

HYDROCARBON RESOURCES LIMITED

REPORT AND ACCOUNTS

FOR THE PERIOD ENDED

30 DECEMBER 2005



REGISTERED NO: 3115179

Hydrocarbon Resources Limited

DIRECTORS' REPORT

The Directors present their report and the audited accounts of Hydrocarbon Resources Limited ("the Company") for the period ended 30 December 2005. The accounting reference date for 2005 has been changed to 30 December 2005 resulting in the preparation of accounts for the period then ended. As a result, comparatives for the Profit and Loss Account, the Statement of Total Recognised Gains and Losses and related notes are not comparable.

Principal activities

The principal activity of the Company is the production of gas from the North and South Morecambe Gas fields. On 2 November 2005 the Company transferred the beneficial interest in part of its gas production business and assets to The Centrica Gas Production LP, a subsidiary of the Centrica group.

Business review

The Company, as part of the Centrica plc group, continued its major activity in the production of gas and associated condensate from its two production fields (North and South Morecambe) in Morecambe Bay. These fields represent the largest producing gas fields in the UK continental shelf, with proven and probable reserves of approximately 1,136 billion cubic feet at 30 December 2005 (31 December 2004 – 1,369 billion cubic feet). Production of gas amounted to 246 billion cubic feet (31 December 2004: 347 billion cubic feet) in the period with total condensate sales equivalent to 500,000 barrels of oil equivalent (31 December 2004: 556,000 barrels of oil equivalent). On 2 November 2005 the Company transferred a beneficial interest in the licences to operate the North and South Morecambe Gas fields, a beneficial interest in owned platforms relating to the South Morecambe Gas fields and novated certain gas supply agreements to The Centrica Gas Production Limited Partnership. The transfers were carried out in exchange for an increase in the Company's general partnership interest in The Centrica Gas Production LP. The Company entered into an Asset Management Agreement on 2 November 2005 to provide gas production services to the partnership in respect of the North and South Morecambe Gas fields. On 2 December 2005 a new limited partner was admitted to the partnership, resulting in variations to the Company's entitlement under the Partnership Agreement. The Company includes its share of partnership profits and losses within its profit and loss account and includes its share of partnership assets and liabilities within its balance sheet on a proportional consolidation basis.

In addition to the Morecambe gas fields, Hydrocarbon Resources Limited is Operator of the Bains field (52.8% working interest).

Future developments

The Company is in a good position to take advantage of any opportunities which may arise in the future.

Financial results and dividends

The Company's profit after tax for the period is £652,047,000 (restated for year ended 31 December 2004: £609,012,000). In the period to 30 December 2005, £652,047,000 has been transferred to reserves (£1,790,988,000 transferred to reserves for the year ended 31 December 2004).

Hydrocarbon Resources Limited

DIRECTORS' REPORT (continued)

No dividends were paid during the period and the Directors do not recommend the payment of a dividend. (2004: Two 'special' dividends of £2,000,000,000 and £400,000,000 were paid during the fourth quarter of the year).

Financial risk management

The Directors have established objectives and policies for managing financial risks to enable the Company to achieve its long-term shareholder value growth targets within a prudent risk management framework. These objectives and policies are regularly reviewed. Exposure to commodity price risk, counterparty credit risk and liquidity risk arises in the normal course of the Company's business. The most significant financial risk facing the Company relates to commodity prices. The risk is primarily that market prices for commodities will move adversely thereby potentially reducing expected margins. Counterparty credit exposures are monitored by individual counterparty and by category of credit rating, and are subject to approved limits. Credit risk is predominantly limited to exposures with other Centrica Group companies. Cash forecasts identifying the liquidity requirements of the Company are produced frequently and reviewed regularly to ensure there is sufficient financial headroom for at least a 12 month period.

Directors

Michael Garstang, Jake Ulrich and Kevin Cochrane served as directors throughout the financial year. Changes since 1 January 2005 are as follows:

John Shears (appointed 28 April 2005)

Nicholas Dunn (appointed 28 April 2005, resigned 19 January 2006)

Andrew Le Poidevin (appointed 19 January 2006)

Directors' interests

At no time during the period ended 30 December 2005, did any Director have any interest in the shares of the Company or any other company in the Centrica group, except for the interests in, and the options over, the shares and interests of the ultimate parent company, Centrica plc.

The remaining Directors with interests in and options over the ordinary shares of Centrica plc at period-end are as follows:

Interests in ordinary shares

(As defined by section 325 of the Companies Act 1985)

Beneficial Interest in ordinary shares

| | As at 1 January 2005 | As at 30 December 2005 |
|------------------|-------------------------|---------------------------|
| Kevin Cochrane | 32,921 | 40,349 |
| Nicholas Dunn * | 13,587 | - |
| Michael Garstang | - | 12,541 |
| Jacob Ulrich | 527,936 | 693,871 |
| John Shears * | 1,851 | 2,174 |

Hydrocarbon Resources Limited

DIRECTORS' REPORT (continued)

* As at date of appointment

The figures above include shares appropriated under the terms of the Centrica Share Incentive Plan.

Centrica Sharesave scheme

| | As at 1 January 2005 | Granted during the period | Exercised during the period | Lapsed during the period | As at 30 December 2005 |
|----------------|----------------------------|---------------------------------|-----------------------------------|--------------------------------|------------------------------|
| Kevin Cochrane | 8,500 | 2,021 | 832 | - | 9,689 |
| Jacob Ulrich | 8,823 | - | - | - | 8,823 |
| John Shears * | 15,336 | - | - | - | 15,336 |

* As at date of appointment

Options were granted under the terms of the Sharesave scheme on 6 April 2005 at an option price of 187.5 pence per share.

Long-term Incentive scheme (LTIS)

| | As at 1 January 2005 | Allocations made during the period | Allocations transferred during the period | Allocations lapsed during the period | As at 30 December 2005 |
|------------------|----------------------------|---|--|---|------------------------------|
| Kevin Cochrane | 75,674 | 20,358 | 23,354 | 3,848 | 68,830 |
| Nicholas Dunn * | 122,027 | - | - | - | 122,027 |
| Michael Garstang | 94,377 | 25,147 | 36,609 | 4,664 | 78,251 |
| Jacob Ulrich | 718,696 | 168,926 | 279,593 | 33,816 | 574,213 |
| John Shears * | 205,794 | - | 48,726 | - | 157,068 |

* As at date of appointment

Total allocations as at 30 December 2005 shown above are subject to challenging performance conditions. At the end of the performance period the Total Shareholder Return of Centrica plc will be assessed against that of the relevant LTIS comparator group. If, and to the extent that, the performance conditions are met, the relevant number of shares will be released to the Directors at the Trustee's discretion as soon as practicable thereafter.

