

POWERGEN LIMITED

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2003

Registered No: 3586615

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003

The directors present their report and the consolidated accounts of Powergen Limited (described herein also as 'Powergen' and 'the Company') for the year ended 31 December 2003.

Activities

The Company is the holding company of a Group ('the Group', being Powergen and its subsidiaries) whose principal activities are the generation, distribution, retailing and trading of electricity and the shipping, retailing and trading of gas. The Group's main activities during the year under review were located in the United Kingdom ('UK') with other residual international investments. On 1 March 2003 Powergen sold its US Operations, LG&E Energy Corp. and its subsidiaries (together 'LG&E'), which operates in the mid west region of the United States ('US') to E.ON US Holdings GmbH, through the disposal of its shareholding in LG&E's immediate holding company, E.ON US Investments Corp. Proceeds for the disposal totalled \$1,800 million (£1,142 million) resulting in a profit on disposal of £942 million which has been treated as exceptional in these accounts .

Powergen's aim is to maintain its position as a leading integrated player in the UK's electricity and gas markets. Powergen's strategy in the UK is to build on its current position, to sustain and develop its distribution and generation asset businesses and build competitive trading and retail businesses.

On 16 January 2004 Powergen completed the acquisition of the distribution business of Midlands Electricity from Aquila Sterling Holdings LLC for £1,173 million (including net debt acquired and acquisition costs). This effectively doubled the size of Powergen's distribution business, which will be operated as a single business unit under the name Central Networks.

Powergen also acquired a number of other businesses in the transaction. These include an electrical contracting operation and an electricity and gas metering business in the UK as well as minority equity stakes in companies operating three generation plants located in the UK, Turkey and Pakistan. Powergen is currently involved in a process to divest the overseas investments.

In addition, during 2003 Powergen acquired Edenderry Power Limited, which operates a 120 MW peat fired power station plant in the Republic of Ireland for £9 million from Ruhrgas Holdings GmbH, a fellow E.ON group undertaking.

A description of the development of the business during the financial year under report and the outlook for the future is given below and in the subsequent section headed 'Financial Review'. The following section includes information about the Group's research and development ('R&D') activities.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

UK Operations

Powergen is one of the UK's leading integrated electricity and gas companies, with a business built on:

- Marketing and selling electricity, gas, telecoms and other services to residential and business customers
- Asset management in electricity production and distribution
- Energy trading to support these activities.

Retail

Powergen sells electricity, gas, fixed line telecommunications and other services to three customer segments: residential, business and large industrial customers throughout the UK. At 31 December 2003, Powergen supplied 8.7 million customer accounts, of which 8.6 million were residential and small and medium sized business customer accounts and 0.1 million industrial customer accounts. Powergen continues to focus on reducing the costs of its retail business through improved business efficiencies, better procurement of services and through utilisation of lower cost sales channels.

Residential and small and medium sized business customers

67 per cent of Powergen's residential customer accounts are electricity customers, 31 per cent are gas customers and 2 per cent are fixed line telephone customers. Individual retail customers who buy more than one product (i.e. electricity, gas or fixed line telephone services) are counted as having a separate account for each product, although they may choose to receive a single bill for all Powergen-provided services.

Powergen targets residential and small and medium sized business customers through national marketing activity such as media advertising (including print, television and radio), targeted direct mail, public relations and online campaigns. Powergen also seeks to continue to exploit the high level of national awareness of its brand and has taken steps to enhance the strength of its brand, including the sponsorship of high profile national sports competitions such as the Powergen Cup in both Rugby Union and Rugby League. Powergen is also the main sponsor for Ipswich Town, an English First Division football team.

Powergen announced price rises to its residential customers for gas and electricity in November 2003, which came into effect in January 2004. These price increases were attributable to rising wholesale energy prices seen in the UK marketplace which has also encouraged other energy suppliers to raise prices during 2003. Powergen has delayed the impact of the rises to some of its financially disadvantaged and elderly customers. A further restructuring of prices, including the abolition of standing charges was announced on 1 June 2004, effective from 6 September 2004.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

The acquisition of the TXU Group's UK retail business in 2002 more than doubled the size of Powergen's retail business. Powergen has completed the integration of the former TXU operations with its own retail activities and has rebranded the former TXU services under the Powergen brand. The integration process included the re-negotiation of TXU's contract with Vertex, a division of United Utilities plc. This renegotiation secured cost savings in the provision of call related support, billing and collection services to the TXU retail customers.

Industrial & Commercial

In the industrial and commercial sector, Powergen sold 33TWh of electricity and 36 TWh of gas in 2003. The focus of this area of the business remains in retaining and acquiring the most profitable contracts in the market

Generation

Powergen focuses on maintaining a low cost, efficient and flexible electricity generation business in order to compete effectively in the wholesale electricity market. At 31 December 2003, Powergen owned either wholly, or through joint ventures, power stations in the UK with an attributable registered generating capacity of 9,614 MW, including 613 MW of CHP plants and 50 MW of hydroelectric plant. Powergen's attributable portfolio of operational wind capacity stood at 106 MW at the same date.

Powergen's UK plant generated 35.9TWh during 2003, an increase of 6.8 per cent on the 33.6TWh generated in 2002. Powergen's share of the generation market in England and Wales remained relatively stable in 2003 at approximately 11 per cent. The three plants for which control was acquired from TXU in October 2002 did not have a significant impact on Powergen's market share position as two of the three stations were closed in March 2003.

Powergen generates electricity from a diverse portfolio of fuel sources. In 2003, 65 per cent of Powergen's electricity output (excluding CHP) was fuelled by coal and approximately 34 per cent by gas, the remaining 1 per cent being generated from hydroelectric, wind and oil-fired plants. Powergen is continuing its effort to secure a balanced and diverse portfolio of fuel sources, giving it the flexibility to respond to market conditions and to minimise costs.

In October 2002, Powergen announced its intention to mothball the remaining two oil-fired units at Grain and the remaining gas-fired module at Killingholme. One of the Grain units was withdrawn immediately. In March 2003, Powergen closed High Marnham and Drakelow C, two old and inefficient coal stations for which control was acquired from TXU, and mothballed the remaining modules at Killingholme and Grain. By December 2003, two oil-fired units at Grain had been returned to service following the recovery of wholesale power prices during the latter half of the year, while both modules at Killingholme were operating in limited open cycle mode (600MW) under a standing reserve contract with National Grid Transco plc. Powergen regularly monitors the economic status of its operational and mothballed plant and will react to future movements in the market accordingly.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

Renewable Energy

Powergen plans to grow its renewable generation business in response to recent UK government and regulatory initiatives. Since 1999, Powergen's wind generation projects have been developed by Powergen Renewables Limited, which was initially a joint venture with Abbot Group plc ('Abbot'). Given the importance of renewable generation growth in Powergen's overall strategy, Powergen bought out Abbot's share in the joint venture in October 2002. Powergen is already one of the UK's leading developers and owner/operators of wind farms, with interests in 15 operational onshore and offshore wind farms in the UK and Ireland with total capacity of 118 MW, of which 106 MW is attributable to Powergen. As a part of its balanced approach, Powergen seeks to fulfil its renewables obligation through a combination of its own generation and renewable energy purchased from other tradable Renewable Obligation Certificate ('ROC') generators under contract and direct payment of any residual obligation into the buyout fund. During the period April 2002 to March 2003, Powergen achieved its 3% renewable obligation.

During 2003, Powergen began construction of a large major offshore wind farm at Scroby Sands (60MW) building on the success of completing the UK's first offshore wind farm at Blyth during 2001. Further onshore wind projects totalling 16 MW are currently under construction and 755 MW of wind schemes are in the development phase. Powergen's development strategy is now focused on larger capacity (greater than 15MW) schemes rather than small-scale wind and hydro projects in order to maximise the renewables capacity and optimize development focus. In addition to the wind portfolio Powergen is evaluating dedicated biomass developments and has obtained permission from the Environment Agency to co-fire biomass materials at Kingsnorth, Ironbridge and Ratcliffe power stations which in total generated 39 GWh of renewables output during 2003.

CHP

Powergen also operates large-scale combined heat and power (CHP) schemes. CHP is an energy efficient technology which recovers heat from the power generation process and uses it for industrial processes such as steam generation, product drying, fermentation, sterilizing or heating. Powergen's total operational CHP electricity capacity is 613 MW with clients ranging across a number of sectors, including pharmaceuticals, chemicals, paper and oil-refining. One project with a total capacity of 30 MW is in the final stage of commissioning.

Distribution

Central Networks East plc (formerly East Midlands Electricity Distribution plc, 'EME') and the newly-acquired Midlands Electricity plc, both wholly owned subsidiaries of Powergen UK plc, own, manage and operate two electricity distribution networks servicing the East and West Midlands areas of England, respectively. The combined service areas cover approximately 11,200 square miles, extending from the Welsh border in the West to the Lincolnshire coast in the East and from Chesterfield in the North to the northern outskirts of Bristol in the South and containing a resident population of approximately 10 million people. The networks distribute electricity to approximately 4.8

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

million homes and businesses in the combined service areas, and virtually all electricity supplied to consumers in the service areas (whether Powergen's retail business or by other suppliers) is transported through the EME or Midlands Electricity distribution network.

Powergen has initiated an integration process for the EME and Midlands Electricity distribution businesses which it expects to result in more efficient operations as well as cost savings. Powergen intends to manage the two distribution networks in a single business, to be called "Central Networks." This combined business will be managed by a centralised management team at Powergen but will maintain the current, separate distribution licences.

The Electricity Price Control Review (DR4) has commenced and will run throughout 2004. The Price Control Review will set the allowed revenue, allowed capital and performance targets for the distribution businesses for five years from April 2005. Powergen is expecting final proposals from Ofgem in November 2004 to be effective from 1 April 2005.

Energy Trading

Energy Trading is at the centre of Powergen's integrated electricity and gas business in the UK. It engages in asset-based energy marketing in gas and electricity markets to assist in the commercial risk management and optimisation of both UK electricity and gas assets and to manage the price and volume risks associated with the UK retail business. The business also co-ordinates market actions within the UK business and seeks to maximise the value from generation and customer assets. Powergen's plant portfolio is strictly monitored and controlled to ensure that changing levels of exposure are appropriately managed.

Powergen also engages in a controlled amount of proprietary trading in gas, power, coal and oil markets in order to take advantage of market opportunities and maintain the highest levels of market understanding required to support optimisation and risk management activities. In 2003, proprietary trading gross volumes totalled 40.4TWh in power (2002: 45.6TWh) and 10.5 billion therms of gas (2002: 10.1 billion therms)

Other activities

The UK Services business provides a single shared service function delivering IT, facilities management, HR, procurement, insurance, property and finance support for all of Powergen's UK operations.

Powergen's engineering and scientific development activities, carried out at its Powertechnology Centre, are focused on supporting the Company's strategic business objectives and technology challenges through delivery of R&D programmes, providing innovative services and products and growing profitable new income streams.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

Asian Asset Management

In 2003, Powergen continued divestment of its Asian asset management business, which consisted of joint venture equity and operating interests in independent power production ("IPP") activities in India, Australia and Indonesia. By 31 December 2003, Powergen had completed the sale of its interests in operating plants in India and Australia, together with a development project in Thailand to CLP Power International. It had also concluded a bidding process for the sale of its only remaining Asian interest being a 35 per cent of PT Jawa Power, owner of a 1,220 MW plant at Paiton in Indonesia, and 100 per cent of the associated operating and maintenance company. The sale of this interest is expected to complete before the end of 2004.

Results and dividends

The profit before taxation for the year ended 31 December 2003 was £1,191 million an increase of £1,290 million on the loss for the year to 31 December 2002 of £99 million.

The directors do not recommend the payment of a dividend for the year. Dividends amounting to 18.4p per ordinary share were paid for the year ended 31 December 2002.

After a tax charge of £26 million and a charge from minority interests of £1 million the profit for the year amounted to £1,164 million (2002 £130 million loss).

Directors and their interests

During the year and subsequent to the year end, the following directors have served on the Board.

	Date of appointment*	Date of resignation
Dr Paul Golby		
Graham Bartlett	30/01/2004	
Graham Wood	22/03/2004	
Dr Wulf Bernotat	01/05/2003	30/01/2004
Michael Söhlke		22/03/2004
Victor Staffieri		30/01/2004
Ulrich Hartmann		30/04/2003
Edmund Wallis		17/07/2003
Dr Hans Michael Gaul		17/07/2003
Dr Hans Dieter Harig		17/07/2003
Professor Rainer Elsässer		17/07/2003
Thomas Oates		17/07/2003
Peter Wilson		17/07/2003

* if either during the year or subsequent to the year end.

Information on directors' emoluments is given in Note 4 to the Accounts, on page 39.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

No director had, at any time during the period under report, any interest in the shares of the Company or any subsidiary undertaking. At 31 December 2003 and 31 December 2002 no director had any interest requiring disclosure in these accounts.

Employees

The Company provides an environment in which communication is open and constructive. There are well-established arrangements for communication and consultation with employees and their representatives at local and Company level which covers a wide range of business and employment issues including those considered by the E.ON European Works Council, which provides a forum for consultation on major issues affecting E.ON Group companies in Europe.

Powergen is committed to offering equal opportunities to both current and prospective employees. The Company continues to review and develop best practices and procedures to ensure that all staff are treated fairly in all aspects of employment. It also strives for a diverse environment that is supportive of all staff. Individual differences which do not relate to job performance such as gender, marital status, sexual orientation, race, colour, ethnic origin, nationality, religion, age or disability are respected.

