0.0	0.0
(Increase)/Decrease in bank loan	(10.0)	5.0
Movement in net debt resulting from cashflows	**(2.4)**	**2.4**
Non cash adjustment - amortisation of bond issue costs	(1.0)	(1.1)
Non cash adjustment - collateralised cash security	2.3	24.0
Movement in net debt during the year	**(1.1)**	**25.3**
Opening net debt	(233.4)	(258.7)
Closing net debt	**(234.5)**	**(233.4)**
Analysed as follows		
Bank loans > 1 year	(10.0)	0.0
Bond	(269.3)	(268.3)
Loan from parent	0.0	0.0
Cash at bank and in hand*	44.8	34.9
Closing net debt	**(234.5)**	**(233.4)**

*Cash at bank and in hand does not include £1.7m (2010: £4.0m) which is held in collateral and does not meet the definition of cash within FRS1 (Cash Flow Statements)

25. PENSION COMMITMENTS

The group operates two pension schemes:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £0.6m (2010: £0.6m).

NOTES (CONTINUED)

26. CAPITAL COMMITMENTS

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Capital expenditure				
Contracted but not provided for	3.0	0.0	3.0	0.0

27. CONTINGENT LIABILITIES

At 31 December 2011 the Group and company had no contingent liabilities (31 December 2010: £Nil). At the year end bank and cash balances totalling £1.7m (2010: £4.0m) were collateralised in respect of ongoing contractual obligations.

28. FINANCIAL COMMITMENTS

At 31 December 2011 the Group and company had annual commitments under non cancellable operating leases expiring as follows:

	Group 2011 £'m	Company 2011 £'m	Group 2010 £'m	Company 2010 £'m
Motor Vehicles				
Within one year	0.1	0.0	0.1	0.0
Within two to five years	0.4	0.0	0.4	0.0
After five years	0.0	0.0	0.0	0.0
	0.5	**0.0**	**0.5**	**0.0**
Property				
Within one year	0.0	0.0	0.0	0.0
Within two to five years	0.5	0.0	0.5	0.0
After five years	0.0	0.0	0.0	0.0
	0.5	**0.0**	**0.5**	**0.0**

29. RELATED PARTY DISCLOSURES

As at 31 December 2011 the company owed its immediate parent and controlling company, Carmel Capital II Sarl, £nil (2010: £nil). Interest payable on the loan note during the year was £nil (2010: £nil). Advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the consolidated Group.

30. ULTIMATE CONTROLLING PARTY

The immediate parent company and controlling company is Carmel Capital II Sarl, a company incorporated in Luxemburg, with registered office address 41 Boulevard du Prince Henri, L-1724 Luxembourg. Group accounts are not prepared at this level.
The directors regard TFCP Capital Investments Limited to be the ultimate parent company and Guy Hands to be the ultimate controlling party.

31. COMPARATIVE AMOUNTS

Comparative amounts have been regrouped and reclassified where considered necessary in order to enable comparison with the current year.

OTHER INFORMATION

Directors
G P Greener - Chairman
P V Dixon - Group Chief Executive Officer
W F M McKinstry - Group Finance Director
L Levi
G Loughran
S Kassam
L Woods

Secretary
Taylor Wessing Secretaries Limited

Auditors
KPMG
17/25 College Square East
Belfast
BT1 6DH

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

Registered office
5 New Street Square
London
EC4A 3TW

Kellen Investments Limited
Registered in England and Wales
Company Registration Number: 05366077


KG KELLEN GROUP

KELLEN GROUP

Kellen Investments Limited

197 Airport Road West

Belfast

BT3 9ED

Telephone: 08454 55 55 55

Fax: (028) 9055 5500

Email: info@phoenixgroupni.com

Web: www.phoenixgroupni.com

KG KELLEN GROUP

BIG TICK 2012
BUSINESS IN THE COMMUNITY

ANNUAL REPORT & ACCOUNTS 2012

PHOENIX

CONTENTS

KELLEN GROUP HISTORY

1996 Launch of Phoenix Natural Gas by British Gas plc in September. At the time of its launch, the Phoenix development was one of the largest 'greenfield' private sector-led integrated gas transmission, distribution and supply investments in the world. This first year saw a licence being granted, construction commencing and the first customer connected.

1997 Purchase of a 24.5% stake in Phoenix by Keyspan. February marked an Anglo-American link-up, with the owners of The Brooklyn Union Gas Company.

2001 Purchase of a 24.5% stake in Phoenix by ESH plc. East Surrey Holdings (ESH) plc (a GB based water and gas utility) took a 24.5% in Phoenix reducing the BG holding to 51%.

2001 Established Phoenix Energy Services Limited as a provider of downstream services into the Northern Ireland energy market.

2003 Purchase of remaining 75.5% stake by ESH plc. ESH raised the finance to complete a buy-out of other partners, becoming sole owner of Phoenix.

2005 Purchase of ESH plc by Terra Firma. Through its Kellen vehicle, Terra Firma secured the purchase of East Surrey Holdings plc by the end of 2005.

2006 Sale of Sutton and East Surrey Water (SESW) plus subsidiaries. In spring, the sale of the SESW to Deutsche Bank was completed. In summer that same year, ESP (East Surrey Pipelines) was sold to ABN AMRO Infrastructure.

2007 Separation of Phoenix Supply Division. In line with the requirements of the Second EU Gas Directive 2003/55/EC, Phoenix legally separated its gas trading and supply division from its transmission and distribution business on 1st January 2007.

2008 Separation of Phoenix Natural Gas. On 1st January 2008 Phoenix completed the separation of its distribution division from that of transmission.

2008 Sale of Transmission Division. Phoenix completed the sale of its transmission assets to Northern Ireland Energy Holdings (NIEH) on 31st March 2008.

2009 Issue of £275m of Bonds due 2017 at rate of 5.5% by Phoenix Natural Gas Finance plc, guaranteed by Phoenix Natural Gas Limited and Phoenix Distribution Holdings Limited, with the proceeds being used as part of a restructuring process to refinance Group activities. These Bonds received a rating of Baa2 by Moody's and BBB+ by Fitch.

2009 Phoenix extends its supply operations into the Republic of Ireland as its new subsidiary Phoenix Energy Limited commences trading.

2012 Sale of Gas Supply Business. Phoenix completed the sale of 100% of the share capital of both Phoenix Supply Limited, its gas supply business in Northern Ireland and Phoenix Energy Limited, its supply business in Republic of Ireland to Airtricity/SSE plc on 22nd June 2012.

THE KELLEN GROUP

The Kellen Group, trading under the Phoenix banner, is the pre-eminent natural gas business in Northern Ireland. Since 1996 Phoenix has been successful in introducing natural gas to a new market and establishing a strong and vibrant supporting industry. In the process, Phoenix has gained a strong international reputation for its innovative, commercial infrastructure development in a 'greenfield' environment. Following the successful introduction of competition in gas supply in Greater Belfast, Phoenix has now divested itself of its gas supply activities however as owner of the distribution asset in Greater Belfast, Phoenix retains responsibility for the growth and development of the market to its optimum size. Alongside its significant operational achievements since its formation, Phoenix has also been recognised for its outstanding performance within the arena of both safety and corporate social responsibility culminating in the award of its second British Safety Council 'Sword of Honour' in recognition of world-class health, safety and environmental practices. In addition, the Group received Business in the Community's 'Big Tick Award' for an eighth consecutive year, celebrating excellence in the delivery of leading edge corporate social responsibility programmes. This award underlines its commitment to both its staff and the community it serves.

FINANCIAL HIGHLIGHTS

- Decrease in Group turnover of £42.3m to £118.1m in 2012, however turnover has been impacted adversely by sale of the supply businesses midway through the year. If you adjust these figures to remove the impact of the discontinued businesses, Group turnover actually increased by £6.0m (15%) from £39.9m in 2011 to £45.9m in 2012. This has been driven both by a 10% increase in the volume of gas transported through the distribution network together with the application of inflationary increases to distribution charges in the period.

- Increase in Group operating profit of £0.1m to £20.2m in 2012, despite the performance of supply businesses only being consolidated for half of the year. If you adjust to remove the impact of the discontinued businesses, Group operating profit increased by £1.5m in 2012 from £15.5m to £17.0m. The increase in income is partially offset by higher operating costs associated with maintaining and servicing the larger customer base over time together with exceptional costs associated to the Northern Ireland Authority for Utility Regulation's (NIAUR's) referral of the Group's distribution business (PNG) to the UK Competition Commission in the year.

  The CC determined that NIAUR's proposal in its Price Control Determination to adjust retrospectively PNG's opening asset value (TRV) by c£80m was not in the public interest, although it concluded that a smaller adjustment of £13.6m was to be made. This adjustment has no impact on financial statements as

assets are carried at a cost lower than the TRV. The Commission also determined that £1.35m of the costs incurred by PNG in the process should be allowed and thereby recovered from customers as part of distribution charges in the future.

- An operating cash-flow of £31.6m was generated in 2012 compared to £26.7m in the previous year.
- The Group successfully completed the sale of both Phoenix Supply Limited, its gas supply business in Northern Ireland and Phoenix Energy Limited, its supply business in Republic of Ireland to Airtricity/SSE plc on 22nd June 2012 generating a profit of £15.9m.

OPERATIONAL HIGHLIGHTS

- Transported 128.7 million therms of gas to users in 2012 through its gas distribution network in Northern Ireland, 11.4 million therms more than 2011 with year on year average temperatures slightly colder than 2011.
- Invested a further £12.6m in 2012, extending the gas network by a further 44 kilometres and connecting an additional 10,523 customers. This brings the total network coverage to 3,192 kilometres and customer connections to circa 159,000.
- The Group's Health, Safety and Environmental performance (HSE) was once again recognised as being amongst the highest in Northern Ireland with the Group being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards.
- The Group was accredited with a 'Big Tick Award' from Business in the Community for excellence in its Corporate Social Responsibility (CSR) activity across Northern Ireland. This was the eighth consecutive year that the Group had received such acclaim

KELLEN GROUP AT A GLANCE

DISTRIBUTION

PHOENIX NATURAL GAS

Owner and operator of the licence for the distribution network in the Greater Belfast and Larne areas of Northern Ireland. The distribution business is responsible for the development of the pipeline network. It also provides a 24/7 operational and transportation service platform to gas suppliers under the rules of the company's network code.

The Phoenix network currently extends to 3,192 kilometres of intermediate, medium and low pressure mains, which distribute natural gas throughout the licence area, representing around 40% of the population of Northern Ireland. Phoenix Natural Gas manages the construction and operation of the network and is also responsible for the development of the market in Greater Belfast including the marketing of natural gas to new gas consumers and the related management and support associated with the customer up until point of connection; already some 159,000 customers have been connected to the natural gas network in the 16 years since natural gas first became available in Northern Ireland.

The business is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

ENERGY SERVICES

PHOENIX ENERGY SERVICES

A specialist provider of downstream services into the Northern Ireland energy market, Energy Services' remit includes the provision of a 24/7 emergency response to Phoenix Natural Gas, together with other metering services activity across the natural gas industry in Greater Belfast and Larne. In addition, the company delivers a range of other services to energy users on a demand and contract basis.

SUPPLY NI & ROI

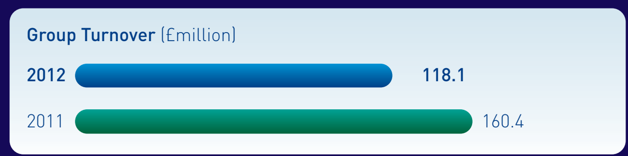
PHOENIX NATURAL GAS SUPPLY

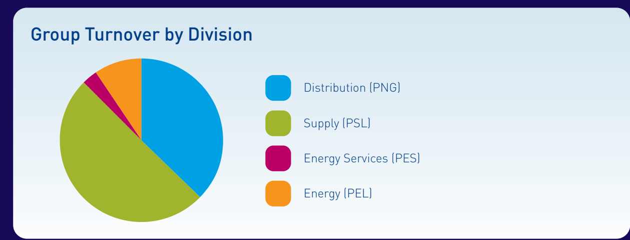
On 16th May 2012, the Group announced that it had reached agreement with Airtricity/SSE plc to sell 100% of the share capital of both Phoenix Supply Limited and Phoenix Energy Limited for £19.1m. Following on from the receipt of the necessary approval from the Irish Competition Authority the sale was completed on 22nd June 2012 generating a profit on consolidation of £15.9m.

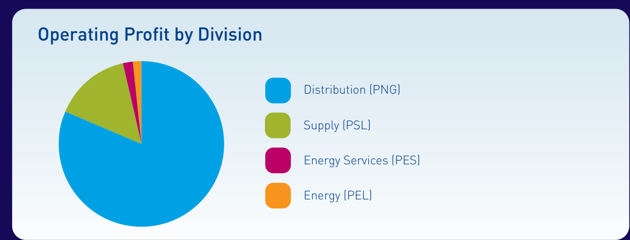
As part of the sale, the loan arrangement between Phoenix Natural Gas Limited and Phoenix Supply Limited was repaid in full.

- Phoenix Supply (PSL) is the market leader in gas supply in Northern Ireland providing natural gas to customers from the PNG distribution network.
- Phoenix Energy (PEL) is a gas supply company operating in the Republic of Ireland which commenced trading in the latter part of 2009 and was established to expand the Group's retail activities across the island of Ireland.

Subsequent to the sale Phoenix Supply Limited has been re-named Airtricity Gas Supply (NI) Limited and Phoenix Energy Limited has been re-named Airtricity Gas Limited.







CHAIRMAN'S REPORT

The Group is now focused on its gas distribution business, Phoenix Natural Gas, and its gas service activities, Phoenix Energy Services, following the sale of its two gas supply businesses, Phoenix Supply Limited and Phoenix Energy Limited, to Airtricity/SSEplc.

Despite unfavourable market conditions, the weight of the burden imposed on the Group as a result of PNG's price control being referred by the NIAUR to the Competition Commission and the sale of the supply divisions, I am pleased to report that all operating businesses, including the supply businesses up to the point of their sale, delivered results ahead of planned expectations. Demand for gas exceeded forecasts and growth through new connections and network expansion was strong.