A conditional allocation of shares was made under the terms of the scheme on 1 April 2005 at a price of 228 pence per share.

Hydrocarbon Resources Limited

DIRECTORS' REPORT (continued)

Centrica Executive Share Option Scheme

| | As at 1 January 2005 | Granted during the period | Exercised during the period | As at 30 December 2005 |
|-----------------|----------------------------|---------------------------------|-----------------------------------|------------------------------|
| Nicholas Dunn * | 308,348 | - | - | 308,348 |
| Jacob Ulrich | 1,737,626 | 450,470 | - | 2,188,096 |
| John Shears * | 456,499 | - | - | 456,499 |

* As at date of appointment

Under the terms of the Executive Share Option Scheme a grant of options over shares was made on 1 April 2005 at an option price of 228.65 pence per share.

Details of the ultimate parent company's Sharesave Scheme, Executive Share Option Scheme and LTIS can be found in the 2005 accounts of Centrica plc, copies of which can be obtained from www.centrica.com.

The middle market price of a Centrica plc ordinary share on the last day of trading of 2005 (30 December) was 254.75 pence. The range during the year was 264.75 pence (high) and 217.50 pence (low).

As at 30 December 2005, nil shares and 2,591 shares (1 January 2005: 6,370,264 and 2,548) were held by the respective Trustees of employee share trusts for the purposes of the LTIS and the Share Incentive Plan. As with other employees, the Directors are deemed to have a potential interest in those shares, being beneficiaries under the trust.

There were no contracts of significance during or at the end of the financial year to which the Company or any subsidiary and associated undertakings is a party and in which any Director is or was materially interested.

Related party transactions

The Company has taken advantage of the exemptions within Financial Reporting Standard No 8 "Related Party Disclosures" from disclosure of transactions with other Centrica group companies. There have been no other disclosable related party transactions during the year (year ended 31 December 2004: £nil).

Creditor payment policy

The Company aims to pay all its creditors promptly within agreed contract terms. The number of days' purchases represented by trade creditors at the year-end was 29 days.

Political and charitable donations

The Company made no political or charitable donations during the year (2004: £nil).

Hydrocarbon Resources Limited

DIRECTORS' REPORT (continued)

Employment policies

During 2005, the Company employed an average of 307 people, all employed in the United Kingdom (2004: 329).

The Company is committed to pursuing equality and diversity in all its employment activities and continues to support initiatives to provide employment for people from minority groups in the community, including people with disabilities, carers and lone parents. To the extent possible, people with disabilities are offered the same employment training, career development and promotion opportunities as other employees. The Centrica Group, to which SF (UK) Limited belongs, is actively working with a number of organisations in the diversity arena including the Employers' Forum on Disability, the Employers' Forum on Age, Race for Opportunity, Carers UK, Opportunity Now, Working Families and Jobcentre Plus.

The Company's business principles and policies set out standards of behaviour expected of its employees in conducting business in an ethical way.

Employees are regularly updated on performance against the Company's strategy. There are regular employee surveys, action planning forums and dialogue with representatives of local employee consultative bodies and recognised trade unions to ensure a comprehensive understanding of employees' views. The Centrica Group, to which SF (UK) Limited belongs, encourages employee share ownership by operating tax authority-approved share schemes open to all eligible employees, including Executive Directors.

Directors and Officers Liability

Directors and officers liability insurance has been purchased by the ultimate parent company, Centrica Plc, and was in place throughout the period under review.

Events after the Balance Sheet Date

In December 2005, the UK government announced an increase in the supplementary charge levied on upstream profits from 10% to 20%, effective from 1 January 2006. At 30 December 2005 the tax rate change was not substantively enacted. The deferred tax credit would have increased by approximately £9 million had the change of tax rate been substantially enacted at the balance sheet date.

Auditors

In accordance with Section 386 of the Companies Act 1985, the Company has elected to dispense with the obligation to reappoint auditors annually, and PricewaterhouseCoopers LLP will therefore continue in office.

Hydrocarbon Resources Limited

DIRECTORS' REPORT (continued)

This report was approved by the Board on 30 October 2006

for and on behalf of
Centrica Secretaries Limited
Company Secretary

30 October 2006

Registered Office
Millstream
Maidenhead Road
Windsor
Berkshire SL4 5GD

Hydrocarbon Resources Limited

STATEMENT OF 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 profit or loss for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the period ended 30 December 2005 and that applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at the time the financial position of the company 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 hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Hydrocarbon Resources Limited

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF HYDROCARBON RESOURCES LIMITED

We have audited the financial statements of Hydrocarbon Resources Limited for the period ended 30th December 2005 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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 into 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 information given in the Directors' Report is consistent with the financial statements. 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 30th December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

1 Embankment Place, London. WC2N 6RH

30 October 2006

Hydrocarbon Resources Limited

PROFIT AND LOSS ACCOUNT FOR THE PERIOD ENDED 30 DECEMBER 2005

| | Notes | Period ended 30 December 2005 £000 | Restated Year ended 31 December 2004 £000 |
|---|-------|--|--|
| Turnover | 2 | 1,296,444 | 1,268,611 |
| Cost of sales | | (448,554) | (428,881) |
| Gross profit | | 847,890 | 839,730 |
| Other income | | 1,746 | — |
| Operating Profit | | 849,636 | 839,730 |
| Other interest receivable and similar income | 5 | 6,468 | 3,540 |
| Interest payable and similar charges | 5 | (5,959) | (12,072) |
| Profit on ordinary activities before taxation | 3 | 850,145 | 831,198 |
| Tax on profit on ordinary activities | 6 | (198,098) | (222,186) |
| Profit on ordinary activities after taxation | | 652,047 | 609,012 |
| Dividend | | — | (2,400,000) |
| Retained profit/ (loss) for the financial period | 16 | 652,047 | (1,790,988) |

There are no differences between the profit on ordinary activities before taxation and the retained profit for the year stated above and their historical cost equivalents.

The notes on pages 12 to 32 form part of these financial statements.

Hydrocarbon Resources Limited

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

| | Note | Period ended 30 December 2005 £000 | Restated Year ended 31 December 2004 £000 |
|--|-------------|---|--|
| Retained Total recognised gains and losses relating to the year | | 652,047 | (1,790,988) |
| Prior year adjustment- Increase in net assets as at 31/12/04 | 21 | 1,508 | |
| Total recognised gains and losses since last financial statements | | 653,555 | |

All activities relate to continuing operations.

The notes on pages 12 to 32 form part of these Financial Statements.