Powergen believes in ensuring that disabled people can compete fairly for job opportunities, training and development, through the promotion and development of best practices. Links and contacts with external disability networks and organisations are maintained to identify best practices in the employment of people with disabilities. In the event of existing employees becoming disabled, Powergen will seek to maintain their employment through training, redeployment and adjustments to the job role and workplace, where it is reasonable and practicable to do so.

Training and development of staff remains a key priority in achieving Powergen's growth strategy and ensuring that all staff perform at the highest level.

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by Powergen and its UK subsidiaries amounted to £41,418. The decrease from the prior year value of £150,872 is due to the timing of payments as opposed to a reduction in donation values. No political donations were made.

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

Policy on payment of creditors

Where appropriate in relation to specific contracts, the Company's practice is to:

- a) settle the terms of payment with the supplier when agreeing the terms of each transaction;
- b) ensure that those suppliers are made aware of the terms of payment by inclusion of other relevant terms in the contracts; and
- c) pay in accordance with its contractual and other legal obligations.

In the UK, the Company supports the Better Payments Practice Code and has in place well developed arrangements with a view to ensuring that this is observed in all other cases. Group companies operating overseas are encouraged to adopt equivalent arrangements by applying local best practices.

The average number of days taken to pay the Company's trade suppliers calculated in accordance with the requirements of the Companies Act is 45 days for the UK business (31 December 2002: 29 days).

Introduction of the Euro

The Powergen Group recognises the wide implications of the Euro for businesses, including impacts on commercial arrangements and financial systems. In the UK, the Powergen Group's preparations recognise the uncertain position regarding possible UK entry to the single currency, and the situation is monitored closely.

Going Concern

The Board has reviewed the Group's budget and cash flow forecasts for the year ended 31 December 2004 and the outline projections for the two subsequent years. The directors confirm that they have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing the Company's consolidated financial statements.

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss of the Group for that year. In preparing those financial statements, the directors are required to:

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

POWERGEN LIMITED

Directors' report for the year ended 31 December 2003 (continued)

- d) 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 proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The directors believe that they have fulfilled their responsibilities.

Auditors

On 15 September 2003, the Company passed an elective resolution dispensing with the requirement to appoint auditors annually. Therefore PricewaterhouseCoopers LLP will continue in office.

By order of the Board

Fiona Stark
Company Secretary
Powergen Limited
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
23 June 2004

POWERGEN LIMITED

Financial review for the year ended 31 December 2003

This review is designed to give further financial information concerning the Powergen Group results for the year.

Overview

2003 was a year of consolidation for Powergen following the completion of the acquisition of the Powergen Group by E.ON AG on 1 July 2002 and the acquisition of the TXU retail business on 21 October 2002 which has enabled Powergen to become the UK's largest retail electricity supplier and the second largest in the whole retail energy sector. During 2003 the TXU business has been fully integrated into the existing UK structure.

On 1 March 2003 Powergen's US Operations were sold to E.ON US Holdings GmbH for proceeds of \$1,800 million and consequently the US Operations are classified as discontinued activities in these accounts. A significant profit arose as a result of this sale, further details of which are set out in note 3 to the financial statements. The results from US Operations included in these accounts therefore represent two months trading in 2003 compared with twelve months trading in 2002.

Accounting Policies

There have been no significant changes in accounting policies during the year.

Group financial results

Profit before tax and exceptional items for the year ended 31 December 2003 was £371 million, compared to £332 million for the same period last year. The profit before tax was £1,191 million compared with a loss of £99 million for the previous twelve months.

Turnover

Group turnover grew by £753 million during the year to £7,057 million, an increase of 12 per cent. Turnover in the UK increased by almost 45 per cent which was primarily due to the inclusion of a full year's trading from the ex-TXU retail business which was acquired in October 2002. There was no group turnover during 2003 in Asian Asset Management following the sale of the controlling stake in GPEC (India) during February 2002. Sales from US Operations include two months trading in 2003 compared with twelve months in 2002.

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

Turnover is further analysed below:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	2,282	2,104
Electricity – distribution	303	289
Electricity and gas – retail	4,324	2,417
Internal charges from distribution to retail	(137)	(125)
	6,772	4,685
Asian Asset Management	-	15
Continuing activities	6,772	4,700
US Operations – discontinued activities	285	1,604
	7,057	6,304

Operating Costs

Details of the Group's operating costs are set out in note 2 to the financial statements. The figures are summarised below.

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Fuel costs	444	784
Power purchases and other costs of sales	5,131	3,676
Staff costs	248	341
Depreciation, including exceptional charges	184	379
Goodwill amortisation	194	169
Other operating charges, including restructuring and other exceptional charges	708	967
	6,909	6,316

Total fuel costs within the Group fell from £784 million to £444 million. This figure comprised £75 million in respect of US Operations and £369 million in respect of UK Operations. The overall fall was principally the result of the disposal of the US Operations.

In the UK, power purchases and other costs of sales continued to include the cost of electricity purchased to meet customer sales obligations, charges from the National Grid Transco Group and Regional Electricity Companies for the use of their transmission and distribution systems, and costs of the gas trading and retail businesses. In the US, they included purchased power, fuel purchased

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

for resale and related costs. The increase of £1,455 million in costs during the year again primarily reflected the inclusion of a full year's power purchases and other costs from the ex-TXU retail business in the UK, partly offset by the disposal of the US Operations.

Staff costs at £248 million were 27 per cent lower than in the previous year, despite the acquisition of 1,900 staff with the TXU business in October 2002. Costs primarily fell due to the disposal of the US Operations (£114 million). Staff numbers at 31 December 2003 totalled 6,559 of whom 6,188 were in the UK and 371 in Asian Asset Management and the Corporate Centre.

The Group's depreciation charge for the year fell by £195 million compared with the previous 12 months. However, the figure for 2002 included £94 million of exceptional impairment charges relating to Powergen's subsidiary undertaking in Argentina. The 'underlying' annual charge was therefore £184 million in 2003 compared with £285 million in 2002. This fall was principally due to the disposal of the US Operations.

Goodwill amortisation rose from £169 million in 2002 to £194 million in 2003. The increase was primarily due to the acquisition of TXU, which represented £90 million of the increase during the year, together with £2 million in respect of the UK Renewables acquisition in late 2002 offset by the disposal of the US Operations (£67 million).

Other operating charges included the costs of running the UK, and Asian Asset Management businesses and the supporting corporate infrastructure. Major business costs included maintenance and overhaul costs at power stations, business rates and insurance costs. The 2003 figure of £708 million includes £123 million of exceptional costs relating to business restructuring in the UK following the integration of TXU into Powergen. The 2002 figure of £967 million includes £296 million of exceptional costs relating to onerous contracts in the US together with restructuring initiatives across the group. The resulting underlying fall from £671 million to £585 million is primarily attributable to the disposal of the US Operations.

Operating income

Other operating income was £112 million compared with £111 million in the year to 31 December 2002. The 2003 figure includes £100 million of deferred warranty income as part of the disposal arrangements for Fiddler's Ferry and Ferrybridge C power stations in July 1999. The warranty income is recognised as Powergen agreed to provide services associated with a major parts warranty in respect of future operations, capability and maintenance of each station. The comparable figure in 2002 was also £100 million.

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

Exceptional items

The Group's results include a number of exceptional items totalling a £820 million credit (year ended 31 December 2002 £431 million charge) that are fully disclosed in note 3 to the financial statements.

These exceptionals fell into three main categories:

- Disposal of the Group's US Operations
- UK business integration costs
- International and UK business disposals and write downs

Operating profits

Operating profits including share of associates and joint ventures, but excluding exceptional items, totalled £456 million for the year compared with £603 million in the same period to 31 December 2002.

Within UK Operations, profits increased by £175 million to £583 million. Within this total, wholesale and trading profits fell by £110 million to a £19 million loss, largely due to the impact of higher wholesale purchase costs and higher balancing mechanism participation charges.

The distribution business saw profits increase by £26 million to £155 million. This was due to higher allowed regulatory income together with cost savings reflecting the continuing benefits of a four year cost saving programme completed in 2002.

Within the retail business, profits increased by £316 million to £421 million. This was largely due to profits from the ex-TXU business acquired on 21 October 2002.

There was also a £57 million reduction in lease and other income and charges, largely due to lower gas provisioning requirements following the acquisition of the TXU retail business in October 2002, and a full years cost of central TXU activities absorbed into the combined Powergen business.

Profits from Asian Asset Management totalled £58 million, compared with £65 million in the year to 31 December 2002. Results for the year were split between Paiton, together with its operating and maintenance company, contributing £59 million (2002 £57 million) less central costs and overheads of £1 million (2002 £6 million). The 2002 results also included £14 million from GPEC prior to the sale of the controlling interest.

Corporate costs fell from £22 million in 2002 to £15 million in 2003. This reduction followed a significant reorganisation and reduction in headcount following the E.ON acquisition.

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

A more detailed analysis of operating profits and a reconciliation to profit before tax, is set out below:

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
UK Operations		
Electricity and gas – wholesale and trading	(19)	91
Electricity – distribution	155	129
Electricity and gas – retail	421	105
Lease and other income and charges	26	83
	583	408
Asian Asset Management	58	65
Corporate costs	(15)	(22)
Continuing activities	626	451
US Operations (discontinued activities)	24	321
Goodwill amortisation	(194)	(169)
Operating profit before exceptional items	456	603
Interest costs	(85)	(271)
Exceptional items	820	(431)
Profit/(Loss) before tax	1,191	(99)

Interest costs

Interest costs comprise group interest costs and interest costs for associates and joint ventures. The latter fell from £42 million to £26 million for the year ended 31 December 2003 principally due to the disposal of the US Operations. Group interest costs fell by £170 million from £229 million to £59 million. The prior year cost included £58 million of exceptional charges leaving an underlying fall of £112 million reflecting the lower interest rates in the UK, cheaper financing from E.ON, and the interest benefit from the disposal of the US Operations.

Treasury management

Following the integration of Powergen into the E.ON Group all treasury policies are set centrally by E.ON AG. Powergen, in common with other major E.ON subsidiaries, must comply with E.ON financial management and treasury policies and procedures but must also have its own local operational treasury team which services the treasury requirements of the business. The teams liaise closely with the local business to ensure that liquidity and risk management needs are met within the requirements of the E.ON policies and procedures. The treasury team works closely with the treasury and corporate finance teams at E.ON AG.

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

E.ON has a central department that is responsible for financing and treasury strategy, policies and procedure throughout the E.ON Group. All strategic financings and corporate finance actions are planned and executed by the corporate finance team at E.ON. There is also a treasury team which co-ordinates currency and interest risk management as well as cash management for the whole E.ON Group.

Powergen also operates its own specific board approved treasury procedures within the overall E.ON treasury framework.

E.ON's central financing strategy

E.ON's financing policy is to centralise external financing at the E.ON AG holding company level, and to reduce external debt in subsidiaries wherever possible. E.ON AG has the strongest credit rating in the E.ON Group, and this allows the finest terms for external finance to be negotiated. E.ON AG then funds its subsidiaries with inter-company finance. This finance may be in the form of equity or debt, as appropriate.

The Powergen UK treasury team employs a continuous forecasting and monitoring process to ensure that the Group complies with all its banking and other financial covenants, and also the regulatory constraints that apply to the financing of the UK business. Powergen Treasury works in close liaison with the various operating businesses within the Group, when considering hedging requirements on behalf of their activities. A group-wide cash forecasting and currency exposure reporting process exists which ensures regular reporting into treasury of future positions, both short and medium term. Information is submitted to E.ON for incorporation into E.ON Group forecasting processes on a monthly and quarterly basis

Powergen does not enter into speculative treasury arrangements. Accordingly, all transactions in financial instruments are matched to an underlying business requirement, such as planned purchases or forecast debt requirements. Treasury activities are reviewed by internal audit on an annual basis.

The year end position described in more detail below is representative of the Group's current position in terms of its objectives, policies and strategies. These will continue to evolve as the Group's business develops, in line with the requirements, objectives, policies and strategies of E.ON as the parent company of the Powergen Group.

Foreign exchange risk management

Powergen's principal currency exposure is to the US dollar. Powergen operates within the framework of E.ON's guidelines for foreign exchange risk management. Powergen has local Board approved policies dealing with transaction exposures (typically trading cash flows which impact the profit and loss account) and translation exposures (the value of foreign currency liabilities and assets in the

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

balance sheet). Powergen's policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. Powergen also covers a proportion of forecast foreign currency cash flows, and will also hedge more uncertain cash flows if this is appropriate, using flexible financial instruments that do not commit the Group.

Powergen's policy towards translation exposures is to hedge these exposures where practicable, with the intention of protecting the Sterling net asset value. These hedges are normally achieved through a combination of borrowing in local currency, forward currency contracts or foreign currency swaps.

Where the foreign currency transaction exposure is hedged, the value of the exposure is translated into Sterling at the exchange rate achieved in the associated hedging contracts. Details of the Group's foreign exchange contracts and swaps are set out in note 28 to the accounts.

Interest rate risk management

Powergen operates within the E.ON framework for interest rate risk management. The Powergen Group has a significant portfolio of debt, and is exposed to movements in interest rates. This exposure is to both Sterling and US Dollar interest rates, and Powergen manages these interest rate movements primarily through the use of fixed and floating rate borrowings and interest rate swaps.

Off balance sheet finance

Powergen has minority equity interests in certain joint ventures that are principally financed by debt. In each case the joint venture debt is secured against the assets of the project and has no, or very limited, recourse back to Powergen. Powergen also has small operating lease financings typical for a company of its size.