The Group continues to focus successfully on delivering the efficiencies and cost savings required to meet its regulatory control targets. Our gas distribution business in Northern Ireland, PNG, met all its obligations under the terms of its bonds. The Group, with its focus now firmly on distribution, is strongly positioned to expand its network, bid for new distribution licences as they become available and increase the take-up of connections in its existing licence area through further market development.

In August 2011, PNG received a consultation paper from the NIAUR concerning its periodic price control for the two year period beginning 1st January 2012. As has been extensively reported, NIAUR unexpectedly included a proposal to remove retrospectively c.£80m from PNG's regulated asset base. The NIAUR's proposal was confirmed in a determination received by PNG in January 2012. PNG believed that this proposed action was wrong, would not be in the public interest and would be damaging to both PNG and to the continued development of the natural gas industry throughout Northern Ireland, preventing consumers in the longer term from making considerable savings to their fuel bills by switching to natural gas. PNG therefore rejected NIAUR's price control determination with its proposed licence modification. NIAUR referred the matter to the Competition Commission for determination.

The Competition Commission agreed that NIAUR's proposal was not in the public interest and that only two minor adjustments amounting to £13.6 million of PNG's Regulated Asset Value (TRV) should be made. The involvement of the Competition Commission in the process and the quality of its final determination should provide the basis for a more stable regulatory environment in Northern Ireland, which will be of great benefit to consumers and investors alike.

Despite the distraction of the Competition Commission process, PNG performed well operationally with new customer connections substantially above 2011 levels. The long term prospects remain good and demand for natural gas is forecast to continue to increase in PNG's current licensed area and beyond. We look forward to exploring opportunities in new distribution licence areas such as East Down and the West of Northern Ireland, the outcome of harmonisation of the gas sector in the island of Ireland and the possible disposal of assets by Bord Gais Eirean (BGE).

The members of our Board are very much aware of their responsibilities as directors of a Group which delivers

essential utility services on a 24/7 basis and which are of such strategic importance to the economy of Northern Ireland and its people. We remain fully committed to ensuring high standards of performance and in minimising the risk to the public from our extensive operations and construction activity as benefits are delivered.

I am pleased to report that the Group was once again recognised for its positive contribution to the environment by Business in the Community. Our procedures in the areas of environmental performance and occupational health and safety continue to meet IS14001 and 18001 accreditations.

The Kellen Group remains committed to the growth and development of its core distribution and service businesses with Phoenix Natural Gas as Northern Ireland's leading gas distribution provider with responsibility for marketing natural gas across the Province. We gratefully acknowledge the contributions from all our people who dealt so effectively with the many challenges to make the past twelve months such a success.

Dr George Greener CBE
Chairman

CHIEF EXECUTIVE'S REVIEW

I am pleased to report that the Kellen Group delivered an operating profit of £20.2m in 2012 together with a consolidated profit on sale of supply businesses of £15.9m. The underlying value of the Group was greatly enhanced by a strong operating performance across our continuing businesses together with sustained development of our gas network and growth of our customer connection base. In addition the results reflect continued strong performance of our supply businesses up until the date of sale to Airtricity/SSE plc in June 2012.

Despite the continued poor economic conditions, we continue to deliver strong connection growth by ensuring that our service offering meet the needs of our growing potential customer base. Our 2012 performance was ahead of expectations in all areas across the Group. This underlines the robustness of our business plan and strength of our management and staff. We remain confident that, despite the economic challenges, the Group, now predominantly a distribution business, is well placed to deliver on its growth plan and thereby to build upon past success.

THE MARKET

Despite the subdued economic activity, gas volumes for the year were ahead of expectations. Delivered heating oil prices into Northern Ireland remained higher than gas tariffs throughout the year.

Natural gas still remains a relatively new energy option in the Northern Ireland market, having only become available since 1996 to a growing potential customer base; based mainly in the Greater Belfast area. Given the progressive 'roll-out' nature of the new network across that period, gas on average has been available at the doorstep of approximately 296,000 homes and businesses for up to twelve years. This compares to over 40-years for GB, where natural gas is the fuel of choice.

Following the sale of the supply businesses Kellen, under the Phoenix brand, now only holds a licence for the distribution of natural gas in the Greater Belfast area. The Kellen Group now consists of the following trading companies: Phoenix Natural Gas Limited (PNG), and Phoenix Energy Services Limited (PES) who operate in Northern Ireland only. In the context of the market they operate, both companies are significant in their own right with circa 320 staff employed directly, or through operating and alliance partnerships. Phoenix is the largest natural gas distributor in Northern Ireland. Phoenix has had unbroken growth for over 16 years. The growth to date has all been organically driven.

PNG's rolling 40-year conveyance Licence sets out clearly that a target of making natural gas available to around 81% of all households and businesses in the Greater Belfast area must be delivered by 2016. As of 2012 PNG has made natural gas available to circa 90% of properties; and as such has significantly exceeded its regulatory requirements. In addition, PNG set its own target of connecting circa 60% of these potential customers to the gas network by this date. This entails ensuring that new properties and developments are built with gas heating incorporated and that existing properties are converted to gas, either when existing heating equipment needs to be replaced or as a result of marketing aimed at accelerating customer conversion. The principal challenge for natural gas is to displace oil as the main energy source for homes and businesses. For PNG to meet its penetration target it aims to connect circa 180,000 properties by 2016, as at 2012 PNG has accelerated its connection rate to around 159,000. At the current rate of connection it is on target to achieve this goal.

THE BUSINESS

Following the sale of its supply businesses, the Group has consolidated its activity around its asset management and distribution and market development activity relating to PNG. 2012 was, despite the distraction of the Competition Commission Inquiry and supply business sale, yet another year of solid growth across all the operating companies.

In relation to the Competition Commission (CC) inquiry, the CC found NIAUR's retrospective proposals not to be in the public interest. PNG believed it was necessary to seek adjudication at the CC in this instance and whilst a significant amount of time was necessarily involved in supporting such a process, the clear principles of good regulatory practice set out in the CC's final determination gave us the confidence to continue to look for opportunities to grow and expand and it is important that these principles are reflected in NIAUR's decision-making going forward.

PNG continues to expand its network coverage and connections to homes and businesses. Meanwhile PES continues to grow its share of the downstream after-sales

market with repeat business and new product offerings underpinning the growth of this business, alongside its key role in supporting the metering, maintenance and emergency response activities to its sister companies.

During the year, PNG invested a further £12.6m in extending its network by a further 44 kilometres to establish gas in developing areas such as Comber and Millisle and to enable the connection of new customers to gas across the network for the first time. The Group continues to seek new opportunities to expand PNG's current licence areas in relation to distribution activities. In this respect development work, in this area, moved on at pace throughout the year. This culminated in the DETI Minister welcoming the announcement that the Northern Ireland's Executive had committed to part-fund the new gas transmission extension that will facilitate natural gas to be piped to homes and business in the West of the Province. The Minister said

"I am very pleased that Executive Ministers have stated their support for my proposals to extend the provision of natural gas to the main towns in the west, including Dungannon, Coalisland, Cookstown, Magherafelt, Omagh, Strabane, and to Enniskillen and Derrylin in County Fermanagh. This is a good news story and a positive commitment by the Executive, backed by financial resource of some £32.5million. Natural gas is the cleanest burning fossil fuel. By extending the gas network, it is my intention to see some 34,000 additional business and domestic consumers in the West benefitting from the current lower cost, convenience, and efficiency which natural gas provides. New natural gas provision will help to lower manufacturing and production costs for businesses, thus improving their competitiveness, and will also help to reduce the level of fuel poverty affecting some domestic consumers. The Utility Regulator will be consulting in early 2013 on licensing issues for gas provision in the West, and plans to have gas licenses awarded around the end of the year".

DETI is also progressing plans to extend the availability of natural gas to consumers in other parts of Northern Ireland where it is economically viable to provide new gas infrastructure. This includes areas such as East Down where gas loads have already been identified and are readily connectable to the PNG network.

THE FUTURE

PNG made its GD14 price control to the NIAUR in December 2012. Following on from its December 2012 consultation paper, the NIAUR published details of the approach it intends to adopt for the GD14 price control in March 2013.

The NIAUR gave notice of the licence modifications it proposes to make for the purpose of implementing the Competition Commission's PNGL12 determination to PNG in February 2013 and invited comments. Following consideration of the consultation responses, the NIAUR is expected to notify the Competition Commission of its proposed licence modifications and of its reasons for making the modifications by the summer. The Competition Commission then has four weeks in which, if necessary, to direct the NIAUR not to make some or all of the proposed modifications, and to propose different modifications, which seem to the Competition Commission requisite for implementing its findings.

The distribution of natural gas outside of Belfast in the so called 'ten towns', is currently being developed by BGE's subsidiary, firmus energy. It is expected that as part of the Irish Government's asset disposal programme firmus will be sold. PNG has already publicly stated that it would be interested in bidding for these assets. The sale process is anticipated to start in mid-2013. In addition, PNG has confirmed to NIAUR that in line with their timescales, it will bid for a licence extension to East Down in the first quarter of 2014 following the planned completion of the GD14 price control.

Kellen Group will continue to focus on investing and growing its core business, Phoenix Natural Gas, which operates the Greater Belfast natural gas network and is responsible for making gas available to almost half the population of Northern Ireland. Phoenix remains one of the largest private sector investors in Northern Ireland, connecting over 8,000 homes and businesses, on average, to its natural gas network every year.

Phoenix established the natural gas industry in Northern Ireland in 1996 and due to its success there are now over 320,000 homes and businesses that have access to a cheaper, cleaner fuel. The scale of the gas network has attracted a number of gas suppliers to the Greater Belfast area where an open and competitive market has developed.

Our long term ambition is to grow our distribution business, extend gas as far as possible across Northern Ireland and in doing consolidate the market in the North. Our past successes were built by our outstanding people and their 'can do' mentality. The same will be true of those working on our future direction with great attention to detail and a willingness to adapt to change.

Peter Dixon
Group Chief Executive

CORPORATE SOCIAL RESPONSIBILITY

Kellen Group's multiple award-winning integrated Corporate Social Responsibility programme is called LIFE, which stands for Leadership in the marketplace, Investing in our people, Fostering our community and Environmental responsibility. LIFE was developed when Phoenix was first established to provide an overarching framework for the range of ongoing initiatives carried out by the Group that positively impact our marketplace, environment and community. In 2012 we were delighted to have, for the eighth year running, received national recognition for our efforts in this area by collecting a Business In The Community 'Big Tick' award for CSR excellence.

LEADERSHIP IN THE MARKETPLACE

The Group has continued to improve upon, evaluate and show leadership in every area of its CSR plans. The Group also continued to be a strong supporter and corporate member of Business In The Community, sitting on its Northern Ireland Board and chairing its environmental arm – ARENA Network.

It was in November 2012 that Business In The Community UK announced that the Group had now won their organisation's Big Tick award more times than any other business throughout the United Kingdom. This achievement received wide recognition and saw the First Minister of Northern Ireland, Peter Robinson, meet with senior executives from the Group to pass on his congratulations (pictured).

John Heaslip, Chief Executive, Business in the Community Northern Ireland, reflected:

"Our national Awards for Excellence are the most credible and influential awards celebrating responsible business in action. They look behind the headlines for hard evidence of positive impact. Achieving the required standard is not easy, so Phoenix's achievement is incredible."

This national accolade is very much testament to the ongoing hard work of all staff within the Group. Since founding the natural gas industry in Northern Ireland in 1996 Phoenix has always placed CSR programmes at the heart of all of its activities. The continued recognition from Business In The Community and others for our ongoing positive impact further highlights to staff that the Group's approach continues to make a difference and it inspires everyone involved to do even more throughout the community in the future.

INVESTING IN OUR PEOPLE

The Group continues to invest in its most important asset – its people. Feedback from staff indicates that they view their time spent volunteering as beneficial – even beyond the sense of fulfilment that they gain from the experience. 84% of staff have indicated through research that volunteering has enhanced a number of their job-related skills. In 2012 over 160 staff participated in one or more voluntary activities amounting to more than 2,000 hours.

Increasingly, there is evidence that Phoenix's reputation as a socially responsible organisation is helping to attract customers as well as job candidates who recognise the business as being one with a strong focus on its people and in supporting their development. Furthermore, Phoenix's staff turnover fell by 9% in the past year, with staff satisfaction surveys suggesting that CSR activities are a key reason for people staying at Phoenix.

Another key staff initiative involves volunteers working with pupils of primary school age right up to students who are involved in further education at universities and colleges. One of the most recent initiatives has seen members of staff agree to mentor two groups of eight year old children from two different schools as part of the 'Time to Read' and 'Time to Count' programmes. This involves a commitment to attend the local schools once a week for a full year playing a key role in helping to improve the literacy and numeracy levels of children by reading books with them and developing learning based scenarios.

In the past year Phoenix has also partnered with Queen's University Belfast, helping to support the establishment of Riddel Hall – a £15 million purpose built postgraduate and executive education centre. Phoenix are one of fifty founders of the establishment, all of whom have the opportunity to work with the Centre's management experts from across the world in order to shape the content of what is delivered. Phoenix now have access to relevant business tutorials, programmes and training in a number of different areas.

2012 also saw training and skill development provided to over 2,000 local independent gas installers/engineers, which aided opportunities for growth for individual businesses and business start-up for others who then generated a total turnover for the year in excess of £30 million. Phoenix acts as an incubator to these local small independent companies.

FOSTERING OUR COMMUNITY

Phoenix has established a track record of supporting young people and providing them with as much help as possible in meeting their potential goals. Over the past year we have continued with our commitment to support the Ulster Rugby Academy. It is designed to nurture, develop and prepare the next generation of professional sportsmen and it has been doing this with great success. In the past four years, over 30 academy trainees have gone on to secure professional rugby contracts – many of them now being full international players. The success of the Academy makes it one of the best of its kind in European rugby and it continues to inspire local young people to reach their full potential.

In the last 12 months we have also developed a strong partnership with the Gaelic Athletics Association (GAA), setting up the Phoenix GAA Elite Academy. The Academy aims to recognise, develop and focus on the top 90 young players in the Province who have been assessed to be amongst the very best at club, school and county level in both Gaelic Football and Hurling. Another key objective of the Academy is to encourage the young players to look after their health and wellbeing alongside developing their skills in Gaelic Games. Areas such as nutrition, fitness testing, functional movement analysis, diet and flexibility are all assessed.