Hydrocarbon Resources Limited

BALANCE SHEET AS AT 30 DECEMBER 2005

| | | As at 30 December 2005 £000 | Restated As at 31 December 2004 £000 |
|--|-------|-----------------------------------|---|
| | Notes | | |
| Fixed assets | | | |
| Intangible fixed assets | 7 | 456 | - |
| Tangible fixed assets | 8 | <u>438,598</u> | <u>510,135</u> |
| | | 439,053 | 510,135 |
| Current assets | | | |
| Stocks | 9 | 16,225 | 16,948 |
| Debtors (amount falling due within one year) | 10 | 2,528,124 | 1,488,974 |
| Cash at bank and in hand | | <u>182</u> | <u>18</u> |
| | | 2,544,531 | 1,505,940 |
| Creditors (amounts falling due within one year) | | | |
| Borrowings | 11 | - | (24,939) |
| Creditors | 12 | <u>(269,440)</u> | <u>(225,207)</u> |
| | | (269,440) | (250,146) |
| Net current assets | | <u>2,275,091</u> | <u>1,255,794</u> |
| Total assets less current liabilities | | 2,714,144 | 1,765,929 |
| Creditors (amounts falling due after one year) | | | |
| Borrowings | 11 | (282) | (282) |
| Creditors | 12 | (435,065) | - |
| Provisions for liabilities and charges | 13,14 | <u>(224,812)</u> | <u>(364,232)</u> |
| | | (660,159) | (364,514) |
| Net assets | | <u>2,053,985</u> | <u>1,401,415</u> |
| Capital and reserves - equity interests | | | |
| Called up share capital | 15 | 800,000 | 800,000 |
| Share premium account | 16 | 447,162 | 447,162 |
| Share option reserve | 16 | 1,000 | 477 |
| Profit and loss account | 16 | <u>805,823</u> | <u>153,776</u> |
| Shareholder funds | 17 | <u>2,053,985</u> | <u>1,401,415</u> |

The financial statements were approved and authorised for issue by the Board of Directors on 30 October 2006 and were signed on its behalf by:



Andrew Le Poidevin

The notes on pages 12 to 32 form part of these financial statements.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention and the Companies Act 1985. The accounting policies, where applicable, are in accordance with the Statement of Recommended Practice ('SORP') 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' issued by the UK Oil Industry Accounting Committee on 7 June 2001. The following policies have been applied consistently to the Company's financial statements.

1 Principal accounting policies

Basis of preparation

The accounting reference date for 2005 has been changed to 30 December 2005 resulting in the preparation of accounts for the period then ended. As a result, comparatives for the Profit and Loss Account, the Statement of Total Recognised Gains and Losses and related notes are not comparable.

a) Changes in accounting policy

The Company has adopted FRS20 "Share-based payment", FRS17 "Retirement benefits" and FRS21 "Events after the balance sheet date" in the period. The adoption of each of these standards represents a change in accounting policy, and accordingly the comparative figures have been restated where required. Details of the effect of the change in policy are given in note 21.

b) Pensions and other retirement benefits

The Company's employees participate in a number of the Group's defined benefit pension schemes. The Company is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis and therefore accounts for the schemes as if they were defined contribution schemes. The charge to the profit and loss account is equal to the contributions payable to the schemes in the accounting period, which are based on pension costs across the Group as a whole.

c) Exemptions

As the Company is a wholly owned subsidiary of British Gas Trading Limited which is a wholly owned subsidiary of Centrica plc, the Company has taken advantage of the exemptions within FRS 1, "Cash Flow Statements" from presenting a cash flow statement and within FRS 8, "Related Party Disclosures" from disclosure of transactions with other companies that are part of the Centrica plc group.

d) Turnover

Turnover represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

Turnover includes the Company's share of turnover arising within The Centrica Gas Production LP, a limited partnership in which the Company holds a general partnership interest.

Where the Company has ongoing obligations to provide services, revenues are apportioned on a time basis, and those monies received in advance are treated as deferred income and excluded from current turnover.

e) Cost of sales

Cost of sales include the cost of gas produced, and related transportation and royalty costs, bought in materials and services, and direct labour and related overheads on installation works, repairs and service contracts. Gas production costs include petroleum revenue taxes, calculated on a unit of production basis, with changes in estimates dealt with prospectively over the remaining lives of gas fields. Cost of sales includes the Company's share of cost of sales arising within The Centrica Gas Production LP, a limited partnership in which the Company holds a general partnership interest.

f) Other Income

Other operating income includes fees earned from the provision of gas production services in the North and South Morecambe gas fields to The Centrica Gas Production LP. The fees are recognised on the basis of services rendered in the period.

g) Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at closing rates of exchange. Exchange differences on monetary assets and liabilities are taken to the profit and loss account. Year end exchange rates used were £1: \$1.723 (2004 £1: \$1.9031).

h) Emissions Trading Scheme

Granted CO₂ emissions allowances received in a period are initially recognised at nominal value (nil value). Purchased CO₂ emissions allowances are initially recognised at cost (purchase price) within intangible fixed assets. A liability is recognised when the level of emissions exceeds the level of allowances granted. The intangible asset is surrendered at the end of the compliance period reflecting the consumption of economic benefit. As a result no amortisation is recorded during the period.

i) Tangible fixed assets

Tangible fixed assets are included in the balance sheet at cost, less accumulated depreciation and any provisions for impairment. Other tangible fixed assets, except exploration and production assets, are depreciated on a straight-line basis at rates sufficient to write off the cost, less estimated residual values, of individual assets over their estimated useful lives.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

Assets held under finance leases are depreciated over the shorter of the lease term or their useful economic life.

Exploration and production assets are depreciated from the commencement of production in the fields concerned, using the successful efforts and unit of production methods, as defined in the SORP, based on all of the proven and probable reserves of those fields. Changes in these estimates are dealt with prospectively. The net carrying value of fields in production is compared on a field-by-field basis with the likely future net revenues to be derived from the estimated remaining commercial reserves. A provision is made where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues.

j) Decommissioning costs

Provision is made for the net present cost of decommissioning gas production facilities. A corresponding tangible fixed asset is recognised in respect of the decommissioning costs, based on price levels and technology at the balance sheet date. This asset is amortised using the unit of production method, based on proven and probable developed reserves. Notional interest charges arise over time, based upon the discounted decommissioning liabilities.

k) Leases

Assets held under finance leases are capitalised and included in tangible fixed assets at cost. The obligations relating to finance leases, net of finance charges in respect of future periods, are included within borrowings. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect the constant rate of interest on the remaining balance of the obligation for each accounting period. Rentals under operating leases are charged to the profit and loss account on a straight line basis.

l) Stocks

Stocks are valued at the lower of cost and net realisable value.

m) Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits in the foreseeable future from which the reversal of the underlying timing differences can be deducted. Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the financial statements. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

n) Employee Share Schemes

As a subsidiary of Centrica plc, the Company participates in a number of the Group's employee share schemes under which it makes equity-settled share based payments in Centrica plc shares to certain employees. These are detailed in the Annual Report and Accounts of Centrica plc.