Liquidity planning, trends and risks

The acquisition of Powergen by E.ON has significantly improved availability of liquidity to Powergen. Powergen has sufficient committed borrowing facilities, through E.ON Group resources, to meet planned liquidity needs, including facilities provided by its parent company E.ON UK Limited at a lower cost than Powergen could achieve externally. Movements in electricity prices have some impact on operating cash flows, and as electricity generation and distribution is a capital intensive business, planned capital spending remains at significant levels. The level of operating cash is affected by the performance of the business, and market prices and margins amongst other things. Some of these factors are outside the Company's control.

Most of Powergen's capital market bond financings do not have financial covenants, but a fall in the credit rating below investment grade could, in some circumstances, require repayment of these bonds.

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

Credit rating

Following the E.ON acquisition, Powergen's credit rating was upgraded to A by Standard and Poor's and to A2 by Moody's. However, following the acquisition of TXU by Powergen in October 2002, Powergen's credit rating was downgraded to A- by Standard and Poor's and A3 by Moody's.

Borrowings and facilities

Details of the bank term facilities available to the Group at 31 December 2003, including the amounts undrawn on the facilities, and their expiry dates are fully set out in note 19 to the accounts. This note also sets out details of the Group's long-term and short-term bonds raised on UK and US capital markets.

At 31 December 2003, the Powergen Group had total borrowings of £3,502 million (31 December 2002 £6,326 million) including £1,573 million of long-term loans and £1,929 million of short-term loans and overdrafts.

At 31 December 2003, the Group had £41 million of cash and short-term investments (31 December 2002 £111 million). Powergen's policy is to place any surplus funds on short-term deposit with approved banks and financial institutions. Strict limits governing the maximum exposure to these banks and financial institutions are applied. These limits are co-ordinated across the E.ON Group.

The Group's net borrowing position at 31 December 2003 was therefore £3,461 million, compared to £6,215 million at 31 December 2002 reflecting the impact of the LG&E disposal. The average interest rate for the year, when compared to average net borrowings, was 2.5 per cent compared with 4.6 per cent in the previous year. This fall is attributable to lower interest rates from the E.ON group.

Gearing (net debt as a percentage of net assets plus net debt) was 54 per cent at 31 December 2003 compared with 77 per cent at the end of 2002. The decrease year on year is largely due to the disposal of the US Operations.

Commodity risk management

As part of its operating activities, Powergen engages in asset based energy marketing in the gas, electricity, coal and oil markets. This activity is primarily focused around the commercial risk management and optimisation of both UK electricity and gas assets and to manage the price and volume risks associated with its UK retail business, but also encompasses limited proprietary trading in the UK and some European energy markets.

All of Powergen's energy trading operations are subject to Powergen and E.ON's risk management policies. These include value and profit at risk, credit limits, segregation of duties and an independent risk reporting system. To achieve its portfolio optimisation Powergen uses fixed price bilateral

POWERGEN LIMITED

Financial review for the year ended 31 December 2003 (continued)

contracts, futures and option contracts traded on commodity exchanges and swaps and options traded in over-the-counter financial markets.

Taxation

The pre-exceptional tax charge amounted to £36 million for the year compared with £130 million for the same period to 31 December 2002. The effective rate before exceptional items was 10 per cent compared with 39 per cent in the year to 31 December 2002. The main reasons for the decrease in the effective rate were the change in the impact of discounting the deferred tax provision under FRS 19, adjustments to the current and deferred tax provisions in respect of prior year items, a reduction in non-tax deductible goodwill amortisation as a result of the disposal of the US Operations, and a reduction in the impact of higher US tax rates, again due to the disposal of the US Operations.

Dividends

No dividends were paid or payable during the year ended 31 December 2003.

POWERGEN LIMITED

Independent auditors' report to the members of Powergen Limited

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the statement of total recognised gains and losses and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards are set out in the statement of directors' responsibilities.

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

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises the directors' report and financial review.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

POWERGEN LIMITED

Independent auditors' report to the members of Powergen Limited (continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

London

23 June 2004

POWERGEN LIMITED
CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2003

	Year ended 31 December 2003			Year ended 31 December 2002			
	Note	Before Exceptional Items £m	Exceptional Items (note 3) £m	Total £m	Before Exceptional Items £m	Exceptional Items (note 3) £m	Total £m
Turnover		7,230	-	7,230	6,759	-	6,759
Group's share of associates' and joint ventures' turnover		(173)	-	(173)	(455)	-	(455)
Group turnover	1	7,057	-	7,057	6,304	-	6,304
- continuing activities		6,772	-	6,772	4,700	-	4,700
- discontinued activities		285	-	285	1,604	-	1,604
Operating costs	2,3	(6,786)	(123)	(6,909)	(5,926)	(390)	(6,316)
Other operating income	2	112	-	112	111	-	111
Group operating profit/(loss)	2	383	(123)	260	489	(390)	99
- continuing activities		377	(123)	254	286	(48)	238
- discontinued activities		6	-	6	203	(342)	(139)
Group's share of associates' and joint ventures' operating profit		73	-	73	114	-	114
Profits less losses on disposal of fixed assets and investments	3	-	-	-	-	46	46
Profits less losses on disposal of businesses (including provisions)	3	-	943	943	-	(29)	(29)
Net interest payable							
- Group	5	(59)	-	(59)	(229)	(58)	(287)
- Associates and joint ventures		(26)	-	(26)	(42)	-	(42)
Profit/(Loss) on ordinary activities before taxation	6	371	820	1,191	332	(431)	(99)
Tax on profit/(loss) on ordinary activities	7	(36)	10	(26)	(130)	189	59
Profit/(Loss) on ordinary activities after taxation		335	830	1,165	202	(242)	(40)
Minority interest	26	(1)	-	(1)	(11)	42	31
Profit/(Loss) attributable to shareholders		334	830	1,164	191	(200)	(9)
Dividends	8			-			(121)
Profit/(Loss) for the year				1,164			(130)

The notes on pages 25 to 73 form part of these financial statements.

POWERGEN LIMITED

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES for the year ended 31 December 2003

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Profit/(Loss) attributable to shareholders	1,164	(9)
Revaluation of fixed assets and investments on acquisition	-	16
Currency translation differences on foreign currency net investments	(13)	(124)
Total recognised gains/(losses) for the year	1,151	(117)

The notes on pages 25 to 73 form part of these financial statements

POWERGEN LIMITED

BALANCE SHEETS as at 31 December 2003

	Note	The Group		The Company	
		31 December 2003 £m	31 December 2002 £m	31 December 2003 £m	31 December 2002 £m
Fixed assets					
Goodwill	11	2,673	4,133	-	-
Tangible fixed assets	12	2,562	5,014	-	-
Investments	13	197	380	-	2,580
		5,432	9,527	-	2,580
Current assets					
Stocks	14	90	286	-	-
Debtors: amounts falling due after more than one year	15	1,485	80	-	-
Debtors: amounts falling due within one year		1,235	1,424	4,062	2,751
Less: securitisation of trade debtors		-	(69)	-	-
Net debtors falling due within one year	16	1,235	1,355	4,062	2,751
Cash and short-term deposits		41	111	-	-
		2,851	1,832	4,062	2,751
Creditors: amounts falling due within one year					
Loans and overdrafts	17	(1,929)	(3,874)	(150)	(2,550)
Trade and other creditors	18	(1,315)	(1,836)	(14)	(2)
Net current (liabilities)/assets		(393)	(3,878)	3,898	199
Total assets less current liabilities		5,039	5,649	3,898	2,779
Creditors: amounts falling due after more than one year					
Long-term loans	19	(1,573)	(2,452)	(519)	-
Other creditors	20	(129)	(326)	-	-
Provisions for liabilities and charges	22	(211)	(871)	-	-
Deferred tax	23	(218)	(162)	-	-
Net assets		2,908	1,838	3,379	2,779
Capital and reserves					
Called-up share capital	24	479	479	479	479
Share premium account	25	34	33	34	33
Other reserves	25	656	656	-	-
Revaluation reserve	25	15	16	-	-
Profit and loss account	25	1,720	568	2,866	2,267
Shareholders' funds (including non- equity shareholders' funds)	27	2,904	1,752	3,379	2,779
Minority interests (including non-equity)	26	4	86	-	-
		2,908	1,838	3,379	2,779

Approved by the Board on 23 June 2004

G Bartlett
Director

The notes on pages 25 to 73 form part of these financial statements.

POWERGEN LIMITED

Principal Accounting Policies

Nature of operations

During the year, the Powergen Group had three main businesses; UK Operations, US Operations and Asian Asset Management. Powergen's principal business in the UK is the generation, distribution and sale of electricity and the sale of gas. Powergen's principal business overseas is the generation of electricity and associated energy-related businesses. Powergen's principal business in the US was the generation of electricity and the transmission, distribution and sale of electricity and gas. As set out in note 3, on 1 March 2003 Powergen's US Operations were sold to another company in the E.ON Group. The figures for US Operations have therefore been treated as discontinued activities in these financial statements in accordance with Financial Reporting Standard 3 'Reporting Financial Performance'.

Basis of preparation of accounts

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and the Companies Act 1985 except for the accounting policies for commodity instruments (see financial instruments below) and customer contributions (see tangible fixed assets below); and accounting for subsidiaries which were previously accounted for as associated undertakings where the true and fair over-ride has been used as required by Financial Reporting Standard 2 'Accounting for Subsidiary Undertakings'. There have been no changes in accounting policies during the year.

There is no difference between the profit on ordinary activities before taxation and the retained profit for the year stated on the face of the consolidated profit and loss account and their historical cost equivalents. Values of assets and liabilities vested in the Company on 31 March 1990 under the Transfer Scheme made pursuant to the Electricity Act 1989 are based on their historical cost to the Central Electricity Generating Board (CEGB).

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting year. Actual results can differ from those estimates.

Basis of consolidation

The consolidated accounts include the financial statements of the Company and all of its subsidiary undertakings, together with the Group's share of the results and net assets of associated undertakings and joint ventures. The results of subsidiaries sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which control passes. Intra-group sales and profits are eliminated on consolidation.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Associated undertakings and joint ventures

The Group's share of profits less losses of associated undertakings and joint ventures is included in the consolidated profit and loss account. The results of associates and joint ventures sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which significant influence passes. These amounts are taken from the latest audited financial statements of the relevant undertakings, except where the accounting reference date of the undertaking is not coterminous with the parent company, where management accounts are used.

The accounting reference dates of associated undertakings and joint ventures are set out in note 13. Where the accounting policies of associated undertakings and joint ventures do not conform to those of the Group, adjustments are made on consolidation where the amounts involved are material to the Group.

Turnover

Turnover within the Group comprises wholesales of electricity, revenue from the sale of electricity and gas to industrial and commercial customers; sales of electricity, gas and telephony services to domestic customers; revenue from the distribution of electricity and the sale of electricity and steam under combined heat and power schemes. Turnover excludes Value Added Tax.

Income from the sale of electricity and gas to industrial, commercial and domestic customers in both the United Kingdom and the United States is recognised when earned and reflects the value of units supplied, including an estimated value of units supplied to customers between the date of their last meter reading and the year end.

In the United States the amount of regulated income received from sales of electricity and gas to customers is determined by the Kentucky Public Services Commission.

Restructuring costs

Amounts are set aside for the Group's restructuring programme that involves the reorganisation or future closure of power station and other sites and specific reductions in staff numbers, where the Group is demonstrably committed to such actions.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Depreciation

Provision for depreciation of generating and other assets is made so as to write off, on a straight-line basis, the book value of tangible fixed assets. Assets are depreciated over their estimated useful lives or, in the case of leased assets, over the lease term if shorter. Estimated useful lives are reviewed periodically. No depreciation is provided on freehold land or assets in the course of construction.

The estimated useful lives for the other principal categories of fixed assets are:

<i>Asset</i>	<i>Life in years</i>
Generating assets	25-45
Distribution and transmission networks	40-60
Other assets	3-40

Overhaul of generation plant

Overhaul costs are capitalised as part of generating assets and depreciated on a straight-line basis over their estimated useful life, typically the period until the next major overhaul. That period is usually four years.

Decommissioning

A fixed asset and related provision is recognised in respect of the estimated total discounted cost of decommissioning UK Operations' generating assets. The resulting fixed asset is depreciated on a straight-line basis, and the discount on the provision is amortised, over the useful life of the associated power stations.

Foreign exchange

Assets and liabilities expressed in foreign currencies, including those of subsidiaries, associated undertakings and joint ventures, are translated to Sterling at the rate of exchange ruling at the end of the financial year. The results of foreign subsidiaries, associated undertakings and joint ventures are translated to Sterling using average exchange rates.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Transactions denominated in foreign currencies are translated to Sterling at the exchange rate ruling on the date payment takes place unless related or matching forward foreign exchange contracts have been entered into when the rate specified in the contract is used. Differences on exchange arising from the re-translation of the opening net investment in and results of subsidiaries, associated undertakings and joint ventures are taken to reserves and, where the net investments are hedged, are matched with differences arising on the translation of related foreign currency borrowings and forward exchange contracts. Any differences arising are reported in the statement of total recognised gains and losses. All other realised foreign exchange differences are taken to the profit and loss account in the year in which they arise.

Deferred income

Amounts received in advance in respect of the provision of services under warranty arrangements are taken to deferred income and recognised in operating income over the period to which the warranty cover relates. Costs associated with the provision of services under the warranty arrangements are netted against the operating income, and are recognised when incurred.