With regard to the Arts, Phoenix continues to develop its partnerships with the Belfast Grand Opera House and Cinemagic. Cinemagic is an award-winning organisation that uses the power of film and all forms of moving image to entertain, educate, motivate and inspire young people. Designed for and by young people, Cinemagic caters for those aged 4 to 25 who have just about every level of interest in film, whether wanting to watch and enjoy, create their own work or take things further and find out more about a career in the film or television industry. Phoenix is currently supporting a variety of projects in partnership with Cinemagic throughout Northern Ireland.

The most recent Cinemagic initiative, involves a group of Queen's University film students writing, producing, filming and editing a short film on the importance of CSR. As part of the project the students are getting to work with leaders in their field, both in the local film industry and business world. In 2013 Phoenix plan to publicise the completed film widely, whilst Cinemagic have confirmed it will be screened to the public as part of the upcoming Cinemagic Festival in the autumn.

Impressed with the ongoing partnership between Phoenix and Cinemagic, Arts & Business NI also provided further funding for a bespoke film project to focus on what Phoenix does to promote STEM subjects. Science, Technology, Engineering and Maths (STEM) are disciplines that the Government has highlighted as being, key to the nation's future economic success. Phoenix has always been a strong supporter of the STEM agenda and were a key contributor in the setting up of Northern Ireland's first ever gas sector skills qualification at Belfast Metropolitan College. Phoenix is also represented on the DEL Minister's Expert Panel in relation to further education, youth training and apprenticeships.

Phoenix has also extended its long-term partnership with the Belfast Grand Opera House, bolstering its support with two new elements. To encourage more families to get involved with the Arts an agreement was reached to sponsor the Opera House's 'Family Season of Theatre' and to introduce a Christmas 'Charity Pantomime Premiere'. This latter event saw Phoenix and the Opera House together create a unique event with a premiere performance of the pantomime for hundreds of disadvantaged children.

ENVIRONMENTAL RESPONSIBILITY

The strong Health, Safety and Environmental culture throughout Phoenix has been recognised by two British Safety Council Swords of Honour; the processes that underpin this recognition were tested again in 2012 by a detailed ARENA Network survey which saw Phoenix accredited by ARENA Network as being of 'Quintile One' standard – amongst the best in Northern Ireland.

Environmentally around 3 million tonnes of carbon dioxide (CO_2) have already been prevented from entering the local atmosphere as a result of the conversion to natural gas from other fuels, with continued savings of around 250,000 tonnes of CO_2 per annum (or the equivalent of removing approximately 60,000 cars off Northern Ireland's roads every year). Phoenix have also promoted the installation of the latest high efficiency technologies and through its teams of highly trained Energy Advisors have established natural gas as the energy source to replace more polluting fuels like oil and coal. In the last year Phoenix has connected an additional 10,523 properties to its natural gas network.

In addition the Group has spoken to over 100,000 customers in 2012, including visits from our Energy Advisors to homes and businesses to provide essential energy awareness and saving advice tailored to each individual property. Over this time Phoenix's energy efficiency focused marketing campaigns were communicated to around 320,000 homes in Northern Ireland. The Group estimates that its staff has helped around 5,000 homes out of fuel poverty in the last year alone.

ENGAGEMENT

Phoenix's ongoing engagement programme with a wide range of stakeholders on LIFE continues on a daily basis. This includes pro-actively briefing local politicians and other key stakeholders specifically on the importance of CSR in Northern Ireland and using LIFE as a case study of how it can be done to great benefit.

New channels through which to communicate Phoenix LIFE initiatives have also been established, including a Phoenix Twitter account and a bespoke Phoenix You Tube channel. These social media channels are a promotional tool; they give advice, highlight grants and most importantly showcase Phoenix LIFE. 2012 saw sustained levels of growth in terms of engagement and the popularity of these CSR platforms. Their popularity and increased impact are evaluated in terms of interactions, followers and views.

Phoenix's investment in CSR is a long-term one, put in place strategically to benefit both the organisation and the local communities that we serve. The financial resources attributed to Phoenix LIFE are far outweighed by the voluntary effort, commitment and time given by staff to maximise the impact of all initiatives pursued.

KELLEN GROUP

Energy for Children Charitable Trust – Case Study

Although Phoenix's CSR programme, LIFE, is wide-ranging in its approach (see pages 10 to 13), it is the children's Charitable Trust that is perhaps having the biggest impact on those children other charities or support agencies can't reach and for whom even limited support makes a huge difference to their quality of life and well being.

Set up as a formally constituted charity to facilitate the charitable interests of the local natural gas industry, the Energy for Children Charitable Trust was formed by Phoenix in 2005. Since then it has continued to break new ground and reach deeper into the heart of local communities throughout Northern Ireland in order to really make a difference to disadvantaged children's lives.

The Trust is governed by trustees made up of representatives from Phoenix and local people linked to the communities that our industry serves. It focuses on supporting those needy causes that are slipping through the net of the more established charity network, and is founded on the principle that 'all monies raised go directly to local children and young people'. Behind the scenes Phoenix provides all administrative support and funding for the work of the front-line staff that facilitate the funding bids. Although the Trust was founded initially by the natural gas industry, it is now supported by a variety of different sectors and organisations locally as it continues to grow.

Fundraising is primarily undertaken by Phoenix staff and members of the wider Northern Ireland gas industry, this includes: merchants, installers, retailers, distributors, contractors, trade suppliers and training organisations. The Charity is relatively unique in that those who are responsible for raising the money are also those who identify the potential causes it will go towards helping. The wider gas industry, who are working in homes, businesses and communities every day, are well placed to identify individuals who are in real need.

KELLEN GROUP

The Trust also transcends Northern Ireland's traditional religious divide and often it is inner-city areas that need the most help. The Trust works alongside public representatives in order to find those most in need and then target where its help can be most effective.

Having been set up by Phoenix around eight years ago, it is a creditable achievement that so far the Energy for Children Charitable Trust has helped to transform the lives of well over 6,000 local disadvantaged children, with many more set to benefit from this good cause in the future.

DIVISIONAL REVIEW

PHOENIX NATURAL GAS

DISTRIBUTION

Phoenix Natural Gas (PNG) is the owner and operator of 3,192km of distribution network within its licensed area in Northern Ireland, known as 'Greater Belfast and Larne', and has already made gas available to 296,000 premises and connected circa 159,000 customers to its network. The business is a natural monopoly and as such is regulated under licence by the Northern Ireland Authority for Utility Regulation (NIAUR).

The business is partially financed by £275m of 5.5% bonds issued in 2009 and repayable in 2017 through its subsidiary Phoenix Natural Gas Finance plc., guaranteed by both Phoenix Natural Gas Limited and its intermediate holding company Phoenix Distribution Holdings Limited. These bonds are rated BBB+ by Fitch and Baa2 by Moody's. In addition in 2009 the company entered into £80m bank facilities for a 3-year period in order to finance its future capital expenditure and working capital requirements. These facilities have been subsequently refinanced in 2011 reducing the value of the facilities to £60m with a maturity of 2014.

GROWTH AND INVESTMENT

PNG Income of of £45.1m in 2012 was £5.9m higher than that in 2011, generated mainly through the application of published conveyance charges to all gas distribution system users, based on the volume of gas conveyed in the year. Charges are set annually in advance of the year (inclusive of an estimate of any surplus/deficit from the previous year) in order to recover the maximum allowed income for each year, as determined by NIAUR as part of the price control process.

PNG's allowable regulated income is profiled to 2046 so as to provide a flat real price per therm to customers in line with expected growth in the business across that period and deliver a return on estimated costs of 7.5% real to 2016, with return beyond 2016 being subject to review as part of future price controls. In addition because PNG operate with an 'income cap', any differences between allowable regulated income and actual income charged each year is carried forward in a correction mechanism, referred to as a 'Z' with allowable regulated income corrected by a compensating amount in subsequent years.

In respect to allowed income for 2012, this was determined as part of the PNGL12 Price Control process which was the subject of the Competition Commission (CC) referral in 2012. In the absence of a 'determined' allowed income at the time distribution charges were due to be published (September 2011) for 2012, PNG agreed with the NIAUR to apply an inflationary uplift to previous years income and assume no over recovery brought forward. In practice, based on the outcome of the CC process, allowed income was determined at £47.0m for 2012, £2.3m higher than the actual income that was actually charged in the year. However, with an over-recovery brought forward into 2012 ('Z') amounting to £2.4m, the net impact at the end of 2012 is that only a small £0.1m 'Z' over recovery remains. This will be carried forward and returned to all system users through slightly lower conveyance charges in subsequent years.

128.7 million therms (mt) of natural gas was transported through the network, 11.4mt more than 2012. Volumes are estimated to have been only marginally impacted by weather in the year (by the equivalent of 0.4mt) with average temperatures marginally colder than the five year average. This compares to 2011 when volumes were estimated to be 7.2mt lower as a result of temperatures being 0.4° C warmer relative to historic averages.

	2012	2011	Inc/(Dec)
Transported Volumes	128.7mt	117.3mt	11.4mt
Temperature Correction	0.4mt	7.2mt	7.6mt
Estimated Underlying Throughput	128.3mt	124.5mt	3.8mt

Demand in the large industrial & commercial sector (those burning more than 25,000 therms per annum) increased by an estimated 1.9mt in the year, with consumption benefitting at heating related sites by the relatively colder weather in 2012 when compared to 2011. Otherwise demand has been impacted by changes in production levels, utilisation of gas for Combined Heat and Power purposes and the continued focus on energy efficiency and environmental initiatives focused on reducing consumption.

Throughput in the domestic and smaller industrial & commercial sectors increased by 9.5mt compared to 2011, with higher consumption impacted by temperatures returning to average in 2012, in comparison to the previous year when weather was much warmer than average. In addition 2012 consumption benefitted by an estimated 4mt through a 7% increase in the number of users connected to the network.

Operating profits of £15.9m were £1.9m higher than in 2011 with the £5.9m increase in distribution income being offset in part by a £4.0m increase in operating costs, driven mainly by the adviser costs and regulatory licence fees associated to the Competition Commission process. It should be noted that the £1.35m of adviser costs awarded to PNG by the Commission, the increased licence fees associated to the CC process incurred by NIAUR and the costs of the CC itself will be passed through to customers in future prices. Otherwise cost increases have been driven by marketing & incentive costs associated to higher levels of new connections and growth in maintenance and emergency response costs associated with larger and a slightly older network. Actual operating costs in PNG are monitored closely in real terms against the levels determined by NIAUR during the price control reviews. Whilst the implication of growth in the business is that costs tend to increase each year, this has been partially offset in 2012 by the business delivering ongoing efficiency improvements.

PNG invested a further £12.6m in capital expenditure during 2012, constructing 44km of new network and connecting 10,523 new customers. By year-end, PNG had 3,192km of network in operation, making gas available to 296,364 premises in its licensed area, with a total of 158,997 (54%) already connected.

OPERATIONS

PNG met all published standards of customer service, as measured independently by the Consumer Council for Northern Ireland (CCNI) and the NIAUR. In the key areas of connecting new customers and attending public reported escapes, targets were exceeded.

During 2012, the distribution network continued to operate without major incident. No interruptions have occurred to the distribution of gas due to capacity constraints on the PNG network throughout the years 2006 to 2012.

Prior to the winter of 2012 four of Northern Ireland's strategic infrastructure providers, BT, Northern Ireland Electricity, Northern Ireland Water and PNG agreed a 'mutual aid' protocol which will ensure that during exceptional events these critical infrastructure providers will work together to share assets and resources to aid quick restoration of service for the greater good of the Northern Ireland population and economy. The initiative was very much welcomed as a practical approach to prepare for emergencies by both the Minister responsible for energy and the Minister responsible for roads.

A 'peak day' for demand in the year of 19.9 GWH was recorded on 11th December 2012, which is consistent with the 2011 'peak day' which was also 19.9 GWH. However it should be noted that relative mean temperature on the peak day in 2012 was 1.8°C, compared with -1.9°C on the 2011 peak day. The all-time peak day occurred in 2010 of 24.4 GWH however this was driven by exceptionally low temperatures (-10.1°C).

PNG, on behalf of the Group, was recognised for its contribution to the environment by being awarded 1st quintile accreditation in the prestigious Arena Network Annual Environmental Awards, which means that the Group's performance is classified as being exemplary when benchmarked against other organisations throughout Northern Ireland. PNG's ongoing operational procedures in the areas of environmental performance and occupational health and safety were re-affirmed by successfully retaining accreditations of both ISO 14001 and 18001.

REGULATION

As a regulated distribution business, PNG is subject to periodic (normally 5-yearly) price controls undertaken by its regulatory authority (NIAUR). PNG rejected the latest price control determination issued by NIAUR together with the related licence modifications proposed. As a result the matter was referred to the Competition Commission for review during 2012 and a full timeline of this process is provided below:

Regulatory Price Control (PNGL12) – Timeline of events

The PNGL12 price control was instigated by NIAUR as a 'mini' two-year review covering the period 2012 and 2013, in order to align PNG's price control periods with that of firmus energy from 2014 onwards.

Sep-10	PNG submitted its actualisation submission covering the three years from 2007 to 2009 to NIAUR.
Nov-10	PNG made its PNGL12 price control submission to NIAUR; and detailed discussions between NIAUR and PNG started to enable NIAUR to determine the allowed revenue for the period 2012 to 2013.
Aug-11	NIAUR published its draft proposals for consultation which, as well as indicating their view on allowable costs, unexpectedly included a proposal to retrospectively reduce by c.£80m PNG's regulated asset base referred to within its licence as Total Regulatory Value (TRV).
Oct-11	PNG registered its strong opposition to NIAUR's August 2011 draft proposals, clearly stating its rationale and confirming that it would be unable to accept the final determination, if this contained the retrospective reduction to the TRV as proposed by NIAUR.
Jan-12	NIAUR published its final PNG12 price control determination and proposed a separate licence modification to implement the retrospective adjustment to the TRV.
Feb-12	On 6th February 2012 PNG issued a disapplication notice rejecting NIAUR's final PNGL12 price control determination and NIAUR's related licence modification to implement the retrospective adjustment to the TRV.
Mar-12	On 28th March 2012 NIAUR made a reference under Article 15 of the Gas (Northern Ireland) Order 1996 to the Competition Commission. The Competition Commission had a period of six months (a two month extension was later granted) to issue its final determination.
Nov-12	On 28th November 2012 the Competition Commission issued its final determination. The Competition Commission concluded that the NIAUR's c.£80m adjustment was not in the public interest and that only two small adjustments to PNG's TRV (£13.6 million in total) should be made. The Competition Commission's involvement in this process and its final determination should provide the basis for a more stable regulatory environment for Northern Ireland, which will benefit consumers and investors alike.
Feb-13	NIAUR published its notice of the proposed modifications to the conditions of PNG's licence to give effect to the conclusions of the Competition Commission. NIAUR also published a draft copy of the Replacement Determination Notice it proposes to issue to PNG.
Mar-13	PNG submitted its response to NIAUR's February 2013 proposals.

