POWERGEN LIMITED

(formerly Powergen plc)

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2002

Registered No: 3586615

POWERGEN LIMITED
(formerly Powergen plc)

Directors' report for the year ended 31 December 2002

The directors present their report and the audited accounts of Powergen Limited (until 6 January 2003 known as Powergen plc and described herein also as 'Powergen' and 'the Company') for the year ended 31 December 2002.

Acquisition by E.ON AG

The recommended acquisition of Powergen by E.ON UK Limited (formerly E.ON UK plc), a wholly-owned subsidiary of E.ON AG, ('E.ON') by means of a Scheme of Arrangement under Section 425 of the Companies Act 1985, was completed on 1 July 2002. From that date, the ultimate parent undertaking of Powergen has been E.ON AG.

Activities

The Company is the holding company of a Group ('the Group' being Powergen and its subsidiaries) whose principal activities are the generation, distribution, transmission and sale of electricity and the sale of gas. The Group's main activities during the year under review were located in the United Kingdom ('UK') and in the mid-West region of the United States ('US') with other residual international investments. As part of the process for its acquisition of Powergen, E.ON undertook to transfer Powergen's US Operations to another part of the E.ON group within twelve months of the acquisition. On 1 March 2003 Powergen sold its US Operations to E.ON US Holdings GmbH for proceeds of $1.8 billion.

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 this, to sustain and develop its distribution and generation asset businesses and build competitive trading and retail businesses.

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 section headed `Financial Review`. The following section includes information about the Group's research and development ('R&D') activities.

UK business

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 domestic and business customers
- Asset management in electricity production and distribution
- Energy trading to support these activities.

During October 2002, Powergen's UK business acquired the UK retail business of TXU Europe Group plc ('TXU'), together with control of three TXU coal-fired generation plants and certain TXU gas supply contracts for £1.4 billion plus the acquisition of £0.2 billion of debt. This was a transforming deal for Powergen that made the Company the UK's largest retail electricity supplier and number two in the retail energy sector. It also gave Powergen a better balance between customer demand and generation output, reducing the impact of future fluctuations in UK wholesale electricity prices on UK business profitability.

Retail

As part of its integrated UK business, Powergen sells electricity, gas, telecommunications and other services to three business segments: residential, small and medium enterprises ('SMEs') and large industrial and commercial businesses ('major accounts'). By the end of the year, it had reached 9.1 million customer accounts, representing an increase of approximately 2 per cent in the existing business since the beginning of the year, combined with the acquisition of 5.5 million customer accounts as part of the TXU deal referred to above. In addition, the business continued to focus on its cost base to improve margins by using lower cost sales channels and implementing systems to reduce back office costs.

Residential and SME Customers Of the total residential and SME accounts, 68 per cent are electricity customers, 29 per cent are gas customers and 3 per cent are fixed line telephone customers. During the year, the number of customers taking more than one product increased.

Major accounts In the major accounts sector, Powergen has ended the year with annualised volumes of 37 TWh of electricity. Following the acquisition of TXU, Powergen is now one of the leading players in this market and will continue to focus on the higher margin part of the major accounts business. Powergen consolidated its position as one of the leading gas suppliers in the UK industrial consumers` market, with annualised sales of 48 TWh .

Customer Growth and Marketing Powergen continued to target residential consumers and SMEs through national marketing activity such as TV and media advertising, radio campaigns, targeted direct mail, public relations and online campaigns. Powergen also continues to exploit the high level of national awareness of its brand and has taken steps to enhance the strength of the brand, including the sponsorship of two high profile national sports competitions, the Powergen Cups in Rugby Union and Rugby League.

Directors' report for the year ended 31 December 2002 (continued)

In addition to a selective use of face-to-face sales, Powergen continues to operate two telemarketing centres in Dearne Valley in Yorkshire and at Tannochside near Glasgow as well as running several customer service call centres across the Midlands.

Generation

Powergen generates electricity from a diverse portfolio of fuel sources. In the year ended 31 December 2002, 49 per cent of Powergen's electricity output was fuelled by coal, 50 per cent by gas, and 1 per cent generated by hydro, wind and oil-fired plant. Powergen is continuing to secure a balanced and diverse portfolio of fuel sources, giving it the flexibility to respond to market conditions and to reduce costs.

Powergen's UK plant generated 33.7 TWh during 2002, up 16 per cent on the 29.0 TWh generated in 2001. This increase was partly due to the inclusion of 1.3TWh of generation from the TXU plant acquired during the year. In total, in 2002, Powergen generated approximately 11 per cent of the total electricity output sold in England and Wales.

Following an announcement in October 2001, Powergen began mothballing a 450MW gas-fired CCGT module at Killingholme. In late summer 2002, a 485MW coal-fired unit at Kingsnorth, which had been out of service since 1996, was re-commissioned. In October 2002 Powergen announced its intention to mothball the remaining two oil-fired units at Grain (675MW units) and the remaining gas-fired module (450MW) at Killingholme. One of the Grain units was withdrawn immediately. In January 2003 following a review of power station economics, Powergen announced plans to withdraw High Marnham and Drakelow C, two old and inefficient coal stations formerly controlled by TXU. Powergen expects the withdrawals to lead to the closure of both power stations in the spring of 2003. In addition, Powergen plans to mothball the remaining module at Killingholme and the unit at Grain from Spring 2003.