Financial instruments

The Group uses a range of derivative instruments including interest rate swaps, cross-currency swaps, energy based futures and options contracts and foreign exchange contracts and swaps. Derivative instruments are used for hedging purposes, apart from energy based options and futures contracts, which are used for trading purposes. The accounting policy for each instrument is set out below. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate. Accounting for foreign currency transactions is described in the foreign exchange policy set out above. Changes in the market value of futures and options trading contracts are reflected in the profit and loss account in the period in which the change occurs.

Debt instruments

Following the issue of Financial Reporting Standard 4 'Capital instruments' (FRS 4) all borrowings are initially stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Interest rate swaps

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts.

Forward currency contracts

The Group enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. With the exception of contracts used for translation hedging purposes, unrealised gains and losses on currency contracts are not accounted for until the maturity of the contract.

Currency swaps

Currency swap agreements are used to manage foreign currency exposures and are accounted for using hedge accounting. In order to qualify for hedge accounting the instrument must be identified to a specific foreign currency asset or liability and must be an effective hedge. Foreign currency loans, where the repayment of principal is hedged by currency swaps, are included in the balance sheet at the Sterling equivalent of the hedged rate. Interest on the loan is charged to the profit and loss account at the hedged rate.

Commodity instruments

Within the UK, the Group makes use of energy trading derivative financial instruments. These instruments are traded in an established and liquid market place. The Companies Act states that the contracts should be held at the lower of cost or net realisable value. The directors consider that this would not give a true and fair view and consider it appropriate to mark the open derivative positions to market since the marketability of the instruments enables management to decide whether to hold or sell the instruments. The affect of this departure from the historical cost convention on the financial statements for the year is a decrease of £8 million in operating profits (year ended 31 December 2002 £6 million increase) and an increase of £1 million (31 December 2002 £6 million increase) in net assets.

Goodwill

Goodwill arising on consolidation represents the excess or shortfall of the fair value of the consideration given compared to the fair value of the identifiable assets and liabilities acquired. Purchased goodwill is capitalised in the balance sheet and amortised on a straight-line basis through the profit and loss account over a period in line with the directors' view of its estimated minimum useful economic life. Goodwill relating to associates and joint ventures is included within 'investments' in the consolidated balance sheet. Goodwill arising on overseas acquisitions is regarded as a currency asset and is re-translated at each period end at the closing rate of exchange.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Tangible fixed assets

Tangible fixed assets are stated at original cost, net of customer contributions, less accumulated depreciation and any provision for impairment. Impairment losses and any subsequent reversals are recognised in the period in which they are identified. In the case of assets constructed by the Company and its subsidiaries, directly related overheads and commissioning costs are included in cost.

Major assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date. Where borrowings are specifically financing the construction of a major capital project with a long period of development, interest payable, not exceeding the actual amount incurred during the relevant period of construction, is capitalised as part of the cost of the asset and written off over the operational life of the asset.

Customers' contributions towards distribution network assets are credited to the profit and loss account over the life of the distribution network assets to which they relate. The contributions are deducted from the cost of the fixed assets. This is a departure from the Companies Act 1985 which requires fixed assets to be included at their purchase price or production cost and therefore any contribution would be presented as deferred income. However, it is the opinion of the directors that the treatment adopted is necessary to give a true and fair view as the contributions relate directly to the cost of fixed assets used in the distribution network. The negative net book value included within tangible fixed assets at 31 December 2003 was £405 million (31 December 2002 £369 million) and the reduction in depreciation charge during the year was £12 million (year ended 31 December 2002 £12 million).

Leased assets

Assets leased under finance leases are capitalised and depreciated over the shorter of the lease periods and the estimated operational lives of the assets. The interest element of the finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rents payable under operating leases are charged to the profit and loss account evenly over the term of the lease. Income from operating leases is included within other operating income in the profit and loss account. Income is recognised on a straight-line basis except where income receipts vary with output or other factors. Any variable element is recognised as earned.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Fixed asset investments

The Group's share of the net assets of associated undertakings and joint ventures is included in the consolidated balance sheet. Other fixed assets investments are stated at cost less any provision for impairment in value. Investments in subsidiary undertakings are stated in the balance sheet of the parent company at cost, less any provision for impairment in value.

Fuel stocks and stores

Fuel stocks and general and engineering stores are stated at the lower of cost and net realisable value. In general, stocks are recognised in the profit and loss account on a weighted average cost basis. The Companies Act 1985 requires stocks to be categorised between raw materials, work in progress and finished goods. Fuel stocks and stores are raw materials under this definition.

US regulatory assets and liabilities

US Statement of Financial Accounting Standard 71 'Accounting for the Effects of Certain Types of Regulation' (SFAS 71) sets out the appropriate accounting treatment for US utilities whose regulators have the power to approve or regulate charges to customers. As long as, through the regulatory process, the utility is substantially assured of recovering its allowable costs from, or is obligated to refund amounts to, customers, any costs/revenues not yet recovered, or refunded, may be deferred as regulatory assets/liabilities. Due to the different regulatory environment, no equivalent policy applies in the United Kingdom.

Under UK generally accepted accounting principles (GAAP), Powergen's policy is to recognise regulatory assets/liabilities established in accordance with SFAS 71 only where they comprise rights or other access to future economic benefits which have arisen as a result of past transactions or events which have created an obligation to transfer economic benefits to a third party. Measurement of the past transaction or event and therefore the amount of the regulatory asset/liability, is determined in accordance with UK GAAP.

Cash and short-term deposits

Short-term deposits include cash at bank and in hand, and certificates of tax deposit.

Deferred taxation

Deferred taxation arises in respect of items where there is a timing difference between their treatment for accounting purposes and their treatment for taxation purposes. Full provision is made for such timing differences as required under Financial Reporting Standard 19 'Deferred tax' (FRS 19) on a discounted basis. Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and depreciation of fixed assets.

Deferred tax liabilities are recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are only recognised to the extent that their recovery is probable.

POWERGEN LIMITED

Principal Accounting Policies (continued)

Long-term contracts

Profits are recognised on long-term contracts where the final outcome can be assessed with reasonable certainty. The profit included is calculated by using the percentage of completion method based on the proportion of costs incurred to date against total estimated cost. Full provision is made for losses on each contract in the year in which they are first foreseen.

Amounts recoverable on contracts, included in debtors: amounts falling due within one year, are stated at the proportion of the anticipated sales value earned to date less amounts billed on account.

Pensions and post-retirement benefits

The Group provides pension benefits through both defined benefit and defined contribution schemes. Defined benefit pension scheme costs are charged to the profit and loss account so as to spread the cost of pensions over employees' remaining working lives. The regular cost, and any variation from regular cost which is identified as a result of actuarial valuations, is amortised over the average expected remaining service lives of members. Details of these actuarial valuations, including their frequency and methodology are set out in note 21. Differences between the amounts funded and the amounts charged to the profit and loss account are treated as either creditors or debtors in the balance sheet. Payments to defined contribution schemes are charged against profits as incurred. Certain additional post-retirement benefits, principally health care benefits, are provided to eligible retirees within the Group's US Operations. The estimated cost of providing such benefits is charged against profits on a systematic basis over the average expected service lives of employees.

Powergen has adopted the transitional provisions of Financial Reporting Standard 17 'Retirement benefits' (FRS 17) in these accounts. In accordance with the transitional arrangements under FRS 17 full implementation of the standard has been deferred. The transitional disclosures are set out in note 21 to the accounts.

Related parties

The Company is exempt under the terms of Financial Reporting Standard 8 from disclosing related party transactions with entities that are part of the E.ON Group or investees of the E.ON Group.

Cash flow statement

The Company is a wholly-owned subsidiary undertaking of E.ON AG, the ultimate parent undertaking of the E.ON Group and is included in the publicly available consolidated financial statements of E.ON AG. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard 1 (revised 1996).

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003

1 Turnover

Turnover, excluding the Group's share of associates' and joint ventures' turnover, is analysed as follows:

	Year ended 31 December	
	2003 £m	2002 £m
Continuing activities:		
UK Operations		
Electricity and gas – wholesale and trading	2,282	2,104
Electricity – distribution	303	289
Electricity and gas – retail	4,324	2,417
Internal charges from distribution to retail	(137)	(125)
	6,772	4,685
Asian Asset Management	-	15
Continuing activities	6,772	4,700
Discontinued activities:		
US Operations		
Utilities	236	1,223
Non-utilities	49	381
Discontinued activities *	285	1,604
	7,057	6,304

The Group's share of associates' and joint ventures' turnover is analysed as follows:

	Year ended 31 December	
	2003 £m	2002 £m
UK Operations	50	99
Asian Asset Management	93	120
Continuing activities	143	219
US Operations – discontinued activities *	30	236
	173	455

Turnover analysed by geographic destination is not materially different from the analyses by origin shown above.

* The figures shown above for discontinued activities relate to two months of trading in 2003 compared with twelve months during 2002.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

2 Operating costs

Operating costs were as follows:

	Year ended 31 December			Year ended 31 December		
	2003 Continuing activities £m	2003 Discontinued activities* £m	2003 Total £m	2002 Continuing activities £m	2002 Discontinued activities* £m	2002 Total £m
Fuel costs	369	75	444	382	402	784
Power purchases and other costs of sales	5,042	89	5,131	3,296	380	3,676
Staff costs (note 4)	237	23	260	204	137	341
Depreciation, including exceptional charges	162	22	184	146	233	379
Goodwill amortisation	182	12	194	90	79	169
Other operating charges, including restructuring costs	638	58	696	455	512	967
Operating costs, after exceptional items	6,630	279	6,909	4,573	1,743	6,316
Operating costs, before exceptional items	6,507	279	6,786	4,525	1,401	5,926
Exceptional depreciation charges (note 3)	-	-	-	-	94	94
Exceptional operating charges (note 3)	123	-	123	48	248	296

* The figures shown above for discontinued activities relate to two months of trading in 2003 compared with twelve months during 2002.

The directors believe that the nature of the Group's business is such that the analysis of operating costs set out in the Companies Act 1985 format is not appropriate. As required by the Act, the directors have therefore adopted the presented format so that operating costs are disclosed in a manner appropriate to the Group's principal activities.

£4 million of foreign exchange losses were recognised in the profit and loss account (year ended 31 December 2002 £55 million loss, including an exceptional loss of £58 million as detailed in note 3).

Operating costs also include:	Year ended 31 December	
	2003 £m	2002 £m
Repairs and maintenance costs	128	194
Research and development costs	2	3
Operating leases (non-plant)	28	41
Profit on disposal of fixed assets	9	2
Auditors' remuneration for:		
Statutory audit	1.0	0.8
Audit related regulatory reporting	0.2	0.2
Further assurance services	0.5	1.3
Tax services	0.3	0.4
General consulting	-	1.5

Auditors' remuneration in respect of the Company was borne by Powergen UK plc, an indirect subsidiary undertaking, for each of the two years ended 31 December 2003.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

2 Operating costs (continued)

Other operating income includes £100 million (year ended 31 December 2002 £100 million) of deferred income in respect of the provision of services under warranty arrangements associated with the disposal of Fiddler's Ferry and Ferrybridge C power stations to Edison Mission Energy during 1999.

3 Exceptional items

Exceptional items comprise:

	Year ended 31 December	
	2003 £m	2002 £m
Charged against operating profit	(123)	(390)
Profits less losses on disposal of fixed assets and investments	-	46
Profits less losses on disposal of businesses (including provisions)	943	(29)
Charged against interest costs	-	(58)
Exceptional items before taxation	820	(431)
Tax on exceptional items	10	189
Exceptional items after taxation	830	(242)
Minority interest	-	42
Exceptional items attributable to shareholders	830	(200)

Charged against operating profit

Year ended 31 December 2003

UK Operations

Following the acquisition of TXU in October 2002 the Group undertook a detailed review of its UK Operations and established a business reorganisation and restructuring programme. £123 million was charged during the year in respect of that programme, which primarily comprises committed severance and related payments to approximately 1,200 employees, together with costs in respect of rationalisation of IT systems and related infrastructure costs. A tax credit of £10 million arose as a result of this charge.

Year ended 31 December 2002

US Operations

During the first quarter of 2002, following the economic and political uncertainty in Argentina, the collapse of the US dollar/Peso peg, and a presidential decree that all US dollar based contracts should be deemed to be Peso denominated, the functional currency of LG&E's investments in Argentina reverted from the US dollar to the Argentine Peso. At 31 March 2002 the Peso was trading at a rate of 2.935 Pesos to the US dollar, a 66 per cent devaluation.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

3 Exceptional items (continued)

As a result of the devaluation, certain US Dollar denominated liabilities in Distribuidora de Gas del Centro SA, Distribuidora de Gas Cuyana SA and Gas Natural BAN SA were revalued, leading to an exceptional charge as detailed below (see 'Charged against interest costs'). In addition, a further review of the Argentine asset portfolio was undertaken during 2002 resulting in an additional impairment of £75 million, of which £32 million is attributable to the amounts owned by the non-controlling parties and is included in minority interests. The cash flows used in this impairment review were discounted at Powergen's cost of capital for Argentine operations. No tax charge arose as a result of this impairment.