Equity-settled share-based payments are measured at fair value at the date of grant (excluding the effect of non market-based vesting conditions). The fair value determined at the grant date is expensed on a straight line basis together with the corresponding increase in equity over the vesting period, based on the Group's estimate of the number of shares that will vest and adjusted for the effect of non market-based conditions.

Fair value is measured using methods appropriate to each of the different schemes as follows:

| | |
|-----------|--|
| LTIS | A Black-Scholes valuation augmented by a Monte Carlo simulation to predict the Total Shareholder Return performance. |
| Sharesave | Black-Scholes |
| ESOS | Black-Scholes using an adjusted option life assumption to reflect the possibility of early exercise. |

The Company has taken advantage of the transitional provisions of FRS20 "Share-based payment" in respect of equity-settled awards and has applied FRS20 only to equity-settled awards granted after 7 November 2002, that were unvested at 1 January 2005.

o) Financial instruments

Derivative instruments are accounted for under the accrual method. Amounts payable or receivable in respect of these derivatives are recognised as adjustments to cost of sales over the period of the contracts. Changes in the derivatives' fair value are not recognised.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

p) Commercial reserves

Commercial reserves are proved and probable developed and undeveloped oil and gas reserves as defined in the SORP.

q) The Centrica Gas Production LP

The Company is general partner to The Centrica Gas Production LP, a limited partnership and subsidiary of the Company. The Company accounts for its share of The Centrica Gas Production LP partnership profits and losses within the profit and loss account and its share of The Centrica Gas Production LP partnership assets and liabilities within the balance sheet by proportional consolidation.

r) Deferred Income – The Centrica Gas Production LP

Deferred income represents the Company's share of cash invested by a limited partner to the Centrica Gas Production LP in exchange for a limited partnership entitling it to profits from the South Morecambe gas field for the next seven years. The Company, as General Partner to the partnership, is under no obligation to return the cash to the limited partner. The income is deferred and is recognised within turnover on a unit of production basis based on South Morecambe production in the period compared to total production over the seven year period to which it relates.

2 Segmental analysis

Turnover relates to the principal activities of the business and arose wholly in the United Kingdom and comprises:

| | Period Ended 30 December 2005 £000 | Year ended 31 December 2004 £000 |
|--|---|---|
| Turnover | | |
| Turnover – HRL sales of gas and condensate | 1,043,037 | 1,268,611 |
| Turnover - The Centrica Gas Production LP | <u>253,407</u> | <u>-</u> |
| | <u>1,296,444</u> | <u>1,268,611</u> |

Turnover – The Centrica Gas Production LP represents the Company's share of turnover arising within The Centrica Gas Production LP. This includes £19,772,000 (2004: £nil) relating to the release of deferred income as described in more detail in Note 12.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

3 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging/(crediting):

| | Period Ended 30 December 2005 £000 | Year ended 31 December 2004 £000 |
|---|--|--|
| a) Depreciation and amortisation: | | |
| Owned assets | 95,776 | 126,794 |
| Leased assets | <u>13,044</u> | <u>18,517</u> |
| | <u>108,820</u> | <u>145,311</u> |
| b) Operating lease rentals: | | |
| Other operating leases - Land and buildings | 599 | 462 |
| c) Auditors' remuneration: | | |
| Audit fees | 60 | 60 |

4 Directors and employees

i) Directors' emoluments

| | Period ended 30 December 2005 £000 | Year ended 31 December 2004 £000 |
|----------------------|--|--|
| Aggregate emoluments | <u>—</u> | <u>466</u> |

All of the Directors who served during the period are members of the ultimate parent company's defined benefit pension scheme.

Under the Centrica plc Group long-term incentive scheme, five Directors received shares during the year.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

ii) Employee costs

| | Period ended 30 December 2005 £000 | Restated Year ended 31 December 2004 £000 |
|----------------------------|--|--|
| Wages and salaries | 13,957 | 15,889 |
| Social security costs | 1,338 | 1,723 |
| Other pension costs | 2,482 | 2,941 |
| Long-term incentive scheme | 52 | 19 |
| Employee sharesave scheme | <u>472</u> | <u>226</u> |
| | <u>18,301</u> | <u>20,798</u> |

iii) Employee numbers

The average number of employees during the period ended 30 December 2005 was 307 (year ended 31 December 2004: 329).

| | Period ended 30 December 2005 | Year ended 31 December 2004 |
|------------|----------------------------------|--------------------------------|
| Production | 272 | 292 |
| Admin | <u>35</u> | <u>37</u> |
| | <u>307</u> | <u>329</u> |

5 Interest

i) Other interest receivable and similar income:

| | | |
|---|----------------|----------------|
| Interest receivable from group undertakings | (6,468) | (3,540) |
| | <u>(6,468)</u> | <u>(3,540)</u> |

ii) Interest payable and similar charges:

| | | |
|---|--------------|---------------|
| Finance lease charges | 1,291 | 4,383 |
| Other interest payable | 1,710 | 4,889 |
| Notional interest arising on discounted items | <u>2,958</u> | <u>2,800</u> |
| | <u>5,959</u> | <u>12,072</u> |

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

6 Tax on profit on ordinary activities

a) Analysis of tax charge in the period

The tax charge comprises:

| | Period ended 30 December 2005 £000 | Restated Year ended 31 December 2004 £000 |
|--|--|--|
| Current tax: | | |
| - UK corporation tax at 30% | 191,685 | 160,432 |
| - Supplemental Upstream Tax at 10% | 64,137 | 54,501 |
| - Adjustments in respect of prior periods | <u>(12,489)</u> | <u>9,355</u> |
| Total current tax | 243,333 | 224,288 |
| Deferred tax: | | |
| - Deferred petroleum revenue tax (PRT) relief | 39,850 | 35,966 |
| - Origination and reversal of timing differences | (93,457) | (38,068) |
| - Adjustments in respect of prior periods | <u>8,372</u> | <u>-</u> |
| Total tax on profit on ordinary activities | <u>198,098</u> | <u>222,186</u> |

In December 2005, the UK government announced an increase in the supplementary charge levied on upstream profits from 10% to 20%, effective from 1 January 2006. At 30 December 2005 the tax rate change was not substantively enacted. The deferred tax credit would have increased by approximately £9 million had the change of tax rate been substantially enacted at the balance sheet date.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