Regulatory Price Control (GD14)

A subsequent price control (GD14) was instigated by NIAUR in 2012, as a five-year review covering the period 2014 to 2018.

PNG made its GD14 price control submission to NIAUR in December 2012; and detailed information requests and discussions between NIAUR and PNG have commenced to determine the allowed revenue for the GD14 review.

NIAUR issued a consultation paper in December 2012 on the scope of the GD14 review. In March 2013 NIAUR issued an update on its overall approach. The key milestones are:

Key Milestones of GD14

Key Points	Proposed Date
Stakeholder engagement	April - June 2013
Publication of draft price control determination for consultation	July 2013
Stakeholder engagement during consultation period	July - September 2013
Clorure of public consultation	September 2013
Price conrol final determination published	November/December 2013

NIAUR have also stated in its March paper that it is minded to shorten the duration of GD14, to a 3-year control period. This would mean that GD14 would run from 2014 – 2016. The final decision will be made as part of the final determination and any comments will be considered before then.

GAS ON GAS COMPETITION

PNG has been instrumental in the successful delivery of gas supply competition across all market sectors in Greater Belfast & Larne thereby ensuring that the necessary systems and processes, enabling customers to switch from one supplier to another in response to the supply offering available, are in palace.

Currently seven suppliers hold licences for the supply of natural gas in the PNG Licensed area with four actually supplying gas to customers during 2012. Currently firmus energy and Airtricity (Energy Supply) NI (formerly Phoenix Supply) are the only suppliers actively competing within the domestic tariff market. Another supplier is progressing with the implemention of the required systems and processes in order to be in the position to supply to industrial and commercial customers from the second quarter of 2013.

MARKET OVERVIEW AND OUTLOOK

PNG has connected on average around 10,000 homes and businesses each year to natural gas since forming the industry in Northern Ireland in 1996. Its challenge has been to make natural gas available to around half the population and to establish natural gas as the fuel of choice for households, businesses, housing associations, developers and architects.

A recent report by Lord Whitty, which was commissioned by the NI Consumer Council, highlighted difficulties with the current energy mix in Northern Ireland and the report argued strongly for the need for heating oil to be replaced by natural gas and for energy efficiency measures to be better promoted.

Other reports have highlighted the fact that there is a strong correlation between the number of homes in Northern Ireland using heating oil and the incidence of fuel poverty. In recent years this has been publicly recognised by local politicians and agencies, with greater support becoming evident for the need to displace dependency on more expensive and less environmentally friendly fuels like heating oil by making natural gas available to more households.

This aspiration is reflected in the Northern Ireland Executive's target to make natural gas available to around 70 per cent of the population.

GROWING SUPPORT

PNG and the wider local gas industry have campaigned for the introduction of a boiler scrappage scheme since January 2010 when such a UK boiler scheme was launched by the Government that included England, Scotland and Wales, but excluded Northern Ireland.

Since then PNG has successfully operated a relatively small privately funded boiler scrappage scheme of its own which has been consistently oversubscribed. Following the success of this pilot, and with the support of the local gas industry, a government funded boiler scheme was eventually launched regionally by the Department for Social Development in September 2012. This scheme has secured government backing for at least 3 more years and a further application has been made to the Northern Ireland Executive for additional funding.

A renewables focused Green New Deal was not supported by the Northern Ireland Executive for economic reasons, and it was cited that the boiler replacement scheme will aim to deliver on many of the goals that the former proposal hoped to achieve, including: reducing the amount of energy properties are using, cutting energy bills and lowering domestic carbon emissions with A-rated high efficiency boilers that are around 90% per cent efficient. To put this into context, many homes are still using old costly boilers that can be as low as 60% efficient. In these cases for every £1,000 a householder spends on fuel, around £400 of that spend is being lost straight away.

In the first six months since the government grant was launched around 30,000 customers have registered their interest in participating in this scheme and this has in turn helped to create a wider awareness in Northern Ireland of the importance of energy efficiency in the home.

HELPING TACKLE FUEL POVERTY

Northern Ireland has been identified as having one of the highest levels of fuel poverty in the UK. PNG continues to play its part in helping to identify those who need some additional help and support.

PNG provides continued energy efficiency training to all 'customer facing' staff. These staff must hold a minimum qualification that allows them to provide advice to householders on how to reduce their energy consumption. An energy audit is completed as part of the visit to every home and from this evaluation PNG representatives are able to provide key information to help with energy efficiency requirements and suggested improvements.

Discussions surrounding levels of spend as well as household income allows PNG to signpost householders to a wide range of schemes provided by the government; where they may

be eligible for further assistance. In many cases PNG are able to highlight the government's Warm Homes Scheme, where the homeowner may qualify for a new heating system funded entirely through a grant.

PNG continue to be instrumental in helping to identify consumers who qualify for a natural gas heating installation through a wider range of schemes, where funding provided by Government is collectively in the region of around £30 million per year.

INDUSTRY RECOGNITION

PNG have continued to attract visits from senior gas industry officials from around the world who are undertaking or who are about to undertake the development of gas infrastructure on a commercial basis.

In 2012 a delegation of leading gas industry representatives from Serbia, including the Serbian Utility Regulator, visited PNG as part of a best practice visit to learn more about the unique development of the Northern Ireland gas industry.

The underground natural gas network throughout Greater Belfast remains one of the most modern of its kind in the world, built using the latest and most innovative engineering technologies. In recognition of its world-class expertise PNG has also previously attracted similar delegations from countries as far afield as: India, Brazil, Argentina, China and Israel. Such visits remain important for PNG staff development as engineers and executives are able to be challenged by, and share best practice with, other industry experts.

NEW BUILD INNOVATIONS

Within the new build housing sector, natural gas is now almost exclusively the fuel of choice and therefore PNG's connections activity is highly dependent in this area on the state of the general housing market. 2012 saw a continued slowdown in activity in this particular market, both in terms of house sales and new housing schemes starting up, with the majority of schemes that were completed being developed on the back of public sector funding by Housing Associations. Recent planning and build activity did however notably continue to improve throughout 2012 and PNG are currently working on plans to develop over 10,000 properties that have received planning permission and are in various stages of being brought to the market.

There have been a small number of property developers who have experimented with renewable technologies and have used these technologies as marketing tools to promote and ultimately sell their properties.

During 2012 PNG completed the changing over of heating systems from biomass to natural gas at Northern Ireland's first eco-village in Lisburn, County Antrim.

In the marketing literature homeowners at the eco-village were promised they would see major savings but it soon turned out that the company providing the biomass heating would serve notice to the residents that the renewables system would have to be shut down.

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These property owners were faced with the prospect of high energy bills, a winter without heating or hot water and a developer in administration. PNG worked in conjunction with each of the property owners and local politicians, and after a short period of discussion 100% of the properties owners agreed that they wanted to convert their homes to natural gas. There were 200 homes in the original scheme and an additional 200 homes that were to be added. PNG was able to use its experience of innovative and leading edge solutions to make natural gas available to every property in the eco-village development. There were many operational and legal difficulties with this project that needed to be addressed and overcome, and gaining the support and co-operation from both public representatives and the householders meant natural gas was introduced to the eco-village and is now playing its part alongside other remaining renewable technologies.

IMPROVING CUSTOMER SERVICE

Throughout 2012 PNG and the local industry continued to maintain and improve upon its high levels of customer service. The growth of PNG has established a wide network of gas related businesses such as manufacturers, distributers, merchants, retailers, training centres and installers throughout its licence area. PNG acts as an incubator to these networks, which are essential to the overall development of the wider industry and ensure that leading technologies are installed in homes, businesses and in the public sector.

PNG has also formally established the Northern Ireland Natural Gas Association (NINGA), providing it with its own identity, website and training capabilities. There are now a significant number of companies and individuals that regularly attend NINGA training events and this helps to underpin the strong customer focused ethos and reputation that Phoenix sets out to attain.

There is of course an amount of inevitable disruption involved in digging up roads, digging driveways, removing radiators, oil tanks and boilers. Despite this, independent market research continues to indicate that around 98% of customers would recommend getting natural gas installed. Customer expectations continue to be exceeded, and this is a testament to the hard work and investment by PNG and others in the local industry.

DIVISIONAL REVIEW

ENERGY SERVICES

Phoenix Energy Services (PES) is the leading provider of natural gas emergency response, metering services, boiler and appliance servicing in Northern Ireland. The company now undertakes more than 52,000 service engineering visits per year, using a professional team of multi-skilled Gas Safe Registered engineers. The level of skill and professionalism within the team ensures that natural gas customers receive the highest standard of service with a clear focus on gas safety.

BUSINESS REVIEW

Turnover of £3.6m in PES in 2012 was £0.1m lower than in 2011 however income was impacted by around £0.3m by the transfer of meter reading services from PES to PSL prior to sale on 22nd June 2012. Therefore income in the ongoing business actually increased by £0.2m, in line with the continued expansion of the business, both internally to PNG and externally through growth in services to home owners and businesses.

Operating profits were £0.1m lower than 2011 levels at £0.4m with the business choosing to maintain prices at previous year levels despite the inflationary pressure on costs.

Phoenix Energy Services is now a well established brand in Northern Ireland's growing natural gas market. Along with the proven capability of delivering a world-class emergency service to gas consumers, the business also provides professional support to the Group's distribution business through a range of other business-critical activities, including gas meter installation, maintenance and meter inspection services.

The achievements of the company through its support of the gas apprenticeship scheme during 2012 have again been recognised within the industry with the presentation of PMST "Apprentice of the Year " awards in two separate categories.

24/7 EMERGENCY RESPONSE SERVICE

PES continues to deliver a professional downstream emergency response service to the core distribution division, ahead of agreed industry standards. This area of operations currently accounts for 31% of the service engineering visits undertaken, with activity growing alongside the expanding natural gas infrastructure in Northern Ireland. All Emergency Service Engineers continue to receive annual refresher training and are also audited by accredited "A2" supervisors throughout the year to ensure that gas competency and customer service levels are being maintained at all times. All Technician level engineers are fully trained in IGE/GL8 carbon monoxide investigation processes. This is a specialist service that is offered to all gas suppliers in the License area.

ASSET INSTALLATION AND MAINTENANCE

This section of the business delivers a range of meter installation and maintenance services to the distribution division and constitutes a further 51% of downstream service engineering activity. While minimising unnecessary activity in this area will obviously be a focus for the distribution business, activities will grow in line with the increasing customer base, competition in the supply market and the changing age profile of the network. The flexibility offered by a disciplined multi-skilled engineering team means that work requests from the distribution business or gas suppliers can be responded to quickly and efficiently. This delivers a seamless service for customers and helps to enhance the natural gas experience.

CUSTOMER SUPPORT SERVICES

PES provides a one-stop-shop for boiler and appliance maintenance, repair, landlord inspection, commercial planned maintenance and boiler insurance breakdown protection. This work constitutes 18% of the downstream service engineering activity and continued to deliver significant revenue into the business in 2012 despite the general economic downturn. This workload reflects continued success in this developing market and is the result of building customer loyalty through excellent service delivery and the innovative marketing of products such as the boiler insurance breakdown package "Phoenix ServiceCare". Additional opportunities have been arising as the age profile of the domestic boiler increases in the Northern Ireland market particularly with system cleaning, boiler repair and replacement. A series of focused marketing campaigns has also delivered growth in the boiler service area while on-going media campaigns by the HSE(NI) have highlighted the importance of appliance maintenance which has strengthened the PES approach.

MARKET OVERVIEW AND OUTLOOK

The focus on standards of service in the delivery of emergency service workload and asset maintenance will remain the key drivers for PES in 2013.Trading conditions remain buoyant in the customer support services sector, due to ongoing targeted marketing supported by continued repeat business despite the challenging economic conditions. Customer awareness of increased energy efficiency across all areas of the economy has been a strong driver for proactive maintenance of all appliances. With volatility in the cost of fuel and other domestic expenditure, the benefits of fixed price boiler insurance packages such as 'Phoenix ServiceCare' remain attractive.

Emergency services and asset maintenance activities will continue to grow in tandem with the expanding natural gas market in Northern Ireland. The increasing age of installed plant and equipment will also be an ongoing source of work in this safety critical area.

Overall, the future growth prospects of PES are looking extremely healthy, thanks to anticipated further growth of the Northern Ireland gas infrastructure and consumer market.

BOARD OF DIRECTORS

DR GEORGE GREENER CBE
CHAIRMAN

George Greener brings to Kellen significant and varied experience at directorship level, most recently as Chairman of the National Health Service in London. Before joining the Kellen Board, he was Senior Independent Director of Reckitt Benckiser plc, as well as Chairman of the British Waterways Board, The Big Food Group plc, Swallow Hotels plc, Allied Dunbar Assurance plc, Eagle Star Holdings plc and Threadneedle Asset Management plc. In addition, George held the posts of Chief Executive Officer of BAT Financial Services and Director of BAT Industries plc. George has also served as Group Chief Executive Officer of Hillsdown Holdings plc.

SAMI KASSAM
NON EXECUTIVE DIRECTOR

Sami is a Director at TFCP. Sami brings with him significant transaction experience, having been on the investment team at TFCP since 2006. Whilst at TFCP, Sami has been primarily focused on the energy and infrastructure space, with recent notable transactions including the refinancing of Infinis, the take private of Novera Energy and the acquisition of Consolidated Pastoral Company. Prior to joining TFCP, Sami worked as an Investment Banker within Citigroup's M&A team.