One of LG&E's non-utility businesses, Western Kentucky Energy Corp. ('WKE') has a twenty-five year lease of, and operates the generating facilities of Big Rivers Electric Corporation ('BREC'), a power generation co-operative in western Kentucky, and a coal fired facility owned by the city of Henderson in Kentucky, which commenced in 1998. Almost 90% of WKE's generation services BREC's three member co-operatives and regional aluminium smelters through long term electricity contracts. Following a review of these contracted obligations in the light of increasing fuel costs, a provision of £263 million has been recorded in these accounts to reflect the degree to which, in the directors' opinion, the contract is onerous. £37 million of this provision has been recorded as a fixed asset impairment. A tax credit of £105 million arose as a result of this provision.

US Operations, UK Operations and Corporate

Following the acquisition of the Group by E.ON on 1 July 2002 a number of senior directors and employees left the Powergen Group. At the same time certain restructuring initiatives were undertaken. This has resulted in costs being incurred within US Operations (£4 million), UK Operations (£32 million) and within the Corporate Centre (£16 million). A tax credit of £11 million arose as a result of these transactions.

Profit less losses on disposal of fixed assets and investments

Year ended 31 December 2003

Asian Asset Management

As part of Powergen's ongoing strategy to withdraw from the international markets, bids have been received for the 35% investment in PT Jawa Power (Paiton) and the 100% investment in the associated operating and maintenance company. As a result of these bids, the carrying value of that investment has been reviewed and impaired by £25 million. No tax credit arose as a result of this impairment.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

3 Exceptional items (continued)

On 16 April 2003, Powergen completed the sale of its remaining indirect 18.4% interest in Yallourn power station in Australia to CLP International (CLP) for proceeds of £41 million. Net assets disposed of totalled £16 million giving rise to an exceptional profit of £25 million. No tax charge arose as a result of this disposal.

Year ended 31 December 2002

US Operations

In February 2002, LG&E completed the sale of its Monroe and Tiger Creek facilities in Georgia to Progress Ventures Inc. Proceeds received for these assets totalled £242 million in cash. Net assets disposed of, including debt finance of £115 million, were £196 million giving rise to an exceptional profit of £46 million. A £19 million tax charge arose on these disposals.

Profits less losses on disposal of businesses (including provisions)

Year ended 31 December 2003

US Operations

On 1 March 2003, Powergen disposed of its entire US Operations, comprising E.ON US Investments Corp. ('EUSIC') and its subsidiaries, including the two utilities Louisville Gas and Electric Company and Kentucky Utilities Company to E.ON US Holdings GmbH, another company within the E.ON Group for proceeds of £1,142 million (\$1,800 million). Net assets disposed of were £200 million giving rise to a profit on disposal of £942 million. No tax charge arose as a result of this disposal.

Asian Asset Management

On 11 June 2003, Powergen completed the sale of its remaining investment in CLP Powergen India Limited (CPIL) to CLP for proceeds of £28 million. Net assets disposed, together with related disposal costs totalled £20 million giving rise to a profit on disposal of £8 million. No tax charge arose as a result of this disposal.

Corporate

On 11 December 2003, Powergen sold its captive insurance company, Ergon Insurance Limited, to E.ON UK Limited, the immediate parent undertaking. Consideration totalled £104 million and net assets disposed were £111 million resulting in an exceptional loss on disposal of £7 million. No tax credit arose on the transaction.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

3 Exceptional items (continued)

Year ended 31 December 2002

Asian Asset Management

On 28 February 2002 Powergen completed the sale of its 88 per cent stake in GPEC to CPIL, a company that is 80 per cent owned by CLP and 20 per cent owned by the Powergen Group. Proceeds received were £202 million. Net assets disposed of, together with related disposal costs, were £209 million giving rise to a loss on disposal of £7 million.

On 20 February 2002 Powergen acquired the remaining 12 per cent of GPEC it did not previously own and, on 23 October 2002, sold this stake to CPIL. Proceeds received were £21 million and the book value of assets disposed of including provisions were £25 million, giving rise to a loss of £4 million.

On 8 November 2002 Powergen finalised the terms of sale of its investment in CPIL to CLP. The value of Powergen's investment has been impaired by £18 million to reflect the value implicit in this agreement. No tax charge arose as a result of this series of transactions.

Charged against interest costs

Year ended 31 December 2002

US Operations

As a result of the devaluation of the Argentine Peso (as detailed above), certain US Dollar denominated liabilities in Distribuidora de Gas del Centro SA, Distribuidora de Gas Cuyana SA and Gas Natural BAN SA increased significantly within the local Peso denominated ledgers. The translation of these liabilities (primarily debt) at the average rate for the quarter rather than at parity resulted in an exceptional charge of £58 million, of which £10 million is attributable to the amounts of the three distribution companies owned by the non-controlling parties and is included in minority interests. A tax credit of £17 million arose as a result of the devaluation.

Subsequent movements in the US dollar/Peso exchange rate have been treated in accordance with the Group's accounting policy for foreign exchange and therefore impact upon operating profit and reserves.

Tax credit

Year ended 31 December 2002

UK Operations

In addition to the tax impact on the items detailed above, during March 2002 Powergen reached agreement with the Inland Revenue with regard to the principles for the valuation of power stations for capital gains tax purposes. As a result of this agreement, £75 million of tax previously provided for on the disposal in 1999 of Fiddler's Ferry and Ferrybridge C power stations has been released as an exceptional profit through the tax line during 2002.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

4 Employee information, including directors' remuneration

The average number of persons employed by the Group, including executive directors, analysed by activity was:

	Year ended 31 December	
	2003	2002
UK Operations (including Corporate Centre)	6,397	5,959
US Operations *	640	4,137
Asian Asset Management	320	364
	7,357	10,460

* The US Operations were disposed of on 1 March 2003. As a result, the 2003 figure shown above represents the annual weighted average number of employees for the two months prior to that date.

The salaries and related costs of employees, including directors, were:

	Year ended 31 December	
	2003 £m	2002 £m
Wages and salaries	229	326
Social security costs	21	26
Other pension and retirement benefit costs (note 21)	14	26
	264	378
Capitalised in fixed assets	(16)	(37)
Charged in profit and loss account as staff costs	248	341

The total remuneration of Powergen's directors, together with details of the individual remuneration of the highest paid director are as follows:

	Year ended 31 December	
	2003 £'000	2002 £'000
All directors		
Aggregate emoluments	2,891	4,371
Compensation for loss of office	393	6,045
	3,284	10,416

Retirement benefits are accruing to two directors under a defined benefit scheme (year ended 31 December 2002 four directors). During the year no (2002: four) directors exercised options over shares they were awarded for services to the Powergen Group.

	Year ended 31 December	
	2003 £'000	2002 £'000
Highest paid director		
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	1,489	2,200
Defined benefit pension scheme:		
– Accrued pension at end of year	430	290

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

5 Net interest payable – Group

	Year ended 31 December	
	2003 £m	2002 £m
Interest receivable:		
Investment income	2	3
From associates and joint ventures	5	6
From E.ON Group companies	74	8
Other interest receivable and similar income	29	34
Total interest receivable and similar items	110	51
Interest payable:		
Bank loans and overdrafts	(8)	(61)
Loans from E.ON Group companies	(53)	(13)
Other loans	(103)	(190)
Total interest payable and similar items	(164)	(264)
	(54)	(213)
Unwinding of discount in provisions	(5)	(16)
	(59)	(229)
Exceptional interest costs (note 3)	-	(58)
	(59)	(287)

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

6 Profit on ordinary activities before taxation

	Year ended 31 December	
	2003	2002
	£m	£m
Continuing activities:		
<i>UK Operations</i>		
Electricity and gas – wholesale and trading	(19)	91
Electricity – distribution	155	129
Electricity and gas – retail	421	105
Lease and other income and charges	26	83
	583	408
<i>Asian Asset Management</i>		
Corporate costs	(15)	(22)
Continuing activities	626	451
Discontinued activities:		
<i>US Operations</i>		
Utilities	20	257
Non-utilities	4	64
Discontinued activities	24	321
	650	772
Net interest payable:		
Group	(59)	(229)
Associates and joint ventures	(26)	(42)
Goodwill amortisation	(194)	(169)
Exceptional items (note 3)	820	(431)
	1,191	(99)

The Group's share of associates' and joint ventures' operating profit can be analysed as follows:

	Year ended 31 December	
	2003	2002
	£m	£m
UK Operations	10	16
US Operations *	6	39
Asian Asset Management	57	59
	73	114

Goodwill amortisation can be analysed as follows:

	Year ended 31 December	
	2003	2002
	£m	£m
UK Operations	182	90
US Operations *	12	79
	194	169

* The figures shown above for US Operations relate to two months of trading in 2003 compared with twelve months during 2002.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

6 Profit on ordinary activities before taxation (continued)

The net assets of the Group are analysed as follows:

	As at 31 December	
	2003 £m	2002 £m
UK Operations	6,282	4,524
US Operations	-	2,291
Asian Asset Management	89	138
Unallocated net liabilities	(3,463)	(5,115)
	2,908	1,838

The profits and nets assets analysed by geographic destination is not materially different from the analyses by origin shown above.

7 Tax on profit on ordinary activities

	Year ended 31 December	
	2003 £m	2002 £m
Current tax:		
United Kingdom Corporation tax at 30%	27	26
Over provision in prior years	(14)	(86)
Overseas taxation	1	1
Total current tax charge/(credit)	14	(59)
Deferred tax:		
Origination and reversal of timing differences	19	(51)
Decrease/(Increase) in discount	(9)	38
Over provision in prior years	(11)	-
Total deferred tax credit (note 23)	(1)	(13)
Associates and joint ventures	13	13
Tax charge/(credit) on profit on ordinary activities	26	(59)

The effective tax rate is expected to increase in future periods as a result of the following:

- (a) the sale of the US Operations on 1 March 2003.
- (b) The ending of the period covered by the major parts warranty given to the purchaser on the disposal of Fiddler's Ferry and Ferrybridge C power stations in 1999. Part of the proceeds on the disposal was deferred and is recognised in the profit and loss account over the period covered by the warranty. This deferred income was subject to tax when actually received and is therefore not subject to tax when recognised in the profit and loss account. The effective rate of tax will increase in 2004 and subsequent periods as a result of the warranty period coming to an end.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

7 Tax on profit on ordinary activities (continued)

The difference between the current tax on the profit on ordinary activities for the year and the tax assessed on the profit on ordinary activities for the year assessed at the standard rate of corporation tax in the UK (30%) can be explained as follows:

	Year ended 31 December	
	2003 £m	2002 £m
Profit/(Loss) on ordinary activities before tax	1,191	(99)
Tax charge/(credit) on profit/(loss) on ordinary activities at 30%	357	(30)
Prior year adjustment	(14)	(86)
Expenses not deductible for tax purposes (mainly goodwill)	66	65
Non-taxable income	(357)	(31)
Impact of different rates of tax in overseas business	(5)	(34)
Origination and reversal of timing differences	(20)	70
Associates and joint ventures	(13)	(13)
Current tax charge/(credit) for the year	14	(59)

8 Dividends

	Pence per ordinary share Year ended 31 December		Year ended 31 December	
	2003	2002	2003 £m	2002 £m
First interim dividend paid	-	9.2p	-	60
Second interim dividend paid	-	9.2p	-	61
	-	18.4p	-	121

9 Profit of the Company

The profit after taxation for the financial year of the Company is £599 million (year ended 31 December 2002 £448 million loss). The Company is not publishing a separate profit and loss account, as permitted by Section 230 of the Companies Act 1985.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

10 Acquisitions and revisions to provisional fair values

On 16 July 2003, Powergen acquired Edenderry Power Limited (Edenderry), a Company based in Ireland, from Ruhrgas Holdings GmbH, a fellow group undertaking. Ruhrgas Holdings GmbH had acquired Edenderry from Fortum on 3 July 2003. The consideration paid by Powergen totalled £9 million and the fair value of the net assets acquired was £9 million. Therefore no goodwill arose as a consequence of this transaction which has been acquisition accounted.

Details of the acquisition are set out as follows:

	Book value	Revaluation ⁽¹⁾	Fair value to the Powergen Group
	£m	£m	£m
Net assets acquired:			
Tangible fixed assets	58	(11)	47
Working capital	(38)	-	(38)
	<u>20</u>	<u>(11)</u>	<u>9</u>
Goodwill arising			-
Consideration, including costs of acquisition			<u>9</u>

1 – Revaluation adjustments principally comprise valuation adjustments to the generation plant at fair value

On 25 November 2003, Powergen acquired Solway Offshore Limited and Offshore Energy Resources Limited. These companies hold development rights and the necessary consents to build windfarms in the Solway Firth. The consideration paid was £6 million resulting in goodwill arising of £6 million.

On 21 October 2002, Powergen acquired the UK retail energy business, certain gas supply contracts, and control of three power stations from TXU Europe Group plc (TXU). Two of the three power stations were already owned by Powergen and had been leased to TXU. The third power station was purchased as part of the transaction. The consideration payable totalled £1,627 million in cash, including acquisition costs of £10 million and the repurchase of securitised debtors of £247 million.