(b) Factors affecting the tax charge for the period

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax are as follows:

| | Period ended 30 December 2005 £000 | Year ended 31 December 2004 £000 |
|--|--|--|
| Profit on ordinary activities before tax | <u>850,145</u> | <u>831,199</u> |
| Tax on profit on ordinary activities at standard UK corporation tax rate of 30% | 255,044 | 249,360 |
| Effects of: | | |
| - Net income not taxable | (100,109) | (89,334) |
| - Utilisation of timing differences | 45,116 | 4,439 |
| - Depreciation in excess of capital allowances | 25,864 | 27,701 |
| - Movement on deferred PRT provision | (29,888) | (31,399) |
| - Supplementary charge applicable to upstream profits | 64,137 | 54,501 |
| - UK: UK transfer pricing adjustment | 3,935 | 20,897 |
| - Group relief for nil consideration | (8,277) | (21,232) |
| - Adjustments to tax charge in respect of previous periods | <u>(12,489)</u> | <u>9,355</u> |
| Current tax charge for the period | <u>243,333</u> | <u>224,288</u> |

7 Intangible fixed assets

Cost

As at 1 January 2005

Additions

As at 30 December 2005

£000

-

456

456

Amortisation

As at 1 January 2005

Charge for the year

As at 30 December 2005

-

-

-

Net book value

As at 30 December 2005

456

As at 1 January 2005

-

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

8 Fixed assets – proved gas properties

| | £000 |
|--------------------------------------|------------------|
| Cost | |
| As at 1 January 2005 | 2,778,098 |
| Additions | 34,799 |
| Revision of abandonment asset | <u>2,483</u> |
| As at 30 December 2005 | <u>2,815,380</u> |
| Depreciation and amortisation | |
| As at 1 January 2005 | 2,267,962 |
| Charge for the year | <u>108,820</u> |
| As at 30 December 2005 | <u>2,376,782</u> |
| Net book value | |
| As at 30 December 2005 | <u>438,598</u> |
| As at 1 January 2005 | <u>510,135</u> |

The net book value of tangible fixed assets held under finance leases, as at 30 December 2005, was £76,658,000 (2004: £81,741,000). This represents certain South Morecambe gas field production assets sold and leased back in 1998 and 1999. The net book value of the Company's decommissioning costs; at 30 December 2005 were £8,450,000 (2004: £7,588,000).

9 Stocks

| | As at 30 December 2005 £000 | As at 31 December 2004 £000 |
|------------------------------------|-----------------------------------|-----------------------------------|
| Operational spares and consumables | <u>16,225</u> | <u>16,948</u> |

10 Debtors

| | As at 30 December 2005 £000 | As at 31 December 2004 £000 |
|------------------------------------|-----------------------------------|-----------------------------------|
| Amounts owed by group undertakings | 2,518,302 | 1,482,431 |
| Other debtors | 9,822 | 6,018 |
| Prepayments and accrued income | <u>-</u> | <u>525</u> |
| | <u>2,528,124</u> | <u>1,488,974</u> |

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

11 Borrowings

| | As at 30 December 2005 £000 | As at 31 December 2004 £000 |
|---|-----------------------------------|-----------------------------------|
| Amount falling due within one year | | |
| Amounts payable under finance leases | <u>-</u> | <u>24,939</u> |
| | <u>-</u> | <u>24,939</u> |
| Amounts falling due after more than one year | | |
| Amounts payable under finance leases | <u>282</u> | <u>282</u> |

Obligations under finance leases were repayable as follows:-

| | As at 30 December 2005 £000 | As at 31 December 2004 £000 |
|----------------------------|-----------------------------------|-----------------------------------|
| Between one and two years | 282 | 282 |
| Between two and five years | <u>-</u> | <u>-</u> |
| Total | <u>282</u> | <u>282</u> |

12 Creditors

| | As at 30 December 2005 £000 | As at 31 December 2004 £000 |
|--|-----------------------------------|-----------------------------------|
| Amounts falling due within one year | | |
| Trade creditors | 2,502 | 1,314 |
| Amounts owed to group undertakings | - | 443 |
| Taxation and social security | 95,102 | 147,543 |
| Other creditors | - | 45,014 |
| Accruals and deferred income | 17,672 | 30,893 |
| Deferred Income – The Centrica Gas Production LP | <u>154,164</u> | <u>-</u> |
| | <u>269,440</u> | <u>225,207</u> |
| Amounts falling due after one year | | |
| Deferred Income – The Centrica Gas Production LP | <u>435,065</u> | <u>-</u> |
| | <u>435,065</u> | <u>-</u> |

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

Deferred Income – The Centrica Gas Production LP represents the Company's share of cash invested by a limited partner in The Centrica Gas Production LP in exchange for a limited partnership interest representing entitlement to profits from South Morecambe gas field for a seven year period. The Company, as General Partner to the partnership, is under no obligation to return the cash to the limited partner. The income has been deferred and is released to turnover on a unit of production basis based on South Morecambe production in the period compared to total production over the seven year period to which it relates. The amount released during the year was £19,772,000.

13 Provisions for liabilities and charges

| | Decommissioning Costs £000 | Deferred PRT £000 | Deferred CT £000 | Total £000 |
|---------------------------------|----------------------------------|-------------------------|------------------------|----------------|
| As at 1 January 2005 Restated | 99,309 | 182,484 | 82,439 | 364,232 |
| Revisions | 2,483 | - | - | 2,483 |
| Profit and loss charge/(credit) | 2,958 | (99,626) | (45,235) | (141,903) |
| Utilised in the period | — | — | — | — |
| As at 30 December 2005 | <u>104,750</u> | <u>82,858</u> | <u>37,204</u> | <u>224,812</u> |

Decommissioning costs

Provision has been made for the estimated net present cost of decommissioning gas production facilities at the end of their producing lives. The estimate has been based on proved and probable reserves, price levels and technology at the balance sheet date. The timing of decommissioning payments are dependent on the lives of a number of fields but are anticipated to occur between 2010 and 2017. The revision in the period is due to an increase in the estimate for gas field abandonment costs. The profit and loss charge includes £2,958,000 (year ended 31 December 2004 - £2,800,000) of notional interest.

Deferred PRT (petroleum revenue tax)

The provision for tax on gas activities has been calculated on a unit of production basis.