LORENZO LEVI
NON EXECUTIVE DIRECTOR

Lorenzo is an Operational Managing Director at TFCP. He has had a wide-ranging career encompassing sales management and corporate development for companies such as IBM and Nortel Networks, to strategy for management consultants, Bain & Co. He now puts these skills and expertise to good use at Terra Firma. In addition to due diligence work on transactions, Lorenzo also handles post-acquisition operational challenges which differ greatly. At Terra Firma, in the cinema investment his role includes driving acquisitions across Europe, while his work in the aircraft leasing business has included managing the integration of the two acquired companies.

LORCAN WOODS
NON EXECUTIVE DIRECTOR

Lorcan joined Terra Firma in London as Finance Director, Portfolio Businesses with current board responsibility for Everpower Wind Holdings and Phoenix Natural Gas. He was brought up in N.Ireland joining Unilever as a graduate trainee and working in a variety of finance roles for 21 years in Foods and Personal Care. His final two roles were as Finance Director, Unilever Mexico and Vice President, M&A where he led a number of transactions including the disposal of Bertolli Olive Oil and the acquisition of the Sara Lee Personal Care business.

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SIR GERRY LOUGHRAN KCB
NON EXECUTIVE DIRECTOR

As Chairman of Phoenix Energy Holdings, Sir Gerry Loughran brings a wealth of experience and expertise in the public and private sectors. He has served as Permanent Secretary of the Industry Department (Department of Economic Development) in Northern Ireland and subsequently was appointed Head of the Northern Ireland Civil Service and Secretary to the Northern Ireland Executive. In this role he led 29,000 members of the Northern Ireland Civil Service until his retirement from the Service in 2002. Since then he has held a number of appointments in the private sector. He is currently Chairman of Blackstaff Press, Director of Allied Irish Banks (UK) PLC, the Baird Group and Forward Emphasis International. He also serves on several Boards in the education and training sectors.

PETER DIXON
GROUP CHIEF EXECUTIVE

Peter has spent his entire career in the gas industry, acquiring over 34 years' experience. He started out as an Engineer in 1976 with North West Gas and went on to play a key role in the break-up of what was then the old British Gas. Peter joined Phoenix Natural Gas as Commercial Director in February 1997. He was appointed Chief Executive in July 2000. He is currently Chairman of the Energy for Children Charitable Trust, as well as Chairman of Arena Network - the environmental arm of Business in the Community of which he is also a Board member. In 2008 he was appointed a Belfast Harbour Commissioner and he is also a Board member of the Winston Churchill Memorial Trust.

MICHAEL MCKINSTRY
GROUP FINANCE DIRECTOR

Michael has been with Phoenix from its earliest days, joining the fledgling company in 1996 as Finance Director. He took his place on the Group Board in January 2006 following the acquisition of Phoenix by Kellen. Because Michael has been at the financial helm of Phoenix throughout its history, overseeing the various changes to its ownership, corporate, financial and regulatory structures, as well as developing its strategies, he has a comprehensive knowledge and understanding of the business. Prior to joining Phoenix, Michael gained extensive financial management experience across a broad range of business sectors, starting in heavy engineering with GEC, in the textiles industry with Ulster Weavers and in the energy industry with Premier Power following its purchase by British Gas.

FINANCIAL REVIEW

This was another momentus year in the history of the Kellen Group with the sale of the supply businesses to SSE plc and the Competition Commission referral during 2012 rightly receiving a large amount of the attention.

Aside from this however underlying operating performance within PNG (the asset owner and gas distribution business) was extremely strong. Despite the focus on the relatively high costs of energy and financial constraints on consumer spending arising from the difficult economic climate, the business performed extremely well with volumes of gas flowing through the network and new connections being well ahead of expectations in the year - this highlights the good value for money that gas offers relative to other forms of energy.

The Competition Commission (CC) inquiry rightly necessitated a significant level of additional resources to be engaged by PNG to support the process, therefore it was pleasing to be awarded the recovery (in future charges) of c.£1.35m of these external costs by the Commission at the conclusion of the process. Therefore whilst actual operating costs were obviously impacted by the costs associated to the CC process in 2012, underlying costs remain in line with target levels after taking account of adjustable price control items such as market development costs associated with the higher levels of connections achieved in the year.

Our energy service business continues to strive to deliver the efficiencies required to support the regulated maintenance and emergency service activities provided by PNG, as well as seeking to add value to the consumer offering where appropriate through the provision of other associated services to energy consumers.

Our gas supply operations in both NI & ROI performed well prior to sale, with profit achieved ahead of budget levels in a highly competitive market.

SALE OF SUPPLY BUSINESSES

On 22nd June 2012, Kellen Group completed the sale of 100% of the share capital of both Phoenix Supply Limited and Phoenix Energy Limited, to SSE plc, through its subsidiaries Airtricity (Energy Supply) Northern Ireland Limited & its Republic of Ireland-registered subsidiary Airtricity Limited for £19.1m excluding working capital adjustments. This generated a profit within the consolidated accounts of £15.9m in 2012.

As part of the sale, the existing loan arrangement between Phoenix Natural Gas Limited and Phoenix Supply Limited was repaid in full.

Following on from the sale, the Group undertook a restructuring leading to an dividend distribution of £46.0m being made by Kellen Investments Limited.

TURNOVER

Group turnover on a continuing business basis of £45.9m in 2012 was £6.0m higher than in 2011. In addition £72.2m of income was generated by the supply businesses prior to their sale in June 2012.

	TURNOVER £ CONTINUED		TURNOVER £ DISCONTINUED	
	2012	2011	2012	2011
Distribution (PNG)	45.1m	39.2m	-	-
Supply (PSL)	-	-	60.9m	106.4m
Energy Limited (PEL)	-	-	11.3m	14.1m
Energy Services (PES)	3.6m	3.7m	-	-
Intra Group Sales	(2.8m)	(3.0m)	-	-
Total	45.9m	39.9m	72.2m	120.5m

Distribution income in Phoenix Natural Gas (PNG) rose by 15% to £45.1m compared to 2011 levels, with gas throughput accounting for 10% of the increase and the remainder arising from an increase in average distribution charges.

Distribution prices are normally set in advance of each year in order to recover the allowed income for the year as determined within the latest price control by forecasting the gas throughput and RPI for both the year in question and the remainder of the preceding year. As a result actual income generated will be higher or lower than the maximum allowed level as a consequence of the utilisation of such forecasting estimates. The difference arising (either surplus or deficit) is thereby accumulated at the end of the year as a 'Z balance', to be adjusted in charges in future years - in this manner NIAUR regulate the rate of return allowed to Phoenix.

In the absence of a final price control at the time of setting 2012 charges, distribution tariffs were simply uplifted by inflation, in the knowledge that there was likely to be a surplus of income brought forward into the year and the 'Z' mechanism was in place to deal with any over/under recovery that may arise in any case when the actual allowed income was known.

In 2012 distribution income generated by PNG was £2.3m lower than the 'allowed levels', based on the

determination by the Competition Commission, for 2012 (2011: £2.9m lower than the level allowed). Therefore on the basis that 'Z' brought forward into 2012 was £2.4m, a balance of £0.1m of over-recovered income remains to be returned to customers at end of 2012.

	2012	2011	Inc/(Dec)
Allowable Income	47.0m	41.8m	5.2m
Under/Over Recovery	(2.3m)	(2.9m)	0.6m
Other Income	0.4m	0.3m	0.1m
Distribution Turnover	45.1m	39.5m	5.9m

Turnover in Phoenix Supply (PSL) of £60.9m reflects the income generated for the period up to date of sale in June 2012. It was 43% lower than the full year of income generated in 2011 however turnover on a like for like basis up to date of sale was ahead of budget and ahead of the prior year, with throughput benefitting from growth in new connections, offsetting any loss of customers to other suppliers and prices rising to offset the higher cost of gas.

Turnover in Phoenix Energy (PEL) of £11.3m also only reflects the income generated up until sale in June 2012. It was just 20% lower than the full year income generated in 2011 however prior to the date of sale, turnover in PEL was well ahead of both prior year and budget comparatives, driven by the continued growth in this business prior to its sale and higher cost of gas being passed onto customers.

Phoenix Energy Services' (PES) income has fallen by £0.1m compared to 2011 primarily as a result transfer of meter reading services to PSL prior to its sale with the resultant loss in turnover of c£0.2m.

Further detail behind movements in turnover is provided within the divisional reports on pages 16 to 25, but a summary is outlined earlier in this report.

OPERATING PROFIT

Group operating profit increased by £0.1m to £20.2m in 2012, however if you exclude the impact of the discontinued activity, operating profit actually increased by £1.5m to £17.0m.

	OPERATING PROFIT £ CONTINUED		OPERATING PROFIT £ DISCONTINUED	
	2012	2011	2012	2011
Distribution (PNG)	15.9m	14.0m	-	-
Supply (PSL)	-	-	2.9m	4.5m
Energy Limited (PEL)	-	-	0.3m	0.1m
Energy Services (PES)	0.4m	0.5m	-	-
Consolidation adjustment (intangible amortisation)	0.7m	1.0m	-	-
Total	17.0m	15.5m	3.2m	4.6m

Operating profit within PNG of £15.9m (2011: £14.0m) is primarily driven in 2012 by a rise in allowed income as determined by the CC for the 2-year period 2012 to 2013, less the respective increase in costs involved in operating the business.

It should be noted that PNG's operating profits in 2012 (and also in 2011) were reduced by £2.3m (reduction of £2.9m in 2011) as a result of an over-recovery of Z (surplus of actual income over allowed income) brought forward from prior years. The value of Z carried forward at the end of 2012 to be returned to customers in discounted charges in the future amounted to £0.1m (compared to £2.4m at the end of 2011).

In addition it should be noted that while PNG's operating costs in 2012 were abnormally affected by the costs of external advisers employed to support the CC process, the company will be allowed to recover c.£1.35m of such costs in the future as part of its allowable income. In addition the costs incurred by NIAUR and the CC themselves in respect to this process levied on the company through licence fees will also be retrospectively allowed.

Operating profit within PSL in 2012 of £2.9m (2011: £4.5m) relates to the period up until sale on 22nd June 2012.

In the period prior to sale PSL continued to operate in line with the principles under its price control where the delivered cost of gas is passed through to customers by adjusting future tariff to reflect any difference between actual and forecast costs assumed. Accordingly, PSL reduced its tariff selling prices by 8.5% on 1st April 2012 reflecting the historic savings achieved on gas costs by the company compared to forecasts assumed in its tariff assumptions and also the assumptions at that time of forecast cost of gas for the following 12 months.

PEL generated an operating profit of £0.3m (2011: £0.1m) in the period up until sale on 22nd June 2012 as it continued to develop its customer base in its gas supply market in ROI following on from starting to trade at the end of 2009.

Operating profit within PES was impacted slightly in 2012 by the transfer of meter reading activity to PSL prior to sale however otherwise turnover rose on the back of increase in maintenance and emergency service activity in the year. PES continues to be reliant on workload from its main customer PNG, both as a result of an increase in planned maintenance activities but also from on-demand metering and emergency response activities which can be influenced by weather conditions.

OPERATING CASH FLOWS

During the year, net cash inflow of £31.6m was generated from operations compared to £26.7m in the previous year.

A further £12.6m (2011: £12.3m) was re-invested in the Group to fund expansion to the distribution network and connect new customers, while £16.8m (2011: £17.1m) was used to meet interest obligations and other financing costs in respect to the Group's bank borrowings and bond providers.

£19.4m was received by the Group as a result of the sale of the supply businesses to Airtricity/SSE plc (net of cash disposed of within the subsidiaries)

Further to the completion of the sale in June 2012, Kellen undertook a group restructuring in order to upstream the cash received from the sale together with other cash retained in the Group in support of potential working capital requirements of supply businesses and thereby distributed a dividend £46.0m.

£5.0m was repaid by PNG under its revolving bank facilities in the year with the repayment of the loan by PSL prior to completion of sale of supply offsetting the cashflow requirements in PNG during the year.

The net result of these cash flow movements was that cash held at bank or in hand at the end of 2012 has decreased by £29.2m from the balance at the end of the previous year.

BANK BORROWINGS

The Group is principally involved in the development of long-term infrastructure assets, owned by PNG, with underlying income growing over time in line with growth in connections.

The Group's principle source of debt finance has been generated from the issue in 2009 of £275m of bonds by Phoenix Natural Gas Finance plc, a 100% subsidiary of PNG, which pay a coupon rate of 5.5. These bonds are guaranteed by PNG and PDHL (the holding company of PNG), are rated Baa2 by Moody's and BBB+ by Fitch and are repayable in 2017.

In addition PNG has three year bank facilities available to it through The Royal Bank of Scotland plc which are due for maturity in August 2014. These facilities are made up of a £30m revolving credit facility to support continued investment in capital expenditure within the distribution division, and a £30m working capital facility to finance working capital requirements within PNG. As part of this working capital facility PNG could lend up to 5% of the value of PNG's Total Regulated Value (TRV) to PSL in order to finance its working facilities. Following on from the sale of PSL this is obviously no longer required. As part of sale process any borrowing by PSL from PNG was repaid in full.

At the end of 2012, net debt increased to £258.1m compared to £232.8m at the end of 2011.

Bank balances at the end of 2012 decreased by £29.2m to £17.3m whilst £5.0m was drawn under PNG's 3-year £60m bank facilities.

There is no longer any cash held as collateral against outstanding guarantees as these arrangements related to the supply businesses.

In addition the balance outstanding to bondholders (net of capitalised fees) increased by £1.1m to £270.4m at the end of 2012 as a result of the amortisation of fees.

The debt facilities require the "financing group" (PDHL, PNG & PNGF) to comply with certain financial and non-financial covenants. The covenants include a limit in borrowings linked to the regulatory asset value of our assets (TRV & DAV) and ratios linking earnings to net interest paid.

BUSINESS GROWTH

The principles underpinning the growth of PNG are defined within the principles of the PNGL12 price control. Plans include: network extension to make gas available to new industrial, commercial and domestic developments, taking gas mains into areas where customers have a strong propensity to convert from their existing fuel to natural gas and meeting our obligations to NIHE to where possible make gas available to tenants in line with its refurbishment programme.

During the year, the Group invested a further £12.6m in capital expenditure. Investments included construction of 44km additional distribution mains and connection of a further 10,523 new customers in 2012.