The fair value of the net liabilities acquired, as stated in the accounts for the year ended 31 December 2002 was £138 million, leading to goodwill arising of £1,765 million. Due to the proximity of the acquisition to the year end the fair value of the assets and liabilities as presented in the accounts for the year ended 31 December 2002 was provisional. During the current year these fair values have been finalised, as permitted by Financial Reporting Standard 7 'Fair values in acquisition accounting'. The final fair value of the net liabilities acquired was £178 million, leading to additional goodwill arising of £40 million, resulting in total goodwill arising of £1,805 million.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

10 Acquisitions and revisions to provisional fair values (continued)

Details of the adjustments made to the TXU provisional fair values are set out below and relate to the finalisation of valuations and the tax treatment ascribed to the original provisional adjustments:

	Provisional fair values as previously stated £m	Revisions to provisional fair values £m	Fair value to the Powergen Group £m
Net assets acquired:			
TXU			
Tangible fixed assets	18	(4)	14
Stocks	15	-	15
Deferred taxation	56	(45)	11
Other working capital	(46)	9	(37)
Provisions	(181)	-	(181)
	(138)	(40)	(178)
Goodwill	1,765	40	1,805
Consideration, including costs of acquisition	1,627		1,627

The revision to provisional fair values in respect of deferred taxation arises due to a change in the expected tax treatment of the utilisation of provisions created in respect of certain long term contracts acquired as part of the purchase of TXU.

11 Goodwill

The Group	£m
Cost	
At 31 December 2002	4,600
Foreign exchange movements	26
Revisions to provisional fair values on acquisition (note 10)	40
Acquisitions (note 10)	6
Disposals	(1,501)
At 31 December 2003	3,171
Amortisation	
At 31 December 2003	467
Foreign exchange movements	3
Charge for the year	194
Disposals	(166)
At 31 December 2003	498
Net book value at 31 December 2003	2,673
Net book value at 31 December 2002	4,133

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

12 Tangible fixed assets

The Group	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
Cost				
At 31 December 2002	5,413	3,481	1,070	9,964
Foreign exchange movements	42	31	6	79
Additions	141	96	26	263
Acquisitions (note 10)	-	-	47	47
Revisions to provisional fair values on acquisition (note 10)	-	-	(4)	(4)
Disposals	(2,490)	(1,815)	(391)	(4,696)
At 31 December 2003	3,106	1,793	754	5,653
Depreciation				
At 31 December 2002	2,953	1,349	648	4,950
Foreign exchange movements	19	13	2	34
Charge for the year	113	53	18	184
Disposals	(1,078)	(763)	(236)	(2,077)
At 31 December 2003	2,007	652	432	3,091
Net book value at 31 December 2003	1,099	1,141	322	2,562
Net book value at 31 December 2002	2,460	2,132	422	5,014

Group assets include freehold land and buildings with a net book value of £126 million (31 December 2002 £319 million) and assets in the course of construction at a cost of £33 million (31 December 2002 £272 million).

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

13 Fixed asset investments

The Group	Net assets		Loans		Other investments £m	Total £m
	Joint ventures £m	Associates £m	Joint ventures £m	Associates £m		
Net assets excluding goodwill						
At 31 December 2002	81	123	32	12	126	374
Additions	-	-	-	1	13	14
Disposals	(41)	(28)	-	-	(117)	(186)
Dividends received	(8)	-	-	-	-	(8)
Impairments	-	(25)	-	-	-	(25)
Retained profits	7	27	-	-	-	34
Foreign exchange movements	-	(12)	-	-	-	(12)
At 31 December 2003	39	85	32	13	22	191
Goodwill						
At 31 December 2002	6	-				6
Amortisation	-	-				-
At 31 December 2003	6	-				6
At 31 December 2003 – Net assets and goodwill	45	85	32	13	22	197
At 31 December 2002 – Net assets and goodwill	87	123	32	12	126	380

Additions to associated undertakings and joint ventures represent equity investments in, and loans to, existing associates and joint ventures respectively.

The Company

During the year, the Company sold its investment in Powergen Group Holdings Limited to Powergen UK Securities, a wholly owned subsidiary. Consideration received totalled £3,555 million and the carrying value of the investment at that time was £2,961 million, following an equity injection during the year of £381 million, realising a profit on the sale of £594 million.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

13 Fixed asset investments (continued)

Interests in Group subsidiary undertakings

Details of the Group's principal investments in subsidiary undertakings are set out below. Principal subsidiaries are those which in the opinion of the directors significantly affect the amount of profit and assets and liabilities shown in the Group accounts. The directors consider that those companies not listed are not significant in relation to Powergen as a whole.

	Class of share capital held	Proportion of nominal value of issued equity shares held by the Group or the Company %	Country of incorporation or registration	Principal business activities
Powergen Group Holdings Limited+	Sterling ordinary shares	100	England and Wales	Holding company for UK based activities
Powergen US Holdings Limited *	Sterling ordinary shares	100	England and Wales	Holding and financing company
Powergen UK plc +	Sterling ordinary shares	100	England and Wales	Generation and sale of electricity
Central Networks East plc + (formerly East Midlands Electricity plc)	Sterling ordinary shares	100	England and Wales	Distribution of electricity
Powergen International Limited +	Sterling ordinary shares	100	England and Wales	Holding company for international activities
Powergen CHP Limited +	Sterling ordinary and preference shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Cogeneration Limited +	Sterling ordinary shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Retail Limited +	Sterling ordinary shares	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Powergen Gas Limited +	Sterling ordinary shares	100	England and Wales	Transportation and marketing of gas in the UK
Powergen Renewables Holdings Limited +	Sterling ordinary shares	100	England and Wales	Holding company for renewable activities

* direct interest + indirect interest

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

13 Fixed asset investments (continued)

Interests in associated undertakings and joint ventures

Details of the Group's principal investments in associated undertakings and joint ventures are as follows:

	Accounting reference date	Country of incorporation or registration	Shares held	Percentage of capital held directly by the Group
PT Jawa Power	31 December	Indonesia	Indonesian rupees ordinary shares	35%
Corby Power Limited *	30 September	England and Wales	Sterling ordinary shares	50%
Cottam Development Centre Limited *	31 December	England and Wales	Sterling ordinary shares	50%

* treated as joint ventures in the Group's accounts

The principal activities of these associated undertakings and joint ventures are:

PT Jawa Power	-	Generation and sale of electricity from coal-fired power station
Corby Power Limited	-	Generation and sale of electricity from gas-fired power station
Cottam Development Centre Limited	-	Construction and operation of gas-fired power station plant and operation of a generator turbine testing facility

On 26 January 2004, Powergen acquired the remaining issued share capital of Cottam Development Centre Limited, giving the Group 100% ownership.

Group share of aggregate associates' and joint ventures' balance sheets and results

	At 31 December 2003		At 31 December 2002	
	Joint ventures £m	Associates £m	Joint ventures £m	Associates £m
Share of assets:				
Share of fixed assets	128	277	285	421
Share of current assets	18	76	44	79
	146	353	329	500
Share of liabilities:				
Amounts falling due within one year	(18)	(15)	(24)	(36)
Amounts falling due after more than one year	(83)	(253)	(218)	(341)
	(101)	(268)	(242)	(377)
Share of net assets	45	85	87	123
Turnover	75	98	276	179
Operating profit	14	59	40	74

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

14 Stocks

	The Group	
	At 31 December 2003 £m	At 31 December 2002 £m
Fuel stocks	61	192
Stores	29	94
	90	286

15 Debtors: amounts falling due after more than one year

	The Group	
	At 31 December 2003 £m	At 31 December 2002 £m
Amounts due from E.ON Group companies	1,475	-
Other debtors	10	80
	1,485	80

Amounts due from E.ON Group companies comprise amounts outstanding on deferred equity calls of a subsidiary undertaking. The amounts are denominated in US Dollars, due on a fixed repayment profile up until 2012, and have been discounted at a rate of 4.62%.

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

16 Debtors: amounts falling due within one year

	The Group	
	At 31 December 2003 £m	At 31 December 2002 £m
Trade debtors	998	1,247
Less: securitisation	-	(69)
Net trade debtors	998	1,178
Amounts recoverable on contracts	-	12
Amounts due from E.ON Group companies	1	-
Other debtors	179	76
Prepayments and accrued income	57	89
	1,235	1,355

The Company has no debtors apart from £4,062 million (31 December 2002 £2,751 million) of inter-company balances due from subsidiaries. Of that balance, £3,899 million is interest bearing with a weighted average interest rate of 4.6%.

17 Short-term loans and overdrafts

	Weighted average interest rate		The Group	
	Year ended 31 December 2003 %	Year ended 31 December 2002 %	At 31 December 2003 £m	At 31 December 2002 £m
Bank overdrafts	-	-	43	12
Short-term loans from E.ON Group companies	2.0	2.3	1,296	3,305
Other short-term loans	5.5	4.4	590	557
	2.4	3.3	1,929	3,874

Following the acquisition by E.ON, short-term funding has been provided through inter-company facilities. During 2003, the Powergen Group had a US \$500 million commercial paper programme in Powergen UK plc and a US \$3,000 million commercial paper programme in Powergen US Funding LLC. These programmes were not used during the year and were cancelled on 7 July 2003.

The Company has no loans and overdrafts apart from £38 million (31 December 2002 £2,550 million) of inter-company balances owed to E.ON UK Limited, the immediate parent undertaking, and a further £112 million owed to Ergon Insurance Limited, a fellow subsidiary of E.ON UK Limited.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

18 Trade and other creditors falling due within one year

	The Group	
	At	At
	31 December	31 December
	2003	2002
	£m	£m
Trade creditors	930	957
Corporation tax	58	61
Other taxation and social security	9	8
Accruals and other creditors	278	710
Deferred income	40	100
	1,315	1,836

Accruals and other creditors include accruals for rationalisation and restructuring costs of the Group. The Company has no trade and other creditors apart from amounts owed to the parent undertaking of £14 million (31 December 2002 £2 million).

19 Long-term loans

	The Group	
	At	At
	31 December	31 December
	2003	2002
	£m	£m
4.5% Global US Dollar bond 2004	-	653
6.205% Medium term US Dollar notes 2004	-	90
8.5% Sterling Bond 2006	250	250
7.45% US Dollar Yankee Bond 2007	231	255
Loan notes 2007	2	3
6.46% Medium term US Dollar notes 2008	-	88
5% Euro Eurobond 2009	326	326
5.75% Medium term US Dollar notes 2011	-	94
6.25% Sterling Eurobond 2024	245	245
First mortgage bonds 2006 – 2027 (secured)	-	112
Pollution control bonds 2007 – 2032 (secured)	-	299
Loans from E.ON Group companies	519	-
Other long-term loans	-	37
	1,573	2,452

None of the bonds outstanding at 31 December 2003 has any financial covenants.

The Company's long term loans represent £519 million of amounts due to other E.ON Group companies. These loans have an average time to maturity of 4.7 years.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

19 Long-term loans (continued)

The maturity profile of the financial liabilities, including overdrafts and long-term loans, is as follows:

	At 31 December 2003 £m	At 31 December 2002 £m
Group		
In one year or less, or on demand	1,929	3,874
In more than one year but not more than two years	-	743
In more than two years but not more than five years	1,002	565
In more than five years	571	1,144
	3,502	6,326
Company		
In one year or less, or on demand	150	2,550
In more than two years but not more than five years	519	-
	669	2,550

At 31 December 2003 there were £365 million of undrawn committed borrowing facilities available to the Group all of which were inter-company facilities which did not contain any material covenant restrictions. These facilities comprise:

	Total Facility £m	Amount undrawn at 31 December 2003 £m	Expiry date	Fees
Powergen UK plc - committed facility from E.ON AG *	150	141	January 2004	10 bps
Powergen UK plc – committed facility from Raab Karcher Electronic Systems plc	20	15	October 2004	-
Powergen US Holdings Limited - committed facility from E.ON AG (\$50m)	28	28	January 2004	10 bps
Powergen Limited – revolving credit facility from E.ON UK plc**	500	150	July 2008	19 bps
Powergen Limited – revolving credit facility from Veba Electronics plc	200	31	December 2008	-
	898	365		

* This facility was extended to July 2004 and increased to £450 million.

** This facility was increased to £1,000 million during January 2004.

The undrawn committed borrowing facilities available to the Group are as follows :

	At 31 December 2003 £m
Expiring in less than one year	184
Expiring in more than two years but less than five years	181
	365

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

20 Other creditors falling due after more than one year

	The Group	
	At 31 December 2003 £m	At 31 December 2002 £m
Accruals and other creditors	129	286
Deferred income	-	40
	129	326

21 Pension scheme arrangements

At 31 December 2003, Powergen had both statutorily approved defined benefit pension schemes and several smaller statutorily approved defined contribution plans.

Powergen participates in the UK industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its UK based employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. At 31 December 2003, the Group has three separate funds within the ESPS, the Powergen fund, the East Midlands Electricity fund, and the TXU fund. An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent, professionally qualified, actuary, who recommends the rates of contribution payable by each group participating in the scheme. In intervening years the actuary reviews the continuing appropriateness of the rates.

The latest published actuarial valuation of the ESPS was at 31 March 2001. Particulars of this actuarial valuation are shown below. The 2001 valuation revealed surpluses of £237 million in respect of the Powergen fund and £116 million in respect of the East Midlands Electricity fund. A fair value exercise was completed by an independent actuary upon the acquisition of TXU in 2002. This valuation showed a deficit of £51 million. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these valuations were:

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

	At 31 March 2001		At 21 October 2002
	Powergen fund	East Midlands Electricity fund	TXU fund
Market value of assets*	£1,604m	£954m	£836m
Funding level	117%	114%	96%
– average nominal rate of return on investments (pre-retirement)	6.3%	6.3%	6.6%
– average nominal rate of return on investments (post-retirement)	5.3%	5.3%	5.6%
– average nominal rate of annual increase in salaries	3.8%	3.8%	3.3%
– average nominal rate of annual increase in pensions	2.5%	2.5%	2.5%
Inflation rate	2.3%	2.3%	2.3%
Method of valuation used	Projected unit	Projected unit	Projected unit

* Assets are taken at a smoothed asset valuation for SSAP 24 purposes. The smoothed value of assets at 31 March 2001 was 102% and 100% of the market value of the assets for the Powergen and East Midlands Electricity funds respectively.