14 Deferred corporation tax

A deferred tax provision has been made in respect of accelerated capital allowances and other timing differences, net of recognised deferred tax assets. As required by FRS 19, deferred tax assets are only recognised when there is persuasive and reliable evidence that the assets can be realised. Detailed operating plans covering two years from the balance sheet date are used for deferred tax asset recognition purposes. Potential deferred tax asset utilisation falling outside that planning horizon is not currently recognised on the balance sheet. As encouraged by FRS 19, deferred tax asset recognition will be regularly reassessed.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

Movement on the deferred corporation tax provision in the period is analysed below:

| | Restated As at 1 January 2005 £000 | Profit and loss charge/ (credit) £'000 | As at 30 December 2005 £'000 |
|----------------------------------|---|---|--|
| Deferred corporation tax | | | |
| - accelerated capital allowances | 160,807 | (34,485) | 126,322 |
| - deferred PRT | (72,994) | 39,850 | (33,144) |
| - other timing differences | <u>(5,374)</u> | <u>(50,600)</u> | <u>(55,974)</u> |
| | <u>82,439</u> | <u>(45,235)</u> | <u>37,204</u> |

Deferred corporation tax provision/(asset) at 40% (as at 31 December 2004: 40%) is analysed as follows:-

| | Provided | | Unprovided | |
|----------------------------------|---|---|---|---|
| | Restated As at 30 December 2005 £'000 | As at 31 December 2004 £'000 | As at 30 December 2005 £'000 | As at 31 December 2004 £'000 |
| Deferred corporation tax | | | | |
| - accelerated capital allowances | 126,322 | 160,807 | - | - |
| - deferred PRT | (33,144) | (72,994) | - | - |
| - other timing differences | <u>(55,974)</u> | <u>(5,374)</u> | <u>(38,823)</u> | <u>(36,992)</u> |
| | <u>37,204</u> | <u>82,439</u> | <u>(38,823)</u> | <u>(36,992)</u> |

15 Called up share capital

| | As at 30 December 2005 & 31 December 2004 £000 |
|--|--|
| Authorised | |
| 800,000,100 ordinary shares of £1 each | <u>800,000</u> |
| Issued, allotted and fully paid | |
| 800,000,001 ordinary shares of £1 each | <u>800,000</u> |

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

16 Reserves

| | Share premium account £000 | Share option reserve £000 | Profit and loss account £000 | Total £000 |
|---------------------------------------|-------------------------------------|------------------------------------|---------------------------------------|---------------|
| 31 December 2004 as previously stated | 447,162 | - | 152,268 | 599,430 |
| Adoption of FRS 20 (note 21) | - | 477 | 805 | 1,282 |
| Adoption of FRS 17 (note 21) | - | - | 703 | 703 |
| 31 December 2004 as restated | 447,162 | 477 | 153,776 | 601,415 |
| Profit for the year | - | - | 652,047 | 652,047 |
| Employee share option schemes | - | 523 | - | 523 |
| 30 December 2005 | 447,162 | 1,000 | 805,823 | 1,253,985 |

17 Reconciliation of movements in shareholder funds

| | 2005 £000 | 2004 £000 |
|-------------------------------|--------------|--------------|
| 1 January | 1,401,415 | 3,191,014 |
| Adoption of FRS 20 (note 21) | - | 623 |
| Adoption of FRS 17 (note 21) | - | 521 |
| 1 January as restated | 1,401,415 | 3,192,158 |
| Dividends paid | - | (2,400,000) |
| Profit for the year | 652,047 | 609,012 |
| Employee share option schemes | 523 | 245 |
| 30 December | 2,053,985 | 1,401,415 |

18 Share-based payments

Centrica plc operates a number of employee share schemes including the Executive Share Option Scheme (ESOS), the Long Term Incentive Scheme (LTIS), Sharesave and the Share Incentive Plan (SIP). These are described in the Directors' Report on page 24 of the Centrica plc Annual Report and Accounts 2005, and in the Remuneration Report on pages 30 to 31 of the Centrica plc Annual Report and Accounts 2005. There were no other share-based payment transactions during the period.

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

ESOS

Under the ESOS the Board may grant options over shares in Centrica plc to employees of the Group. Options are granted with a fixed exercise price equal to the market price of the shares at the date of grant. The contractual life of an option is ten years. Awards under the ESOS are generally reserved for employees at senior management level and above and nil employees are currently eligible to participate. Options granted under the ESOS will become exercisable on the third anniversary of the date of grant, subject to the growth in earnings per share over that period exceeding RPI growth by more than 18 percentage points. The number of options becoming exercisable is reduced on a sliding scale if EPS growth exceeds RPI growth by between nine and 18 percentage points. Options granted up to March 2004 also permit retesting of EPS growth annually for a further two years. Exercise of options is subject to continued employment within the Group. Options were valued using the Black-Scholes option pricing model. No performance conditions were included in the fair value calculations. Early exercise has been taken into account by estimating the expected life of the options. As allowed by FRS 20, only options granted since 7 November 2002 which were unvested at 1 January 2005 have been valued. The fair values and the related assumptions used in the calculations are as follows:

| | | 1 | | | | |
|--------------------------------------|----------------------|-----------------|-------------------|------------------|---------------------|------------------|
| Grant date | 23 September 2005 | 1 April 2005 | September 2004 | 18 March 2004 | 1 September 2003 | 24 March 2003 |
| Share price at grant date | £2.46 | £2.28 | £2.46 | £2.28 | £1.80 | £1.47 |
| Exercise price | £2.51 | £2.29 | £2.45 | £2.24 | £1.78 | £1.47 |
| Number of options originally granted | 291,235 | 8,339,818 | 195,795 | 8,815,399 | 635,599 | 13,319,276 |
| Vesting period | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs |
| Expected volatility (i) | 30% | 30% | 27% | 27% | 35% | 35% |
| Contractual option life | 10 yrs | 10 yrs | 10 yrs | 10 yrs | 10 yrs | 10 yrs |
| Expected life | 5 yrs | 5 yrs | 5 yrs | 5 yrs | 5 yrs | 5 yrs |
| Risk-free rate | 4.80% | 4.70% | 5.00% | 5.01% | 4.45% | 4.44% |
| Expected dividend yield | 4.37% | 4.37% | 4.82% | 4.82% | 3.09% | 3.09% |
| Expected forfeitures | 25% | 25% | 25% | 25% | 25% | 25% |
| Fair value per option | £0.50 | £0.49 | £0.47 | £0.45 | £0.51 | £0.41 |

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the average expected period to exercise. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life.

The company has nil options outstanding under this scheme (2004 nil).

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

LTIS

Under the LTIS, allocations of shares in Centrica plc are made to employees of the Group. Awards under the LTIS are generally reserved for employees at senior management level and above and 4 employees are currently eligible to participate. The number of shares that are to be released to participants is calculated subject to the Company's total shareholder return (TSR) during the three years following the grant date, compared to the TSR of other shares in the FTSE 100 Index over the same period. The number of shares released is reduced on a sliding scale if Centrica's TSR is ranked between 50th and 25th. For allocations granted from October 2001 onwards shares are released to participants immediately following the end of the period in which TSR performance is assessed. For awards granted prior to that date allocations are subject to a further two years retention.