While the licence under which PNG operates requires investment in a network to make gas available to a minimum number of customers, PNG has reached the point where its obligations with respect to this network development plan which is contained within its licence have been fulfilled. Therefore a growing proportion of future investment will be directed at connecting customers to the existing network. In support of this, PNG continues to invest in an extensive sales and marketing programme to all potential new customers and manages customers up until the date they are connected and using gas. PNG charges all gas suppliers, on an equal basis, for utilisation of its network in line with the terms of its network code.

PRINCIPAL RISKS AND RISK MANAGEMENT

The Group's management structures, coupled with appropriate policies and procedures on how the respective businesses function, are designed to enable the achievement of business objectives while controlling the risks associated with the environment within which it operates.

The key business risks and uncertainties affecting the Group, together with the means by which we manage them, are outlined below:

REGULATORY RISK

PNG operates under licences issued by government. As a result, the Group devotes a considerable amount of time to the management of regulatory matters with both NIAUR and DETI (Department of Enterprise, Trade and Investment) in Northern Ireland. Compliance with the ongoing requirements of these licences, changes arising from the evolving regulatory environment, (including those associated with the agreement reached with NIAUR in November 2006), EU obligations, the full introduction of supply competition, and the implications of price controls, mean that significant attention has been and will continue to be dedicated to regulatory compliance. Indeed the Group allocates a specialist resource to this task.

PNG manages the relationship with NIAUR and DETI at senior management level within the company supported by dedicated resource allocated to this key area of activity.

HEALTH & SAFETY RISK

As a provider of an essential service to the public, the Group works in an environment where health and safety must take top priority within the operating businesses. At the heart of the Group's safety culture, the 'ASHES' system ensures all employees understand the rigorous policies and procedures in place to deliver a safe operating environment. Through a dedicated manager within PNG, by stringently controlling health and safety performance from company board level through to field operations, and with the strategic support of The British Safety Council audits and ISO accreditations, the Group is able to manage any health and safety risks that may arise.

BUSINESS CONTINUITY RISK

The Group has measures in place to mitigate the risks associated with managing the business in the event of a gas supply emergency, or any other occurrence which could affect the ability of all or part of the Group to function normally, potentially affecting financial performance.

As a rule, gas supply emergency risks are managed through the contractual relationships that exist in the Transmission Network Codes and the agreements between the Transmission System Operator and the Distribution System Operator. In addition, general operational risks are controlled through the establishment of prudent and safe operational processes and through a structured and highly focused approach to capital expenditure in conjunction with robust maintenance procedures. Regular emergency exercises involving all gas operators and selected local essential service providers in Northern Ireland are simulated to test and further develop the processes in place. The Group also maintains a comprehensive business continuity plan which includes details of our IT recovery plan and is updated, reviewed and tested on a regular basis.

FINANCIAL RISK MANAGEMENT

Group operations bring exposure to a variety of financial risks, including the effects of changes in liquidity and interest rates. The Group exercises strong financial and management accounting controls through the consolidation of all financial and treasury requirements within the finance function within common services in PNG.

Long-term business plans and shorter term budgets and forecasts are tracked monthly against actual performance at both a company and consolidated group level in line with obligations under financing agreements, thereby enabling financial requirements to be monitored against the cash resources available to both the Group as a whole and its constituent parts.

A mixture of long-term debt, raised through the issue of fixed rate bonds, and short-term debt available within our banking facility, are used to ensure that there are sufficient resources available for operational requirements. The Group does not use derivative financial instruments for speculative purposes.

The Group has delegated the responsibility of monitoring financial risk management to the Finance Committee, a sub-committee of the Board. The policies set by this committee are directly implemented by the finance function.

CREDIT RISK

The Group's principal current assets are bank balances, cash, trade and other receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of these cash flows.

PNG is exposed to credit risk arising mainly from the risk that gas suppliers are unable to pay distribution charges as they fall due. The risk is partially mitigated by the requirement for all suppliers to comply with credit arrangements within the PNG Distribution Network Code to evidence their ability to pay for distribution charges when they fall due, thereby reducing the risk of payment default by a supplier.

At the end of 2012, 100% of all distribution income is concentrated with a small number of customers (gas suppliers). c30% of distribution income is currently provided on the basis of prepayment of monthly charges by the gas supplier in advance of the month, whilst the credit requirements provided for the remainder are managed in line with the arrangements associated with the Network Code.

Michael McKinstry
Group Finance Director

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SECTION 2 : BUSINESS REVIEW

BUSINESS AWARDS

WINNER
Big Tick Award
for Corporate Social Reponsibility
2012

WINNER
Arena Network
Quintile One Award
2012

WINNER
Belfast Media Group
Community & Consumer Impact Award
2012

WINNER
The Chartered Institute of Marketing
Silver Award for Best Sales Campaign
2011

WINNER
PMST
Best First Year Apprentice (Gas)
2012

WINNER
PMST
Best Third Year Apprentice (Gas)
2012

WINNER
Energy Supplier
Customer Service Award
2012

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2012.

PRINCIPAL ACTIVITY

The principal activity of the Group is the development and operation of the distribution gas networks together with the supply of gas (up until the date of disposal of supply businesses mid-way through the year) and other energy services.

The principal activity of the Company is that of an intermediate holding company and is the highest EU parent company for which Group accounts will be drawn up.

BUSINESS AND FINANCIAL REVIEW

The Chairman's statement, CEO Review and Financial Review, together with the Divisional Reports, can be viewed on pages 4 to 34.

These provide a comprehensive picture and analysis of the Group's business and performance during the year including the primary KPIs used by the Group in its operations.

EMPLOYEES EQUAL OPPORTUNITIES

The Group is committed to a proactive approach in promoting equality of opportunity. Kellen Group ensures that it operates fairly and equitably in its dealings with employees and prospective staff members.

The Group is opposed to all forms of unlawful and unfair discrimination, ensuring through all of its personnel policies, practices and procedures that employment, training and promotion opportunities within the Kellen Group provide employment equality to all, irrespective of:

- Gender, marital or family status
- Religious belief or political opinion
- Disability
- Race or ethnic origin
- Nationality
- Sexual orientation
- Age

DISABILITY

The Group has taken active steps to implement the Disability Discrimination (Northern Ireland) Order 2006. It is corporate policy to provide people with disabilities equal opportunities for employment, training and career development, having regard to aptitude and ability. Any member of staff who becomes disabled during employment is given assistance and retraining where possible.

EMPLOYEE PARTICIPATION

Within the bounds of commercial confidentiality, information is communicated to staff at every level about matters that affect the progress of the Group and are of interest and concern to them as employees. This encourages staff participation in our performance.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group is a registered supporter of the Better Payment Practice Group's 'Better Payment Practice Code' to which it subscribes when dealing with all suppliers. Copies of the Better Payment Practice Group's code are available from the Department of Trade & Industry. Trade creditors at year end represented 21 days (2011:20 days) of purchases. It is the Group's policy regarding all suppliers to agree payment terms in advance of the supply of goods and to adhere to these terms.

PRINCIPAL RISKS AND FINANCIAL RISK MANAGEMENT

This section is considered in detail within the Group Finance Director's review on pages 28 to 34.

RESULTS AND DIVIDENDS

The profit for the financial year is £19.2m (2011: £2.7m). No dividends were paid during the year.

POLITICAL AND CHARITABLE DONATIONS

The Group made charitable donations amounting to £26,833 in 2012 (2011: £28,218). No donations for political purposes were made during the year (2011: £Nil).

DIRECTORS AND THEIR INTERESTS

Details of the directors who served through 2012 are provided below:
L Woods
S Kassam
L Levi
P V Dixon
G P Greener
G Loughran
W F M McKinstry

DISCLOSURE OF INFORMATION TO AUDITORS

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 Group's auditors are aware of that information.

AUDITORS

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

By order of the Board

W F M McKinstry
Director
13th June 2013

ANNUAL REPORT & ACCOUNTS 2012
KG KELLEN GROUP
SECTION 2 : BUSINESS REVIEW

CORPORATE GOVERNANCE REPORT

The Kellen Group's corporate governance structure is set by the Board of directors of Kellen Investments Limited. The Kellen Group is committed to the highest standards of corporate governance as set out in the Combined Code on Corporate Governance.

The Board of directors of Kellen Investments Limited (the "Kellen Board") believes that effective corporate governance is a fundamental aspect of a well-run business and is committed to achieving the highest standards of corporate governance, corporate responsibility and risk management in directing and controlling the business.

The following paragraphs describe the key governance structures and internal controls operating within the group. Through these mechanisms, the Kellen Group aims to apply the highest standards of corporate governance and to conform to the spirit of the 'Combined Code'.

BOARD CONSTITUTION AND PROCEDURES

The Kellen Board comprises seven members; a non-executive Chairman, two executive directors and four non-executive directors. Biographies of the Kellen Board members are shown on pages 26 and 27.

The Chairman is responsible for the effective running of the Kellen Board and for communications with all directors and shareholders. He ensures the Kellen Board receives sufficient information on financial trading and corporate issues prior to board meetings.

The executive directors are responsible for day-to-day operations and the development of strategic plans for consideration by the Kellen Board as a whole.

The Kellen Board meets regularly during the year. During 2012, four main board meetings were held, plus a number of specific meetings to deal with strategic developments and particular authority issues. All members of the Kellen Board receive detailed financial information and regular presentations from executives on the business performance, in addition to items for decision and minutes of board committees, in advance of every meeting, whether they are able to attend or not. This enables the directors to make informed decisions on corporate and business issues under consideration.

The principles for the corporate governance of the Group were adopted by the Kellen Board on 9th December 2005. These determine the internal policies by which the Group should operate.

To ensure that key policy and strategic decisions are made by Kellen Board, certain matters must be brought to Kellen Board for approval, including but not limited to: final approval of the annual accounts and budget, major acquisitions and disposals and any changes to the Group's financing arrangements and financial policies. Where urgent decisions are required on matters specifically reserved for the board between meetings, there is a process in place to enable discussion and decision-making. Directors also have access to the advice and services of the Company Secretary.

BOARD COMMITTEES

The Kellen Board has established three committees, each with clearly defined terms of reference, procedures, responsibilities and powers.

AUDIT COMMITTEE

The Audit Committee is chaired by Lorcan Woods and consists of three of the independent non-executive directors. Each member brings relevant financial experience at a senior executive level. The expertise and experience of these members is summarised on pages 26 and 27.

Audit Committee members are expected to have an understanding of the following areas:

- the principles of, contents of and developments in financial reporting, including the applicable accounting standards and statements of recommended practice, and in particular, the appropriateness of the Group's accounting policies;
- the Group's wider corporate policies and its financing;
- systems of internal control and matters that require the use of judgment in the presentation of accounts and key figures, as well as the role of internal and external auditors.

The Group Chief Executive, Group Finance Director and external auditors are normally invited to attend the committee meetings. The committee holds a minimum of two meetings during the financial year at appropriate times in the audit reporting cycle.

The committee oversees the relationship with the external auditors, reviews their audit plan and discusses findings with them. In addition, the committee reviews the effectiveness of the Group's internal controls and risk management systems and also ensures there is proportionate and independent investigation of any matter brought to their attention.

Further, this committee is required to assist the Kellen Board to fulfil its responsibilities relating to external financial reporting and associated announcements. During the year, members reviewed, either as a committee, or as part of the Board:

- interim and annual financial statements, including requirements for financial reporting;
- Group trading statements and, where practicable, all proposed announcements to be made by Kellen Group to the extent that they contain material financial information;
- changes proposed to policies and practices;
- significant accounting issues;
- the risk management process.

The committee is also responsible for the development, implementation and monitoring of Kellen Group's policy on external audit and reserves oversight responsibility for monitoring independence, objectivity and compliance with ethical and regulatory requirements. Additional functions include: recommending the appointment and re-appointment of the company's external auditors and annually reviewing a formal letter provided by the external auditors confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards.

With regard to audits, the committee also reviews:

- the terms, areas of responsibility and scope as set out in the external auditor's engagement letter;
- the overall work plan for the forthcoming year, together with the cost-effectiveness of the audit and the auditors' remuneration and performance;
- any major issues which arose during the course of the audit and their resolution;
- key accounting and audit judgements;
- the level of errors identified during the audit including schedules of unadjusted errors and representation letters;
- and lastly, the recommendations made to management by the auditors and the Group response.

REMUNERATION AND NOMINATIONS COMMITTEE

The Remuneration and Nominations Committee is chaired by Lorenzo Levi and consists of three non-executive directors. This committee meets at least once a year and at such other times as the Kellen Board requires.

The committee's specific duties and responsibilities are as follows:

- establish the criteria to be used in selecting directors and ensure the remuneration package is designed to attract, motivate and retain staff of the highest calibre;
- approve the remuneration of the executive directors and management to provide independent and objective assessment of any benefits granted to directors and management;
- ensure that the pension arrangements throughout the Group are appropriate, well supervised and conform to applicable law.

The committee also reviews the design of incentive and performance related pay plans for approval by the Board, together with remuneration policies as a whole and trends across the Group.

FINANCE COMMITTEE

The Finance Committee is chaired by Lorcan Woods and consists of three non-executive directors. In addition, the Group Chief Executive and the Group Finance Director are normally invited to attend the meeting.

This committee is responsible for making recommendations to the Kellen Board on financing and investment policy, including the capital structure of the Group, management of financial risks such as interest rates and foreign exchange, management of credit risk, communication with financial institutions, and the acquisition and divestment of material corporate premises.

Further, the committee is also responsible for making recommendations to the Kellen Board based on proposals by the Group Chief Executive (beyond authority levels so delegated) with regard to the creation or disposal of new subsidiaries, the raising of external finance, approval or divestments within the Group and the granting of securities, guarantees and indemnities.