The funding policy differs from the accounting policy in that it uses a more conservative basis for valuation.

On 1 March 2003, Powergen disposed of its US Operations ('LG&E'). LG&E sponsors a number of qualified and non-qualified pension plans, the majority of which are funded schemes of the defined benefit type. An actuarial valuation of the plans is carried out annually by an independent, professionally qualified, actuary. The pension cost for the period up until disposal and for the year ended 31 December 2002 was been obtained by updating the valuation at 31 December 2001. The update was performed by an independent, professionally qualified actuary. The actuarial valuations used the market value approach in determining both the assets and the liabilities. There are no plan assets in the non-qualified plans.

	LG&E funds	
	At 31 December 2002	At 31 December 2001
Market value of assets	£250m	£336m
Funding level	55%	71%
- average nominal rate of return on investments	9.0%	9.5%
- average nominal rate of annual increase in salaries	3.75%	4.25%
- inflation rate	2.25%	2.75%
Method of valuation used	Projected unit	Projected unit

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

Pension costs for the Group

In the financial year ended 31 December 2003, the pension cost for the Group amounted to £14 million (year ended 31 December 2002 £26 million). Surpluses and deficits are spread as a fixed percentage of total pensionable salaries over the average remaining service lives of members. At 31 December 2003, the Group had a SSAP 24 creditor of £132 million (31 December 2002 £233 million). The reduction of £101 million during the year primarily relates to the disposal of LG&E.

Other post-retirement benefits

LG&E provides healthcare and other benefits through various plans for eligible retirees on a basis substantially similar to those who are active employees. The cost of post-retirement benefits is accrued over the active service lives of employees. These figures are measured under the provisions of Statement of the United States Financial Accounting Standards Board (SFAS) 106 'Employers' Accounting for Post-retirement Benefits Other Than Pensions'. UK Generally Accepted Accounting Principles allow the use of SFAS 106 to measure the costs of post-retirement benefits other than pensions. No similar benefits are offered in the UK.

In the period up until the disposal of LG&E, the cost in respect of post-retirement healthcare amounted to £nil (year ended 31 December 2002 £5 million). This amount was only in respect of the LG&E Group. At 31 December 2002 there was a creditor of £121 million in respect of post-retirement healthcare arrangements.

The net periodic post-retirement benefit cost and significant assumptions were as follows:

	LG&E funds	
	Year ended 31 December 2002	Year ended 31 December 2001
Market value of assets	£6m	£12m
Funding level	4%	9%
Discount rate	6.75%	7.25%
Rate of future salary increases	3.75%	4.25%
Rate of expected return on plan assets	9.0%	9.5%
Initial healthcare cost trend	12.0%	7.0%
Ultimate healthcare cost trend rate	5.0%	5.0%

The majority of the plans are funded schemes of the defined benefit type. An actuarial valuation of the plans is carried out annually by an independent, professionally qualified actuary, on a projected unit basis. The above values have been based on the valuation at 31 December 2001 and adjusted for any known movements during the subsequent period.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

Impact of FRS17

SSAP 24 disclosure and measurement principles have been applied in accounting for pensions and post-retirement benefits in these financial statements. However, FRS17 'Retirement benefits' requires additional disclosures in these financial statements.

The aim of FRS 17 is to move to a market-based approach in valuing the assets and liabilities arising from an employer's retirement benefit obligations and any associated funding. The changes in accounting required to move from a SSAP 24 basis to a market value basis are substantial, and consequently FRS 17 allows a phased implementation of these changes.

The disclosures required which are designed to illustrate the entries which would have been booked in the financial statements if the measurement principles of FRS 17 had been applied, are set out below.

In calculating these disclosures, the figures shown for liabilities have been measured by updating valuations which were performed at 31 March 2001 and various dates between 31 March 2001 and 31 December 2003. These updates were performed by independent, professionally qualified actuaries.

The major assumptions used in these calculations of liabilities at 31 December were:

	2003		2002		2001
	UK Funds %	UK Funds %	LG&E funds %	UK Funds %	LG&E funds %
Average nominal rate of annual increase in salaries	4.00	3.75	3.75	4.00	4.25
Average nominal rate of annual increase in pensions	2.50	2.25	-	2.50	-
Discount rate	5.50	5.75	6.75	5.50	7.25
Inflation rate	2.50	2.25	2.25	2.50	2.75

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

The market value of the assets of the main defined benefit schemes, together with the liabilities calculated in accordance with FRS 17, at 31 December were:

	<u>2003</u>	<u>2002</u>		<u>2001</u>	
	UK Funds £m	UK Funds £m	LG&E funds £m	UK Funds £m	LG&E funds £m
Bonds and gilts	1,093	865	84	424	96
Equities	1,562	1,563	161	1,831	236
Property	196	179	-	107	-
Other	41	42	5	51	4
Total market value of assets	2,892	2,649	250	2,413	336
Present value of scheme liabilities	(3,432)	(3,151)	(456)	(2,285)	(481)
(Deficit)/Surplus in the scheme	(540)	(502)	(206)	128	(145)
Related deferred tax asset	91	81	82	(38)	58
Net pension liability	(449)	(421)	(124)	90	(87)

The long-term rate of return assumed on these assets at 31 December was as follows:

	<u>2003</u>	<u>2002</u>		<u>2001</u>	
	UK Funds %	UK Funds %	LG&E funds %	UK Funds %	LG&E funds %
Bonds and gilts	5.18	5.20	7.00	5.00	6.95
Equities	7.75	8.25	10.00	7.00	10.65
Property	7.75	8.25	-	-	-
Other	3.75	4.00	3.00	4.00	4.00

Prior to the disposal, Powergen also operated certain post retirement healthcare benefit arrangements in its US Operations. The disclosures required by the transitional arrangements of FRS 17 are as follows:

The major assumptions used by the actuary at 31 December were:

		<u>LG&E Funds</u>	
		<u>2002</u> %	<u>2001</u> %
Long-term healthcare cost increases	- initial healthcare cost trend	12.00	10.00
	- ultimate healthcare cost trend	5.00	5.00
Discount rate		6.75	7.25
Expected rate of return on assets		7.00	7.00

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements and other post-retirement benefits (continued)

The net liabilities of the post-retirement healthcare scheme comprised the following assets and actuarial liabilities at 31 December:

	LG&E Funds	
	2002	2001
	£m	£m
Total market value of assets – equities	6	12
Present value of scheme liabilities	(134)	(128)
Deficit	(128)	(116)
Related deferred tax asset	51	46
Net post-retirement liability	<u>(77)</u>	<u>(70)</u>

If FRS 17 had been adopted in the financial statements, the Group's net assets and profit and loss reserve at 31 December would be as follows:

	2003 £m	2002 £m
Net assets at 31 December	2,908	1,838
SSAP 24 pension and SFAS 106 other post retirement benefit liabilities (net of tax)	107	241
Net assets excluding SSAP 24 and SFAS 106 balances	3,015	2,079
Pension and other post-retirement benefit liability under FRS 17*	(449)	(622)
Net assets including pension and other post-retirement benefit liability under FRS 17	<u>2,566</u>	<u>1,457</u>
Profit and loss reserve as at 31 December	1,720	568
SSAP 24 pension and SFAS 106 other post retirement benefit liabilities (net of tax)	107	241
Profit and loss reserve excluding SSAP 24 and SFAS 106 liabilities	1,827	809
Pension and other post-retirement benefit liability under FRS 17*	(449)	(622)
Profit and loss reserve including other post-retirement benefit liability under FRS 17	<u>1,378</u>	<u>187</u>

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's profit and loss account:

	<u>Year ended 31 December 2003</u>		<u>Year ended 31 December 2002</u>	
	<u>UK Funds £m</u>	<u>US Funds £m</u>	<u>UK Funds £m</u>	<u>US Funds £m</u>
Operating profit				
Current service cost	19	1	18	8
Past service cost	53	-	48	1
Total operating charge	72	1	66	9
Other finance income				
Expected return on pension scheme assets	186	3	163	30
Interest on pension scheme liabilities	(177)	(7)	(131)	(41)
Net return	9	(4)	32	(11)

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's STRGL:

	<u>Year ended 31 December 2003</u>		<u>Year ended 31 December 2002</u>	
	<u>UK Funds £m</u>	<u>US Funds £m</u>	<u>UK Funds £m</u>	<u>US Funds £m</u>
Actual return less expected return on pension scheme assets	208	-	(539)	(65)
Experience losses arising on the scheme liabilities	-	-	(66)	(3)
(Losses)/Gains resulting from changes in assumptions underlying the present value of the scheme liabilities	(260)	-	178	(38)
Actuarial loss recognised in the STRGL	(52)	-	(427)	(106)

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

21 Pension scheme arrangements (continued)

The movement in the deficit during the year is analysed as follows:

	Year ended 31 December 2003		Year ended 31 December 2002	
	UK Funds £m	US Funds £m	UK Funds £m	US Funds £m
(Deficit)/Surplus at the beginning of the year	(502)	(334)	128	(261)
Fair value on the acquisition of TXU	-	-	(188)	-
Disposals	-	283	-	-
Current service cost	(19)	(1)	(18)	(8)
Employer contributions	77	62	19	20
Past service costs	(53)	-	(48)	(1)
Other finance income	9	(4)	32	(11)
Foreign exchange	-	(6)	-	33
Actuarial loss recognised in the STRGL	(52)	-	(427)	(106)
Deficit in the schemes at the end of the year	(540)	-	(502)	(334)

The details of experience gains and losses under FRS 17 are as follows:

	Year ended 31 December 2003		Year ended 31 December 2002	
	UK Funds	US Funds	UK Funds	US Funds
Differences between the expected and actual return on scheme assets:				
Amount	£208m	-	£(539)m	£(65)m
Percentage of scheme assets at year end	7%	-	(20)%	(26)%
Experience gains and losses of scheme liabilities:				
Amount	-	-	£(66)m	£(3)m
Percentage of the present value of the scheme liabilities at the year end	-	-	(2)%	(1)%
Total amount recognised in the statement of total recognised gains and losses:				
Amount	£(52)m	-	£(427)m	£(106)m
Percentage of the present value of the scheme liabilities at the year end	(2)%	-	(14)%	(18)%

Contributions in the year ended 31 December 2003 were £139 million (year ended 31 December 2002 £39 million). It has been agreed that contributions for the UK schemes will be 12% of pensionable salary over the forthcoming year depending upon the outcome of the actuarial review as at 31 March 2004.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

22 Provisions for liabilities and charges

Movements on provisions comprise:

	31 December 2002	Charged/ (Released) to profit and loss account	Disposals	Amortisation of discount	Provisions utilised	Exchange movements	31 December 2003
	£m	£m	£m	£m	£m	£m	£m
US contract provisions	478	-	(483)	2	(5)	8	-
UK contract provisions	252	(44)	-	-	(83)	-	125
Liability and damage claims	61	1	(50)	-	-	-	12
Decommissioning	80	(3)	-	3	(6)	-	74
	871	(46)	(533)	5	(94)	8	211

US contract provisions were included in the net assets disposed of on 1 March 2003 with the sale of LG&E. The disposal of the liability and damage claims arose with the sale of Ergon Insurance on 11 December 2003.

UK contract provisions include two items. The first of these relates to out of money electricity purchase contracts, which were acquired on the purchase of East Midlands Electricity and will be utilised over the period to 2008, when the contracts terminate. The second contract provision was acquired with the purchase of TXU and relates to an out of the money outsourced retail service contract arrangement. This will be utilised over the period to 2005 when the contract becomes due for renewal. The release during the year to the profit and loss account arose as a result the renegotiation of the contract.

The liability and damage claims provision includes reserves in respect of future claims for industrial related diseases and gradual pollution. Given the inherent uncertainty surrounding the timing of any potential claims, it is not possible to estimate when these amounts will crystallise.

Decommissioning provisions comprise amounts set aside for the discounted future estimated costs of terminating power station grid connections, decommissioning power stations and subsequent site restoration costs at UK power stations which will be utilised as each power station closes.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

23 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2003 is as follows:

	31 December 2003 £m	31 December 2002 £m
Accelerated capital allowances	418	822
Other timing differences	(64)	(418)
Undiscounted provision for deferred tax	354	404
Discount	(136)	(242)
Discounted provision for deferred tax	218	162
Provision at start of year	162	254
Deferred tax credit for year (note 7)	(1)	(13)
Acquisition	-	(52)
Revision to provisional fair values (note 10)	45	-
Disposals	12	
Foreign exchange movements	-	(27)
Provision at end of year	218	162

The undiscounted liability in respect of accelerated capital allowances and other timing differences is calculated at 30% in respect of the UK business and at 40% in respect of the US business, in both periods.

24 Share capital

The share capital of the Company comprises:

	31 December 2003 £m	31 December 2002 £m
Authorised		
1,050,000,000 ordinary shares of 50p	525	525
49,998 redeemable preference shares of £1	-	-
	525	525
Allotted, called-up and fully paid		
958,306,129 (31 December 2002 958,277,841) ordinary shares of 50p	479	479
No (31 December 2002 49,998) redeemable preference shares of £1	-	-
	479	479

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

24 Share capital (continued)

During the year, the Company issued 28,288 ordinary shares of 50p representing the final outstanding option given to employees by the Company. Consideration received totalled £137,940 resulting in an amount of £123,796 being credited to the share premium account.