Powergen's renewables business is one of the UK's leading developers and owner/operators of wind farms. It has interests in operational onshore and offshore wind farms in the United Kingdom with a total capacity of 134MW. During October 2002, Powergen took full control of this former joint venture operation by purchasing Abbot Group plc's fifty per cent stake in the company. In April 2002, the UK Government granted consent for the construction of Powergen Renewables' Scroby Sands offshore wind farm, off the coast of Norfolk. Scroby Sands will be the UK's first commercial-size offshore wind farm and will consist of 30 turbines each of 2MW. It is expected to become operational in 2004. The business also has a number of development projects that have either planning consents or energy sales contracts in place.

The Government has called for 10 per cent of all energy to be produced from renewable sources by 2010 and the recent Energy White Paper sets an aspirational target that 20 per cent should come from renewable sources by 2020.

Directors' report for the year ended 31 December 2002 (continued)

Powergen's combined heat and power (CHP) business also forms part of the UK Generation business. Powergen's total operational CHP capacity is now 613MWe ranging across a number of sectors, including pharmaceuticals, chemicals, paper and oil refining. Three projects with a total capacity of 112MWe were commissioned during 2002, with a further 30MWe to be commissioned in 2003. There are no plans to initiate any new development projects.

Distribution

Operating profits from electricity distribution increased during the year by £11 million to £129 million, as a result of continuing operational improvements. These included system and technology improvements and outsourcing of certain activities. The current distribution price controls are in effect until March 2005. The distribution business continued to contribute a significant proportion of UK business profits.

Energy Trading

Energy Trading is at the centre of Powergen's integrated electricity and gas business in the United Kingdom. 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 unit 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.

Other activities

Powergen Property manages the UK property portfolio and the sale of its surplus sites. Powergen's centralised UK Services team manages the provision of a wide range of support activities, including IT, personnel, finance and procurement to all UK based businesses.

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 in the UK and US through delivery of R&D programmes, providing innovative services and products, and growing profitable new income streams. During 2002, these activities covered a range of Powergen business interests, including the development of renewable energy resources.

Powertechnology also carries out collaborative and contract R&D work, as part of its portfolio of technical support agreements with its wide external customer base. The collaborative work includes participation in UK and European research programmes. Powergen also retains membership of certain external R&D organisations.

Asian Asset Management

Asian Asset Management (AAM) formerly Powergen’s International business was established to develop integrated energy businesses in a small number of target countries. In February 2002, Powergen sold its 88 per cent stake in Gujarat Paguthan Energy Corporation Pvt. Limited ('GPEC') in India to a company that was 80 per cent owned by CLP Power International ('CLP') and 20 per cent owned by Powergen. Also in February 2002 Powergen acquired the remaining 12 per cent of GPEC from third parties and subsequently also sold this stake to the same company, leaving Powergen with a 20 per cent overall stake in the GPEC project. At 31 December 2002 the business held a minority stake and operating interests in independent power production activities in India, Australia and Indonesia totalling 825MW. In November 2002, Powergen reached agreement to sell its remaining interests in the operating plant in India and Australia together with a development project in Thailand to CLP. The sale of the interest in the project in Thailand completed in January 2003 and Powergen expects the remaining sales to be completed later in 2003. Management intends to dispose of all remaining AAM activities by the end of 2004 subject to market conditions.

US business

LG&E Energy Corp. ('LG&E') is a diversified energy services holding company with businesses in the following areas:

- Retail gas and electricity utility services;
- Power generation and project development; and
- Asset-based energy marketing.

Its power generation and retail electricity and gas services are located principally in Kentucky with a small customer base in Virginia and Tennessee, and are divided between two utility subsidiaries, Louisville Gas & Electric Company (‘LGEC’) and Kentucky Utilities Company (‘KU’). In 2002 LG&E served more than one million customers. LGEC is an electricity and natural gas utility based in Louisville, Kentucky. KU is an electricity utility based in Lexington, Kentucky.

At 31 December 2002, LG&E owned or controlled aggregate generating capacity of approximately 10,333MW, including leased and partially-owned capacity, compared with 10,077MW at 31 December 2001. The plant includes ten independent power generation facilities in western Kentucky and various other holdings throughout the US and in Spain.

LG&E divides its operations into utility and non-utility businesses. Utility operations are subject to state regulation that sets rates charged to retail customers. LG&E's operating profit for 2002 was £321 million. Of this profit £257 million related to the utility business and £64 million to the non-utility business.

Utilities

Total aggregate electricity sales by LGEC in 2002 represented an increase of 6% over 2001. Equivalent gas sales saw an 8% decrease in 2002 against 2001. KU`s total aggregate electricity sales in 2002 represented a 3% increase against 2001. Retail sales were influenced by various factors such as the weather, the level of economic activity, cost of fuel and demand patterns.