In certain specific circumstances, the Kellen Board has delegated authority to the committee to make decisions in these areas.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL 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 year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and parent 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 parent 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 on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

W F M McKinstry
Director
13th June 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KELLEN INVESTMENTS LTD

We have audited the financial statements of Kellen Investments Limited for the year ended 31 December 2012, which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated balance sheet, the company balance sheet, the consolidated cashflow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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 AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 40, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group and parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2012 and of the group's profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared 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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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
13th June 2013

ANNUAL REPORT & ACCOUNTS 2012
KELLEN GROUP
SECTION 3 : FINANCIAL STATEMENTS AND NOTES

FINANCIALS

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	Continued 2012 £'m	Discontinued 2012 £'m	Total 2012 £'m	Continued 2011 £'m	Discontinued 2011 £'m	Total 2011 £'m
Turnover	2	45.9	72.2	118.1	39.9	120.5	160.4
Cost of sales		(2.7)	(66.1)	(68.8)	(2.6)	(111.5)	(114.1)
Gross profit		43.2	6.1	49.3	37.3	9.0	46.3
Net operating expenses	3	(26.2)	(2.9)	(29.1)	(21.8)	(4.4)	(26.2)
Operating profit	4	17.0	3.2	20.2	15.5	4.6	20.1
Profit/(loss) on sale of fixed assets	14	0.0	15.9	15.9	(0.1)	0.0	(0.1)
Interest payable and similar charges	7	(16.6)	(0.2)	(16.8)	(16.9)	(0.2)	(17.1)
Interest receivable and similar income	8	0.2	0.0	0.2	0.1	0.2	0.3
Profit/(loss) on ordinary activities before taxation		0.6	18.9	19.5	(1.4)	4.6	3.2
Taxation	9	(0.9)	0.6	(0.3)	0.7	(1.2)	(0.5)
Profit/(loss) for the financial year	21	(0.3)	19.5	19.2	(0.7)	3.4	2.7

A statement of movements on reserves is given in Note 21.

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

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2012 £'m	2011 £'m
Profit/(Loss) for the financial year	19.2	2.7
Total recognised Profit since last report	19.2	2.7

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

	Note	2012 £'m	2011 £'m
FIXED ASSETS			
Tangible assets	11	208.5	202.5
Intangible assets	13	102.7	105.8
		311.2	308.3
CURRENT ASSETS			
Stocks	15	1.2	1.2
Debtors: Amounts falling due within one year	16	17.3	72.7
Cash at bank and in hand	27	17.3	46.5
Total current assets		35.8	120.4
Creditors: Amounts falling due within one year	17	(43.0)	(94.1)
Net current (liabilities) assets		(7.2)	26.3
Total assets less current liabilities		304.0	334.6
Creditors: Amounts falling due after one year	17	(275.4)	(279.3)
Provisions for liabilities and charges	18	(16.5)	(16.3)
Deferred income	19	(2.4)	(2.5)
Net assets		9.7	36.5
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	(60.1)	(33.3)
Shareholders' funds	22	9.7	36.5

The financial statements were approved by the Board of Directors on 13th June 2013 and are signed on its behalf by:

W F M McKinstry
Director
13th June 2013

The notes on pages 48 to 62 form part of these financial statements.

COMPANY BALANCE SHEET

	Note	2012 £'m	2011 £'m
FIXED ASSETS			
Tangible assets	12	0.0	0.0
Investments	14	67.2	67.2
		67.2	**67.2**
CURRENT ASSETS			
Debtors: Amounts falling due within one year	16	34.4	33.9
Cash at bank and in hand		0.2	0.0
Total current assets		**34.6**	**33.9**
Creditors: Amounts falling due within one year	17	(27.4)	(26.1)
Net current assets		**7.2**	**7.8**
Total assets less current liabilities		**74.4**	**75.0**
Creditors: Amounts falling due after one year	17	0.0	0.0
Net assets		**74.4**	**75.0**
CAPITAL AND RESERVES			
Called up share capital	20	69.8	69.8
Profit and loss account	21	4.6	5.2
Shareholders' funds	**22**	**74.4**	**75.0**

The financial statements were approved by the Board of Directors on 13th June 2013 and are signed on its behalf by:

W F M McKinstry
Director
13th June 2013

Company registration number: 05366077

The notes on pages 48 to 62 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

	Note	2012 £'m	2011 £'m
NET CASH FLOW FROM OPERATING ACTIVITIES	**23**	**31.6**	**26.7**
RETURNS ON INVESTMENT AND SERVICING OF FINANCE			
Interest paid		(16.8)	(17.1)
Interest received		0.2	0.3
Preference share dividends paid		0.0	0.0
Dividends received		0.0	0.0
		(16.6)	**(16.8)**
Taxation		**0.0**	**0.0**
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Purchase of tangible fixed assets		(12.6)	(12.3)
		(12.6)	**(12.3)**
ACQUISITIONS AND DISPOSALS			
Net cash disposed of with subsidiaries		(2.6)	0.0
Sale of subsidiary undertaking		22.0	0.0
		19.4	**0.0**
Ordinary share dividends paid		**(46.0)**	**0.0**
Net cash (out)/in flow before financing		**(24.2)**	**(2.4)**
FINANCING			
Redemption of equity shares		0.0	0.0
Repayment of loan from parent		0.0	0.0
Issue of bond (net of issue costs)		0.0	0.0
(Repayment)/Receipt of loan to bank		(5.0)	10.0
		(5.0)	**10.0**
(Decrease)/Increase in cash in period	**24**	**(29.2)**	**7.6**

The notes on pages 48 to 62 form part of these financial statements.

NOTES FORMING PART OF THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

These financial statements are prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards. The principal accounting policies are set out below.

BASIS OF PREPARATION

The consolidated financial statements incorporate the financial statements of Kellen Investments Limited, Kellen Acquisitions Limited, Phoenix Energy Holdings Limited, Phoenix Distribution Holdings Limited, Phoenix Natural Gas Limited, Phoenix Energy Services Limited and Phoenix Natural Gas Finance plc for the year ended 31 December 2012 and Phoenix Supply Limited and Phoenix Energy Limited up to the date of sale on 22nd June 2012.

All subsidiaries are accounted for using the acquisition method of accounting and the profit and loss account and statement of cash flows of the Group included the results and cash flows of subsidiaries from the date of acquisition to the period end. All transactions between the businesses of the Group have been eliminated in the preparation of the consolidated financial statements.

GOING CONCERN

As highlighted in note 17 to the financial statements, the Group is financed through bank debt loan facilities and bond finance to support continued investment in its infrastructure assets and to meet its general working capital requirements. This debt facility is due for renewal in August 2014 and the bond due for redemption in 2017.

The Group's forecasts and projections, taking account of reasonable levels of possible changes in trading performance, show that the Group is capable of operating well within the level of its current facilities and also able to meet all its covenant requirements until they mature.

As a result of the above the directors consider it appropriate to prepare the financial statements on a going concern basis.

REVENUE RECOGNITION

Turnover represents the invoiced value of goods supplied during the year excluding value added tax and intra group sales. Revenue includes an assessment of energy and transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenue received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services.

Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under recovery.

DEFERRED TAXATION

Deferred tax is recognised in respect of:

1/ Material timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date, and

2/ Tax losses not group relieved in the current period. Timing differences are differences between the company's taxable profit and its results as stated in the financial statements.

Deferred tax assets and liabilities recognised have not been discounted.

INVESTMENTS

Investments held by the company in subsidiary undertakings are stated at cost less amounts written off.

TANGIBLE FIXED ASSETS

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis, beginning with the year following expenditure, over the expected useful economic lives of the assets concerned.

The economic lives used are as follows:

	Years
Distribution mains	60
Distribution services	35
Distribution meters	20
Office equipment and fixtures & fittings	5

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

INTANGIBLE FIXED ASSETS

Intangible fixed assets comprise the value attributed to the various licences acquired with Phoenix Natural Gas Limited. These are being amortised over the distribution licence recovery period of 40 years.

DEBTORS

Debtors are stated after provision has been made against all debts considered doubtful of collection.

PENSIONS

The Group operates two defined contribution pension schemes and costs are accounted for on the basis of charging the pension costs over the period during which the Group will benefit from the employee's services.

INTEREST BEARING BORROWINGS

Immediately after issue, the debt is stated at the fair value of the consideration received on the issue of the capital instrument after deduction of finance costs. These costs are allocated to the debt over the term of the debt at a constant rate of the carrying amount.

STOCKS

Stock has been valued at the lower of cost and net realisable value.

GOVERNMENT GRANTS

The European Regional Development Grant relates specifically to capital expenditure on the high pressure distribution pipeline and is treated as deferred income which is then credited to the profit and loss account over the related asset's useful life.

OPERATING LEASES

Costs in respect of operating leases are charged on a straight line basis over the lease term.

CLASSIFICATION OF FINANCIAL INSTRUMENTS ISSUED BY THE GROUP

Financial instruments issued by the Group are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

a) they include no contractual obligations upon the company (or Group as the case may be) to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the company (or Group); and

b) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes a legal form of the company's own shares, the amounts presented in these financial statements are called up share capital and share premium account exclude amounts in relation to those shares.

Where a financial instrument that contains both an equity and a financial liability component exists these components are separated and accounted for individually under the above policy. The finance cost on the financial liability component is correspondingly higher over the life of the instrument.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholder fund (see dividends policy), are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

CASH LONG TERM INCENTIVE PLAN

The Kellen Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

DIVIDENDS ON SHARES PRESENTED WITHIN SHAREHOLDERS' FUNDS

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they

NOTES (CONTINUED)

1. ACCOUNTING POLICIES (continued)

are appropriately authorised and are no longer at the discretion of the company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

2. ANALYSIS OF TURNOVER

The Group's turnover, profits and net assets all relate to the business of gas distribution in Northern Ireland and gas supply in both Northern Ireland and the Republic of Ireland together with the provision of energy services predominantly for the gas industry. Details of each of its separate business activities are provided within the Financial and Divisional Reviews on pages 16 to 34.

3. NET OPERATING EXPENSES

Net operating expenses were all considered to be administrative expenses.

4. OPERATING PROFIT

This is stated after charging/(crediting):	Group 2012 £'m	Group 2011 £'m
Depreciation – owned assets	6.5	6.2
Amortisation of intangible assets	3.1	3.2
European Regional Development Grant release	(0.1)	0.0
Operating lease rentals	1.0	0.9
Auditors' remuneration	0.1	0.1

The auditors' remuneration in respect of the individual Company accounts amounted to £4k, (2011: £4k). KPMG Belfast were paid £nil for non-audit related services to the Group during the year, (2011: £13k).

NOTES (CONTINUED)

5. EMPLOYEE INFORMATION

The average number of persons employed by the Group (including executive directors) analysed by category during the period was as follows:

	Group 2012 No	Group 2011 No
Operational	114	125
Administration	84	92
	198	**217**

The aggregate staff costs of these persons were as follows:

	Group 2012 £'m	Group 2011 £'m
Wages and salaries	6.8	6.7
Social security costs	0.8	0.8
Other pension costs	0.6	0.6
	8.2	**8.1**

6. DIRECTORS' REMUNERATION

	Group 2012 £'m	Group 2011 £'m
Emoluments	1.0	1.0
Amount receivable under long term incentive schemes	0.2	0.2
Company pension contributions	0.1	0.1
	1.3	**1.3**

Details in respect of the highest paid director are as follows:

	Group 2012 £'m	Group 2011 £'m
Emoluments	0.5	0.5
Amount receivable under long term incentive schemes	0.2	0.2
Company pension contributions	0.0	0.0
	0.7	**0.7**

Retirement benefits are accruing to one executive director under a group defined contributon scheme.

The Group operates a long term incentive plan for certain key executives under which the amounts receivable are dependent on the value of the Kellen Acquisitions Limited (KAL) upon the sale of the KAL Group. This plan is treated as cash settled share-based in accordance with the provisions of FRS 20 Share-based Payments and the cost of the expected payment is recognised over the expected period of the plan.

NOTES (CONTINUED)

7. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2012 £'m	Group 2011 £'m
Amounts payable on bank loans and overdrafts	16.4	16.5
Amounts payable on loan notes	0.0	0.0
Other	0.4	0.6
	16.8	**17.1**

8. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2012 £'m	Group 2010 £'m
Bank interest	0.2	0.3
	0.2	**0.3**

NOTES (CONTINUED)

9. TAXATION

	Group 2012 £'m	Group 2011 £'m
Current tax		
UK corporation tax for the year	0.1	0.0
Adjustments relating to earlier years	0.0	0.0
Total current tax	**0.1**	**0.0**
Deferred tax		
Origination/reversal of timing differences	1.6	1.7
Effect in reduction in tax rate	(1.4)	(1.2)
Adjustments relating to earlier years	0.0	0.0
Total deferred tax charge	**0.2**	**0.5**
Total tax charge	**0.3**	**0.5**

The current tax charge for the period is less than (2011: less than) the standard rate of corporation tax in the UK. The differences are explained below:

	2012 £'m	2011 £'m
Current tax reconciliation		
Profit/(Loss) on ordinary activities before tax	19.5	3.2
Current tax at 24.5% (2011: 26.5%)	4.8	0.8
Effects of:		
Non taxable profit on disposal	(5.3)	0.0
Expenses not deductible for tax purposes	1.0	(0.2)
Excess capital allowances	(1.6)	(1.7)
Deferred tax asset not recognised	0.0	0.0
Other permanent differences	1.2	1.1
Total current tax (credit)/charge	**0.1**	**0.0**

Factors that may affect future tax changes:

The UK Budget in 2012 announced that the UK corporation tax rate was to reduce to 21% over a period of three years from 2012. The first reduction in the UK corporation tax rate from 28% to 27% (effective from 1 April 2011) was substantively enacted in July 2010, and further reductions to 26% (effective from 1 April 2011) and 25% (effective from 1 April 2012) were substantively enacted in March 2011 and July 2011 respectively. The Finance Act 2012, which was substantively enacted on 17 July 2012, amended the main rate of corporation tax to 24% effective from 1 April 2012 and to 23% effective from 1 April 2013. This will reduce the group's future current tax charge accordingly. UK deferred tax balances have been calculated based on the rate of 23% substantively enacted at the reporting date.

NOTES (CONTINUED)

10. PROFIT FOR THE FINANCIAL YEAR

As permitted by Section 408 of the Companies Act 2006, the parent company's profit and loss account has not been included in these financial statements. The parent company's profit for the financial period was £45,421k.