The redeemable preference shares were redeemed at par on 31 October 2003.

Share option schemes

E.ON AG operates a stock appreciation rights programme that has been in existence since 1999. During 2002 and 2003 certain directors and senior managers of Powergen were invited to join the fourth and fifth tranches of this programme. These tranches are not exercisable for three years. Further details of the programme are set out in the accounts of E.ON AG, the ultimate parent undertaking.

25 Reserves

The Group	Share premium account £m	Other reserves £m	Revaluation reserve £m	Profit and loss account £m
At 31 December 2002	33	656	16	568
Premium on shares issued	1	-	-	-
Currency translation differences on foreign currency net investments	-	-	-	(13)
Revaluation transfer	-	-	(1)	1
Profit for the year	-	-	-	1,164
At 31 December 2003	34	656	15	1,720

The element of 'other reserves' relating to the previous capital reserve of £474 million, is not available for distribution as long as any liabilities of Powergen as at 9 December 1998 remain undischarged, unless the persons to whom such liabilities are owed shall otherwise agree, or an appropriate bank guarantee of such liabilities is put in place.

The Company	Share premium account £m	Profit and loss account £m
At 31 December 2002	33	2,267
Premium on shares issued	1	-
Profit for the financial year attributable to shareholders	-	599
At 31 December 2003	34	2,866

Of the £2,866 million profit and loss reserve at 31 December 2002, £2,849 million is not distributable as a result of an internal group reconstruction in 2000, and a further restructuring in 2003.

POWERGEN LIMITED

Notes to the financial statements
for the year ended 31 December 2003 (continued)

26 Minority interests

	31 December 2003			31 December 2002		
	Equity £m	Non-equity £m	Total £m	Equity £m	Non-equity £m	Total £m
Opening minority interests	2	84	86	105	93	198
Disposals	1	(86)	(85)	-	-	-
Profit and loss account	1	-	1	(35)	4	(31)
Acquisition of GPEC minorities	-	-	-	(34)	-	(34)
Exchange movements	-	2	2	(34)	(9)	(43)
Dividends paid to minority parties	-	-	-	-	(4)	(4)
Closing minority interests	4	-	4	2	84	86

27 Reconciliation of movements in shareholders' funds

	31 December 2003 £m	31 December 2002 £m
Profit/(Loss) attributable to shareholders	1,164	(9)
Shares issued	1	164
Dividends	-	(121)
Currency translation differences on foreign currency net investments	(13)	(124)
Revaluation reserve arising on acquisition	-	16
Net increase/(decrease) in shareholders' funds for the year	1,152	(74)
Opening shareholders' funds	1,752	1,826
Closing shareholders' funds	2,904	1,752

Opening shareholders' funds include 49,998 limited-voting redeemable preference shares of £1 fully paid up. These were redeemed at par on 31 October 2003.

Of the £13 million currency translation losses on foreign currency net investments shown above £12 million is attributable to associates and joint ventures (31 December 2002 £81 million loss).

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments

Financial instruments and risk management

As part of the financing of its normal operating activities, the Group uses a variety of financial instruments. These may be assets, liabilities or related commitments, depending on requirements. These instruments are denominated in Sterling or foreign currencies and have various maturities and interest rates. The Group is exposed to movements in market interest rates and foreign currency exchange rates. Active steps are taken to manage these risks, both by management of the portfolio of financial instruments themselves, and by the use of derivative financial instruments, which are primarily used where there is an underlying exposure.

The objectives, policies and strategies connected with the use of financial instruments are discussed in the 'Treasury management' section of the Financial Review.

The Group may be exposed to credit related loss in the event of non-performance by counter parties under these instruments. However, the Group does not anticipate any non-performance given the high credit rating of the established banks and financial institutions and fellow E.ON group companies that form these counter parties. The Group controls this credit risk through credit approvals, strict exposure limits, monitoring procedures and specific controls depending on the size of individual transactions.

There are no significant concentrations of credit risk. The Group does not usually require collateral or other security to support financial instruments with credit risks.

Foreign exchange contracts and options

Powergen enters into foreign exchange contracts in accordance with its hedging policies. These policies are discussed under 'Foreign exchange risk management' in the Financial Review. The net Sterling notional amounts of each foreign currency Powergen has contracted to purchase (or sell) as follows:

	31 December 2003 £m	31 December 2002 £m
US Dollars	(195)	(1,071)
Euros	8	-
Australian dollars	-	(17)
	(187)	(1,088)

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

Some contracts involve purchases or sales of US Dollars against other, non-Sterling currencies. The Sterling equivalent notional amounts of these contracts are as follows:

	31 December 2003 £m	31 December 2002 £m
Indian rupees	<u>-</u>	<u>(22)</u>

The weighted average time to maturity of foreign exchange contracts is four months (year ended 31 December 2002, five months).

The notional amounts of foreign currency swaps are as follows:

	31 December 2003 £m	31 December 2002 £m
Foreign currency swaps into Sterling	<u>577</u>	<u>325</u>

There are no material monetary assets or liabilities of the Group that are not denominated in the functional currency of the entity concerned, other than certain non-Sterling borrowings treated as hedges of net investments in overseas operations.

Interest rate risk management

Powergen has a portfolio of fixed and floating interest rate debt and, in order to mitigate interest rate risk, arranges interest rate hedges to achieve a desired mix of fixed and floating interest rates, with a range of different maturities, as described in the Financial Review. The notional amounts of the instruments used can be summarised as follows:

	31 December 2003 £m	31 December 2002 £m
Interest rate swap contracts	<u>397</u>	<u>2,056</u>

The weighted average time to maturity of interest rate swap contracts is 5.3 years (year ended 31 December 2002, 3.7 years).

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

Interest rate risk profile of financial liabilities

	Total £m	Floating rate financial liabilities £m	Fixed rate financial liabilities		
			£m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
At 31 December 2003					
Sterling	2,681	1,887	794	6.0%	7.5
US Dollar	821	-	821	5.3%	1.5
	3,502	1,887	1,615	5.6%	4.4
At 31 December 2002					
Sterling	4,247	3,758	489	8.3%	7.9
US Dollar	2,079	814	1,265	6.0%	5.2
	6,326	4,572	1,754	6.6%	6.0

The figures in the above table are stated after taking account of relevant interest rate swap contracts.

The floating rate financial liabilities bear interest at variable rates, in some cases fixed in advance for periods up to one year. The floating rates are determined with reference to the Sterling LIBOR.

In addition to the above, the Group's provisions include £125 million (31 December 2002 £730 million) for contract provisions (see note 22) which meet the definition of financial liabilities under Financial Reporting Standard 13 'Derivatives and other financial instruments'. These financial liabilities are considered to be floating rate liabilities as, in establishing the provisions, the cash flows have been discounted. The discount rate is re-appraised at each reporting date to ensure that it reflects current market assessments of the time value of money and the risks specific to the liability.

At 31 December 2003, the Group held £40 million of financial assets in the form of Sterling bank deposits (31 December 2002 £86 million), no US Dollar deposits (31 December 2002 £22 million), and £1 million in other currencies (31 December 2002 £3 million). These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

Fair value

Translation hedging instruments are recorded at fair value in these accounts. The fair value of all other financial instruments, which reflects the estimated amounts Powergen would receive or pay to terminate the contracts at the year end based on market values, is shown below. The fair values therefore reflect current unrealised gains/(losses) on all open contracts.

	31 December 2003 £m	31 December 2002 £m
Foreign currency contracts	(35)	(4)
Foreign currency swaps	36	(3)
Interest rate swaps	19	21

The estimated fair values of the Group's financial assets and liabilities are as follows:

		31 December 2003		31 December 2002	
		Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Assets:					
Cash and short-term deposits	1	41	41	111	111
Investments	2	22	22	126	126
Liabilities:					
Short-term debt	3, 4	(1,929)	(1,942)	(3,874)	(3,874)
Long-term debt	3, 4	(1,573)	(1,681)	(2,452)	(2,582)

1. The fair value of short-term deposits approximates to carrying value due to the short maturity of instruments held.
2. The fair value of investments listed on a recognised stock exchange is estimated at quoted market price. Others are valued at cost.
3. The fair value of the quoted debt at the reporting date has been estimated at market rates.
4. The fair values shown for short and long-term debt do not take account of the fair values of the cross currency swaps shown above.

Short-term debtors and creditors are not included in these disclosures.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

28 Financial instruments (continued)

The movement in unrecognised gains and losses on instruments used for hedging is as follows:

	Gains £m	Losses £m	Total net (losses)/gains £m
Unrecognised gains/(losses) on hedges at 31 December 2002	52	(38)	14
(Gains)/Losses on hedges arising in previous periods that were recognised during the year	(6)	4	(2)
Gains/(Losses) on hedges arising before 31 December 2002 that were not recognised during the year	46	(34)	12
(Gains)/Losses on hedges arising during 2002 that were not recognised during the year	11	(3)	8
Unrecognised gains/(losses) on hedges at 31 December 2003	57	(37)	20
Of which:			
Gains/(Losses) expected to be recognised in 2004	2	(34)	(32)
Gains/(Losses) expected to be recognised in 2005 or later	55	(3)	52

The hedging of translation exposures associated with foreign currency net investments is however recognised in the balance sheet.

29 Commitments and contingent liabilities

- a) At 31 December 2003, the Group had commitments contracted but not provided of £41 million (31 December 2002 £57 million) for capital expenditure.
- b) The Group is aware of claims in respect of current and former employees, including former employees of the Central Electricity Generating Board, and contractors in respect of industrial illness and injury and other potential claims which involve or may involve legal proceedings against the Group.

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

29 Commitments and contingent liabilities (continued)

- c) In 1990 and 1994, complaints were made to the European Commission by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Mines Association (SWSMA) against the Company and National Power plc. The complaints alleged breaches of EU law by the Central Electricity Generating Board in its coal purchasing practices prior to 1990. Under the arrangements for electricity privatisation, it is possible that either or both of the Company and National Power plc (through its successor companies) could be liable to pay any compensation that may ultimately arise. The Commission rejected both complaints, on legal grounds, in 1998, which decisions were appealed by NALOO and some former members of SWSMA (the 'Former SWSMA Members'). In 2003, the Court of Justice of the European Communities found in favour of NALOO, overturning the Commission's rejection of the complaint. As a result of this judgment, the Commission has taken a decision withdrawing its 1998 rejection of the SWSMA complaint insofar as it related to the Former SWSMA Members. It is therefore expected that the Court of First Instance will rule that the proceedings by the Former SWSMA Members are without purpose, since the original SWSMA complaint now stands in respect of the Former SWSMA Members as if it had not been rejected. The Commission therefore has to reconsider the NALOO and (insofar as it relates to the Former SWSMA Members) SWSMA complaints and decide what action to take in respect of them. Powergen has received from the Commission submissions from NALOO and supporting papers upon which it has been asked to comment. It is not practicable to estimate legal costs, or the risk or amount of possible compensation, at this stage.
- d) The Group has in place a portfolio of fuel contracts of varying volume, duration and price, reflecting market conditions at the time of commitment. These contracts are with UK, US and other international suppliers of coal and are backed by transport contracts for rail, road, canal and sea movements. At 31 December 2003 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £53 million (31 December 2002 £788 million).

Following the acquisition of Edenderry (see note 10), the Group also has purchase contracts for peat to burn in that power station. At 31 December 2003 the Group's future purchase commitment totalled £17 million.

The Group is also committed to purchase gas under various long-term gas supply contracts including the supply of gas to the Group's UK CCGT power stations. At 31 December 2002 the estimated minimum commitment for the supply of gas under all these contracts totalled £1,718 million (31 December 2002 £3,279 million).

The Group is also committed to power purchase contracts for the supply of electricity. At 31 December 2003 the total contractual commitment for the group was £978 million (31 December 2002 £1,021 million).

POWERGEN LIMITED

Notes to the financial statements for the year ended 31 December 2003 (continued)

29 Commitments and contingent liabilities (continued)

- e) In the normal course of business the Group gives certain other indemnities and guarantees which are not considered to be material in the context of these financial statements and on which no losses are anticipated to arise.
- f) The Group has non-cancellable operating lease commitments for generating and other assets. The future minimum annual lease payments at 31 December 2003 under these non-cancellable agreements, are analysed as follows:

	At 31 December 2003			At 31 December 2002
	Land and buildings	Other operating leases	Total minimum payments	Total minimum payments
	£m	£m	£m	£m
2003	5	2	7	26
2004	3	2	5	26
2005	2	2	4	25
2006	2	1	3	23
2007	1	-	1	22
In more than five years	2	-	2	331
	<u>15</u>	<u>7</u>	<u>22</u>	<u>453</u>

All of the leases shown above expire after more than five years with the exception of two land and buildings leases which have annual commitments of £1m per annum and expire within two to five years.

30 Ultimate parent undertaking and controlling party

The immediate parent undertaking is E.ON UK Limited. The ultimate parent undertaking and controlling party is E.ON AG, which is the parent company of the largest and smallest group to consolidate these financial statements. Copies of E.ON AG's Annual Report are available from the offices of E.ON AG at the following address:

E.ON AG
E.ON- Platz 1
D-40479
Düsseldorf
Germany

POWERGEN LIMITED

Notes to the financial statements **for the year ended 31 December 2003 (continued)**

31 Post balance sheet event

On 16 January 2004, Powergen acquired the issued share capital of Aquila Sterling Limited. The principal activity of that group is the Midlands Electricity distribution business which services the West Midlands and compliments the East Midlands distribution business already operated by Powergen.