Release of shares is subject to continued employment within the Group at the date of release. Allocations were valued using the Black-Scholes option pricing model.

Performance conditions were included in the fair value calculations, through the use of a Monte Carlo simulation model. As allowed by FRS 20, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been valued. The fair values and the related assumptions used in the calculations are as follows:

| Grant date | 23 September 2005 | 1 April 2005 | 1 September 2004 | 1 April 2004 | 1 September 2003 | 1 April 2003 |
|---------------------------------------|----------------------|-----------------|---------------------|-----------------|---------------------|-----------------|
| Share price at grant date | £2.46 | £2.28 | £2.46 | £2.30 | £1.80 | £1.47 |
| Exercise price | £nil | £nil | £nil | £nil | £nil | £nil |
| Number of shares originally granted | 456,421 | 8,408,130 | 310,460 | 9,765,341 | 665,696 | 13,573,547 |
| Vesting period | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs |
| Expected volatility (i) | 30% | 30% | 27% | 27% | 35% | 35% |
| Contractual life | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs |
| Expected life | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs | 3 yrs |
| Risk-free rate | 4.80% | 4.68% | 5.00% | 5.04% | 4.31% | 3.88% |
| Expected dividend yield | 4.37% | 4.37% | 4.82% | 4.82% | 3.09% | 3.09% |
| Expected forfeitures | 20% | 20% | 20% | 20% | 20% | 20% |
| Average volatility of FTSE 100 | 30% | 30% | 30% | 30% | 30% | 30% |
| Average cross-correlation of FTSE 100 | (ii) | (ii) | 30% | 30% | 30% | 30% |
| Fair value per share allocated | £1.20 | £1.03 | £1.25 | £1.17 | £0.99 | £0.89 |

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the contract life, which is a fixed-term of three years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. A reconciliation of movements in allocations is shown below:

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

| | 2005 | 2004 |
|--------------------------------------|-----------|-----------|
| | Number | Number |
| Outstanding at start of period | 333,671 | 612,321 |
| Granted | - | 28,989 |
| Exercised | (223,504) | (249,808) |
| Forfeited – performance related | (26,220) | (40,526) |
| Forfeited – non-performance related | - | (17,305) |
| Outstanding at the end of the period | 83,947 | 333,671 |
| Exercisable at the end of the period | - | 137,214 |

(ii) From 2005, the cross-correlation of the FTSE 100 has been obtained from a model which calculates the correlation between Centrica's historical share price and each of the FTSE 100 over the period from March 2000.

For shares released during the period the weighted average share price was £2.42 (2004: £2.46).

Centrica Sharesave Scheme

Under the Centrica Sharesave Scheme the Board of Centrica plc may grant options over shares in Centrica plc to UK-based employees of the Group. Options are granted with a fixed exercise price equal to 80% of the average market price of the shares for the three days prior to invitation which is three to four weeks prior to the grant date. Employees pay a fixed amount from salary into a savings account each month, and may elect to save over three or five years. At the end of the savings period, employees have six months in which to exercise their options using the funds saved. If employees decide not to exercise their options, they may withdraw the funds saved, and the options expire. Exercise of options is subject to continued employment within the Centrica Group. Options were valued using the Black-Scholes option pricing model. As allowed by FRS 20, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been valued. The fair values and the related assumptions used in the calculations are as follows:

| Grant date | 6 April 2005 | 6 April 2005 | 1 April 2004 | 1 April 2004 | 8 April 2003 | 8 April 2003 |
|--------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Share price at grant date | £2.36 | £2.36 | £2.30 | £2.30 | £1.59 | £1.59 |
| Exercise price | £1.88 | £1.88 | £1.83 | £1.83 | £1.07 | £1.07 |
| Number of options originally granted | 4,329,658 | 5,791,571 | 3,854,639 | 7,407,793 | 37,280,748 | 34,151,197 |
| Vesting period | 5 yrs | 3 yrs | 5 yrs | 3 yrs | 5 yrs | 3 yrs |
| Expected volatility (i) | 30% | 30% | 27% | 27% | 35% | 35% |
| Contractual option life | 5.5 yrs | 3.5 yrs | 5.5 yrs | 3.5 yrs | 5.5 yrs | 3.5 yrs |
| Expected life | 5 yrs | 3 yrs | 5 yrs | 3 yrs | 5 yrs | 3 yrs |
| Risk-free rate | 4.65% | 4.64% | 5.13% | 5.04% | 3.90% | 3.90% |
| Expected dividend yield | 4.37% | 4.37% | 4.82% | 4.82% | 3.09% | 3.09% |
| Expected forfeitures | 40% | 25% | 40% | 25% | 40% | 25% |
| Fair value per option | £0.68 | £0.64 | £0.61 | £0.58 | £0.64 | £0.60 |

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the contract life, which is a fixed-term of three years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. A reconciliation of movements in allocations is as follows:

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

| | 2005 | | 2004 | |
|--------------------------------------|---------------------------------|------|---------------------------------|------|
| | Weighted average exercise price | | Weighted average exercise price | |
| | Number | £ | Number | £ |
| Outstanding at start of period | 2,351,786 | 1.17 | 2,248,656 | 1.13 |
| Granted | 205,136 | 1.88 | 194,764 | 1.83 |
| Exercised | (54,564) | 1.66 | (53,322) | 1.91 |
| Lapsed | (71,733) | 1.45 | (38,312) | 1.33 |
| Expired | - | - | - | - |
| Outstanding at the end of the period | 2,430,625 | 1.21 | 2,351,786 | 1.17 |
| Exercisable at the end of the period | - | - | - | - |

For options outstanding at the end of the period, the range of exercise prices and the average remaining life was as follows:

| 2005 | | | | 2004 | | | |
|---------------------------------|------------------|------------------------------------|--|---------------------------------|------------------|------------------------------------|--|
| Weighted average exercise price | | Average remaining contractual life | | Weighted average exercise price | | Average remaining contractual life | |
| Range of exercise prices | Number of shares | Years | | Range of exercise prices | Number of shares | Years | |
| £1.00 – £1.09 | 2,005,646 | 2.4 | | £1.00 – £1.09 | 2,051,209 | 3.3 | |
| £1.70 – £1.79 | 42,404 | 2.3 | | £1.70 – £1.79 | 88,280 | 2.3 | |
| £1.80 – £1.89 | 362,434 | 3.9 | | £1.80 – £1.89 | 191,626 | 4.3 | |
| £1.90 – £1.99 | 20,141 | 1.3 | | £1.90 – £1.99 | 20,671 | 2.3 | |
| | 2,430,625 | 2.6 | | | 2,351,786 | 3.4 | |

For options exercised during the period the weighted average share price was £2.33 (2004: £2.35).