11. TANGIBLE FIXED ASSETS (GROUP)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Transmission pipeline £'m	Total £'m
Cost					
At 1 January 2012	2.1	3.2	248.0	0.0	**253.3**
Additions	1.2	(1.1)	12.5	0.0	**12.6**
Disposals	0.0	0.0	(0.3)	0.0	**(0.3)**
At 31 December 2012	3.3	2.1	260.2	0.0	**265.6**
Depreciation					
At 1 January 2012	2.0	1.8	47.0	0.0	**50.8**
Charge for the year	0.4	(0.3)	6.4	0.0	**6.5**
Disposals	0.0	0.0	(0.2)	0.0	**(0.2)**
At 31 December 2012	2.4	1.5	53.2	0.0	**57.1**
Net book value					
At 31 December 2011	0.1	1.4	201.0	0.0	**202.5**
At 31 December 2012	0.9	0.6	207.0	0.0	**208.5**

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SECTION 3 : FINANCIAL STATEMENTS AND NOTES

NOTES (CONTINUED)

12. TANGIBLE FIXED ASSETS (COMPANY)

	Office equipment £'m	Furniture & fixtures £'m	Distribution system £'m	Total £'m
Cost				
At 1 January 2012	0.0	0.0	0.0	**0.0**
Additions	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2012	0.0	0.0	0.0	**0.0**
Depreciation				
At 1 January 2012	0.0	0.0	0.0	**0.0**
Charge for the year	0.0	0.0	0.0	**0.0**
Disposals	0.0	0.0	0.0	**0.0**
At 31 December 2012	0.0	0.0	0.0	**0.0**
Net book value				
At 31 December 2011	0.0	0.0	0.0	**0.0**
At 31 December 2012	0.0	0.0	0.0	**0.0**

13. INTANGIBLE FIXED ASSETS (GROUP)

	Licence £'m	Total £'m
Cost		
At 1 January 2012	127.3	**127.3**
Additions	0.0	**0.0**
Disposals	0.0	**0.0**
At 31 December 2012	127.3	**127.3**
Amortisation		
At 1 January 2012	21.5	**21.5**
Charge for the year	3.1	**3.1**
Disposals	0.0	**0.0**
At 31 December 2012	24.6	**24.6**
Net book value		
At 31 December 2011	105.8	**105.8**
At 31 December 2010	102.7	**102.7**

NOTES (CONTINUED)

14. FIXED ASSET INVESTMENTS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Shares in subsidiary undertakings				
Cost at 1 January	0.0	67.2	0.0	67.2
Preference shares redeemed	0.0	0.0	0.0	0.0
Cost at 31 December	**0.0**	**67.2**	**0.0**	**67.2**
Net Book Value	**0.0**	**67.2**	**0.0**	**67.2**

The Company has ordinary share investments in the following companies at 31 Dec 2012

Company name	Holding	Holding %	Country of incorporation	Activity
Kellen Acquisitions Limited	Direct	100%	Great Britain	Note (iii)
Phoenix Energy Holdings Ltd	Indirect	100%	Great Britain	Note (iii)
Phoenix Distribution Holdings Ltd	Indirect	100%	Great Britain	Note (iii)
Phoenix Natural Gas Ltd	Indirect	100%	Northern Ireland	Note (i)
Phoenix Energy Services Ltd	Indirect	100%	Northern Ireland	Note (ii)
Phoenix Natural Gas Finance plc	Indirect	100%	Northern Ireland	Note (vi)
Belfast Energy Ltd	Indirect	100%	Northern Ireland	Dormant
Belfast Natural Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Gas Ltd	Indirect	100%	Northern Ireland	Dormant
Phoenix Power Ltd	Indirect	100%	Northern Ireland	Dormant
PNG Storage Ltd	Indirect	100%	Northern Ireland	Dormant

Note (i) Phoenix Natural Gas Ltd distributes natural gas to the Greater Belfast area.

Note (ii) Phoenix Energy Services Ltd provides services to Phoenix Natural Gas Ltd. as well as boiler and appliance maintenance services to energy consumers.

Note (iii) Kellen Acquisitions Ltd, Phoenix Energy Holdings Ltd and Phoenix Distribution Holdings Ltd. are intermediate holding companies.

Note (iv) Phoenix Natural Gas Finance plc holds a bond listed on the LSE

All other companies are dormant within the meaning of the Companies Act 2006.

On 16th May 2012, Phoenix Energy Holdings Limited (PEHL) announced that it had entered into an agreement to sell 100% of the share capital of Phoenix Supply Limited, its gas supply business in Northern Ireland and 100% of the share capital of Phoenix Energy Limited, its separate gas supply company operating in the Republic of Ireland, to SSE plc, through its subsidiaries Airtricity (Energy Supply) Northern Ireland Limited & its Republic of Ireland registered subsidiary Airtricity Limited for £19.1m excluding working capital adjustments. This generated a profit within consolidated accounts of £15.9m in 2012.

The sale was completed on 22 June 2012.

NOTES (CONTINUED)

15. STOCKS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Stock of spares and meters	1.2	0.0	1.2	0.0
	1.2	**0.0**	**1.2**	**0.0**

16. DEBTORS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Amounts falling due within one year				
Trade	0.2	0.0	5.1	0.0
Amounts owed by subsidiary undertaking	0.0	29.9	0.0	24.3
Other	0.0	0.0	3.7	0.0
Prepayments and accrued income	17.1	4.5	63.9	9.6
	17.3	**34.4**	**72.7**	**33.9**

NOTES (CONTINUED)

17. CREDITORS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Amounts falling due within one year				
Trade	2.6	0.0	2.2	0.0
Payments in advance	0.0	0.0	31.4	0.0
Amounts owed to subsidiary undertaking	0.0	26.6	0.0	26.0
Other creditors	6.2	0.0	12.3	0.0
Accruals and deferred income	34.2	0.8	48.2	0.1
	43.0	**27.4**	**94.1**	**26.1**
Amounts falling due after one year				
Bank loans	5.0	0.0	10.0	0.0
Bond	270.4	0.0	269.3	0.0
	275.4	**0.0**	**279.3**	**0.0**
Amounts falling due after one year: analysis				
Amounts falling due between one and two years				
Bank loans	0.0	0.0	0.0	0.0
	0.0	**0.0**	**0.0**	**0.0**
Amounts falling due between two and five years				
Bank loans	5.0	0.0	10.0	0.0
Bond	270.4	0.0	0.0	0.0
	275.4	**0.0**	**10.0**	**0.0**
Amounts falling due after five years	0.0	0.0	269.3	0.0
	0.0	**0.0**	**269.3**	**0.0**

- There were no committed undrawn borrowing facilities.
- The Group's borrowings are denominated in sterling.
- The Bonds issued by its subsidiary, Phoenix Natural Gas Finance plc, are guaranteed by Phoenix Natural Gas (PNG) and Phoenix Distribution Holdings (PDHL) whilst the bank debt facilities entered into by PNG are also guaranteed by PDHL. The PDHL guarantees are supported by security over PDHL's assets, principally shares in PNG and an assignment of undertakings from the investors in Kellen Investments Limited (KIL) to PDHL supported by their shares in KIL.
- The bond issued is repayable in 2017 and carries a fixed coupon rate of 5.5% per annum payable quarterly. The £270.4m repayable within 2 to 5 years is stated after deducting issue costs of £8.0m and the addition of amortised loan issue costs of £3.4m.

NOTES (CONTINUED)

18. PROVISIONS FOR LIABILITIES AND CHARGES

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Deferred taxation				
Accelerated capital allowances	(17.3)	0.0	(17.4)	0.0
Short term timing differences	0.8	0.0	1.1	0.0
	(16.5)	**0.0**	**(16.3)**	**0.0**
Deferred tax liability				
At 1 January 2012	**(16.3)**	**0.0**	**(15.8)**	**0.0**
(Charged)/credited to profit and loss account	(0.2)	0.0	(0.5)	0.0
At 31 December 2012	**(16.5)**	**0.0**	**(16.3)**	**0.0**

19. DEFERRED INCOME

	Group £'m	Company £'m
ERD grant received		
At 1 January 2012	2.5	0.0
Credit to profit and loss account	(0.1)	0.0
At 31 December 2012	**2.4**	**0.0**

20. CALLED UP SHARE CAPITAL

	2011 £	2010 £
Allotted and fully paid:		
Ordinary shares of £1 each	49,752,705	49,752,705
A Ordinary shares of £1 each	20,076,752	20,076,752

Ordinary shares each carry one vote. A ordinary shares are non voting.

NOTES (CONTINUED)

21. RECONCILIATION OF MOVEMENTS IN RESERVES

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Revenue reserves brought forward	(33.3)	5.2	(36.0)	3.6
Profit for the financial year	19.2	45.4	2.7	1.6
OSC Dividend paid	(46.0)	(46.0)	0.0	0.0
Revenue reserves carried forward	**(60.1)**	**4.6**	**(33.3)**	**5.2**

22. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Opening shareholders' funds	36.5	75.0	33.8	73.4
Profit/(loss) for the financial year	19.2	45.4	2.7	1.6
OSC dividends paid	(46.0)	(46.0)	0.0	0.0
Closing shareholders' funds	**9.7**	**74.4**	**36.5**	**75.0**

23. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Group 2012 £'m	Group 2011 £'m
Operating profit/(loss)	**20.2**	**20.1**
Release of ERDF Grant	(0.1)	0.0
Depreciation	6.5	6.2
Goodwill amortisation	3.1	3.2
(Increase)/decrease in stocks	0.0	0.0
(Increase)/decrease in debtors	(24.3)	3.8
Increase/(decrease) in creditors	26.2	(6.6)
Net cash flow from operating activities	**31.6**	**26.7**

Effects of disposal of subsidiary undertaking:

	£'m
Working capital	5.9
Cash and cash equivalents	(2.6)
Surplus on disposal	15.9
Consideration (cash)	19.2

The disposal of subsidiaries contributed £13m to the net operating cash flows and paid £0.2m in respect of returns on investment and servicing of finance.

NOTES (CONTINUED)

24. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	Group 2012 £'m	Group 2011 £'m
(Decrease)/increase in cash in period	**(29.2)**	**7.6**
Decrease/(increase) in loan from Parent	0.0	0.0
Increase in bond debt	0.0	0.0
Decrease/(Increase) in bank loan	5.0	(10.0)
Movement in net debt resulting from cashflows	**(24.2)**	**(2.4)**
Non cash adjustment - amortisation of bond issue costs	(1.1)	(1.0)
Non cash adjustment - collateralised cash security	1.7	2.3
Movement in net debt during the year	**(23.6)**	**(1.1)**
Opening net debt	(234.5)	(233.4)
Closing net debt	**(258.1)**	**(234.5)**
Analysed as follows		
Bank loans > 1 year	(5.0)	(10.0)
Bond	(270.4)	(269.3)
Loan from parent	0.0	0.0
Cash at bank and in hand*	17.3	44.8
Closing net debt	**(258.1)**	**(234.5)**

*Cash at bank and in hand does not include £nil (2011: £1.7m) which is held in collateral and does not meet the definition of cash within FRS1 (cash flow statements)

25. PENSION COMMITMENTS

The group operates two pension schemes:

a. Group Personal Pension Scheme A – this is a defined contribution scheme set up to accommodate members transferring from the Water Companies' Pension Scheme. Enhanced employer contributions are made so as to align forecast benefits with those that would otherwise have accrued under the defined benefit Water Companies' Pension scheme. Separate life assurance is provided and paid by the company for all of these employees.

b. Group Personal Pension Scheme B – this is a defined contribution scheme which the company contributes directly towards. Separate life assurance is provided and paid by the company for all of these employees.

The total contributions to the above schemes during the year were £0.6m (2011: £0.6m).

NOTES (CONTINUED)

26. CAPITAL COMMITMENTS

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Capital expenditure				
Contracted but not provided for	2.6	0.0	3.0	0.0

27. CONTINGENT LIABILITIES

At 31 December 2012 the Group and company had no contingent liabilities (31 December 2011: £Nil). At the year end bank and cash balances totalling £nil (2011: £1.7m) were collateralised in respect of ongoing contractual obligations.

28. FINANCIAL COMMITMENTS

At 31 December 2012 the Group and company had annual commitments under non-cancellable operating leases expiring as follows:

	Group 2012 £'m	Company 2012 £'m	Group 2011 £'m	Company 2011 £'m
Motor Vehicles				
Within one year	0.0	0.0	0.1	0.0
Within two to five years	0.2	0.0	0.4	0.0
After five years	0.0	0.0	0.0	0.0
	0.2	**0.0**	**0.5**	**0.0**
Property				
Within one year	0.0	0.0	0.0	0.0
Within two to five years	0.5	0.0	0.5	0.0
After five years	0.0	0.0	0.0	0.0
	0.5	**0.0**	**0.5**	**0.0**

29. RELATED PARTY DISCLOSURES

As at 31 December 2012 the company owed its immediate parent and controlling company, Carmel Capital II Sarl, £nil (2011: £nil). Interest payable on the loan note during the year was £nil (2011: £nil).

Advantage has been taken of the exemption contained in FRS 8 not to disclose transactions or balances with entities which form part of the consolidated Group.

30. ULTIMATE CONTROLLING PARTY

The immediate parent company and controlling company is Carmel Capital II Sarl, a company incorporated in Luxemburg, with registered office address 41 Boulevard du Prince Henri, L- 1724 Luxembourg. Group accounts are not prepared at this level.

The directors regard TFCP Capital Investments Limited to be the ultimate parent company and Guy Hands to be the ultimate controlling party.

31. COMPARATIVE AMOUNTS

Turnover and cost of sales have been adjusted to eliminate the effect of the elimination of intercompany trading for discontinued activities in order to enable comparison with the current year.

OTHER INFORMATION

Directors
G P Greener - Chairman
P V Dixon - Group Chief Executive Officer
W F M McKinstry - Group Finance Director
L Levi
G Loughran
S Kassam
L Woods

Secretary
Taylor Wessing Secretaries Limited

Auditors
KPMG
17/25 College Square East
Belfast
BT1 6DH

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

Registered office
5 New Street Square
London
EC4A 3TW

Kellen Investments Limited
Registered in England and Wales
Company Registration Number: 05366077

KG KELLEN GROUP

KELLEN GROUP

Kellen Investments Limited

197 Airport Road West

Belfast

BT3 9ED

Telephone: 08454 55 55 55

Fax: (028) 9055 5500

Email: info@phoenixgroupni.com

Web: www.phoenixgroupni.com