SIP

Under SIP, employees in the UK may purchase 'partnership shares' through monthly salary deductions. The Company then grants one 'matching share' for every two purchased, up to a maximum of 20 matching shares per employee per month. Both partnership shares and matching shares are held in a trust initially. Partnership shares may be withdrawn at any time, but matching shares are forfeited if the related partnership shares are withdrawn within three years from the original purchase date. Matching shares vest unconditionally for employees after being held for three years in the trust. Vesting of matching shares is also subject to continued employment within the Group. Matching shares are valued at the market price at the grant date. The average fair value of these awards during the year was £2.36 (2004: £2.74). The number of shares held in trust at 30 December 2005 was 71,508 (2004: 49,585).

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

19 Commitments and contingencies

a) Capital expenditure

Contracted future capital expenditure, as at 30 December 2005, was £1,353,6540. (as at 31 December 2004: £8,225,000).

b) Operating lease commitments

As at 30 December 2005 commitments for the following year under operating leases were as follows:

| | Land and Buildings | | Other | |
|---------------------------|--------------------|-------------|-------------|-------------|
| | As at | As at | As at | As at |
| | 30 December | 31 December | 30 December | 31 December |
| | 2005 | 2004 | 2005 | 2004 |
| | £'000 | £'000 | £'000 | £'000 |
| Expiring after five years | 305 | 292 | 295 | 225 |

c) Abandonment costs

The Company and the ultimate parent company have agreed to provide security to a subsidiary undertaking of BG Group plc, BG International Limited, following the change of name of BG Exploration and Production Limited who, as original licence holder for the Morecambe gas fields, will have exposure to abandonment costs relating to the Morecambe gas fields should liabilities not be fully discharged by the Company and its ultimate parent company. The security is to be provided when the estimated future net revenue stream from the Morecambe gas fields falls below 150% of the estimated cost of such abandonment. The nature of the security may take a number of different forms and will remain in force unless and until the costs of such abandonment have been irrevocably discharged and the relevant Department of Trade and Industry abandonment notice in respect of the Morecambe gas fields has been revoked.

d) Guarantee

Centrica plc has a bilateral credit facility of up to £915,000,000 with various financial institutions. The Company was one of the guarantors of that facility, such that it has guaranteed, jointly and severally, to pay on demand any sum, which Centrica plc does not pay in accordance with the facility agreement.

20 Pensions

The majority of the Company's UK employees as at 31 December 2005 were members of one of the three main schemes in the Centrica plc Group; the Centrica Pension Scheme, the Centrica Engineers Pension Scheme and the Centrica Management Pension Scheme.

These are defined benefit schemes and their assets are held in separate trustee administered funds. However, it is not possible on a reasonable and consistent basis to

Hydrocarbon Resources Limited

NOTES TO THE ACCOUNTS (continued)

identify the Company's share of the underlying assets and liabilities within these schemes, and therefore, as allowed within FRS17, these schemes have been treated as defined contribution schemes. The aggregate contributions to the schemes during the year were £2,482,000 (2004: £2,941,000). The amount outstanding at the balance sheet date was £nil (2004: £nil). The latest actuarial valuation of the schemes, updated for the purposes of FRS17 show a total deficit of £729 million (£511 million net of deferred tax) (2004: total deficit of £643 million (£450 million net of deferred tax)). These pension schemes are included on a consolidated basis within the group accounts of Centrica plc as prepared under IFRS.

The liabilities under the pension schemes will be paid out over an extended period. The Company is contributing to the pension fund on the basis of actuarial advice as to the amounts required to meet these liabilities in full. This actuarial advice is based on triennial funding valuations, the last of which was as at 31 March 2004.

21 Changes in accounting policy

The Company has adopted the following standards with effect from 1 January 2005: FRS17, Retirement Benefits, FRS20, Share-based payment, and FRS 21 (IAS 10) Events after the balance sheet date.

The Company previously accounted for retirement benefits in accordance with SSAP 24. The charge to the Profit and Loss Account comprised the cost of providing retirement pensions and other benefits, spread over the period benefiting the employees' service. The Company recognised a provision or prepayment which represented the difference between charges to the Profit and Loss Account and contributions paid to the pension schemes. Under FRS 17, the Company is unable to identify its share of the underlying assets and liabilities in the schemes on a consistent and reasonable basis. Therefore the Company's charge to the Profit and Loss Account is equal to the contributions payable to the schemes in the accounting period. The implementation of FRS 17 has resulted an increase to the Company's previously reported net assets of £703,000 at 31 December 2004, and an increase of £182,000 to the Company's previously reported profits for the year then ended.

The Company previously accounted for share-based payments in accordance with UITF 38 and UITF 17 (revised 2003). These abstracts required the profit and loss charge to be determined as the intrinsic value of the options granted. Under FRS 20, equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of instruments that will satisfy non-market vesting conditions. The implementation of FRS 20 has resulted in an increase of the Company's previously reported net assets of £1,282,000 at 31 December 2004. This has resulted in an increase in the profit and loss account reserve of £805,000, and an increase in the share option reserve of £477,000 at 31 December 2004. This has also resulted in an increase to the Company's previously reported profits of £414,000, and a credit to the share option reserve of £245,000 for the year ended 31 December 2004.

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NOTES TO THE ACCOUNTS (continued)

The adoption of FRS 21 has not had a material impact on the Company's result or net assets.

22 Events after the balance sheet date

In December 2005, the UK government announced an increase in the supplementary charge levied on upstream profits from 10% to 20%, effective from 1 January 2006. At 30 December 2005 the tax rate change was not substantively enacted. The deferred tax credit would have increased by approximately £9 million had the change of tax rate been substantially enacted at the balance sheet date.

23 Ultimate parent company

The Company is an indirect wholly owned subsidiary undertaking of Centrica plc. The Company's immediate parent undertaking is British Gas Trading Limited, which is a wholly owned subsidiary of Centrica plc. Centrica plc is the ultimate parent undertaking and the only group to consolidate the accounts of the Company. Copies of the Annual Report and Accounts of Centrica plc may be obtained from www.centrica.com.

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GAS RESERVES (un-audited)

The principal fields in the UK are South Morecambe and North Morecambe.

Estimated net proven and probable reserves of gas (billion cubic feet)

| | UK 2005 | UK 2004 |
|---------------------------------|--------------|--------------|
| As at 1 January | 1,369 | 1,716 |
| Revisions of previous estimates | 13 | - |
| Production | (246) | (347) |
| As at 30 December | <u>1,136</u> | <u>1,369</u> |