The utilities had 7,193MW of generating capacity at the end of 2002. 97 per cent of utility generation was from coal-fired units in 2002. The remaining generation was provided by hydro-electric and combustion turbine peaking units.

LG&E is one of a large number of transmission owning members of the Midwest Independent Systems Operations ('MISO'), one of the major regional grid operators in the US. MISO commenced commercial operations on 1 February 2002.

Non-utilities

LG&E's non-utility businesses principally comprise the operations of LG&E Capital Corp. ('LCC'), its primary holding company and LG&E Energy Marketing Inc. ('LEM'), its asset-based energy marketing subsidiary. LCC operates ten generating units in western Kentucky through its wholly owned subsidiary Western Kentucky Energy Corp. and affiliates ('WKE') as well as ongoing interests in Argentina and stakes in a number of power plants in the US through its wholly owned subsidiary LG&E Power Inc. ('LPI'). LG&E also owns CRC-Evans International Inc. ('CRC'), a company that leases equipment and provides services to the oil and gas pipeline industry.

In November 2001, LPI reached an agreement to sell its Monroe and Tiger Creek facilities in Georgia to Progress Ventures Inc. The sale was completed in February 2002, and the profit impact is included within exceptional items in these accounts. Under the terms of the agreement, LG&E also manages the completion of the Tiger Creek plant, which is expected to be operational by June 2003.

In connection with its gas distribution operations in Argentina, LG&E had interests in entities which distribute natural gas to approximately two million customers in Argentina through three distributors. During 2002 the continuing economic and political uncertainties in Argentina and the devaluation of the Peso against the US Dollar have significantly reduced profits from that country. Powergen has reviewed the carrying value of its investments in Argentina in the light of these events and taken a significant impairment charge in its accounts accordingly (fully detailed in note 3). This trend of reduced profitability is likely to continue.

At WKE, the directors have performed a review of the company's long-term sales contract obligations in light of rising fuel costs and other factors. This has resulted in a provision of £263 million being made in respect of these contract obligations (see note 3).

Results and dividends

The loss before taxation for the year ended 31 December 2002 was £99 million a decrease of £142 million on the profit for the year to 31 December 2001 of £43 million.

The directors do not recommend the payment of a final dividend for the year. Interim dividends totalling 18.4p per ordinary share have been paid in respect of 2002. Dividends amounting to 36.8p per ordinary share were paid for the year ended 31 December 2001.

After a tax credit of £59 million, a credit from minority interests of £31 million and dividends paid of £121 million, the loss for the year amounted to £130 million (2001 £190 million loss).

Directors and their interests

During the year the following directors have served on the Board.

	Date of appointment if during the year	Date of resignation if during the year
Ulrich Hartmann	1 July 2002	
Edmund Wallis		
Michael Söhlke	1 July 2002	
Dr Paul Golby	21 January 2002	
Victor Staffieri		
Dr Hans Michael Gaul	1 July 2002	
Dr Hans Dieter Harig	1 July 2002	
Professor Rainer Elsässer	1 July 2002	
Thomas Oates		
Peter Wilson		
Nicholas Baldwin		1 July 2002
Peter Hickson		1 July 2002
Dr Christopher Gibson-Smith		1 July 2002
Dr David Li		1 July 2002
Sir Frederick Crawford		1 July 2002
Sydney Gillibrand CBE		1 July 2002

Directors' report for the year ended 31 December 2002 (continued)

Information on directors` emoluments is given in Note 4 to the Accounts, on page 46.

Directors' report for the year ended 31 December 2002 (continued)

The interests of directors in the ordinary shares of Powergen Limited as at 31 December 2001 are shown below. On 1 July 2002, as already described, E.ON AG became the ultimate parent company. At 31 December 2002 no director had any interest requiring disclosure.

	Beneficial holdings in ordinary shares		Options over ordinary shares	
	At 31 December 2001 or on appointment	**At 31 December 2002**	At 31 December 2001 or on appointment	**At 31 December 2002**
Dr Paul Golby	287	-	142,748	-
Victor Staffieri*	-	-	89,901	-
Edmund Wallis	65,359	-	674,283	-
Restricted Share Plan**	-	-	65,037	-
Peter Wilson***	850	-	-	-

* The 89,901 options held by Victor Staffieri as at 31 December 2001 represents ADSs, each of which comprises four Powergen shares.
** Holdings held in Trust on behalf of the directors under the Powergen Restricted Share Plan (either as a Bonus Enhancement Award or a Medium Term Bonus Award)
*** Non-beneficial interest

Except as disclosed above there were no non-beneficial interests of the directors in the ordinary share capital of the Company.

No director had, at any time during the period under report, any interest (other than as a nominee on behalf of the Company) in the shares of any subsidiary company. Following the acquisition of Powergen by E.ON AG, no director had at any time during the period under report any disclosable interest in the shares of any subsidiary company of E.ON AG.

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 covering a wide range of business and employment issues. The views of staff are both sought and taken into account. In 2003 two representatives elected by Powergen employees will be joining 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 £150,872. No political donations were made.

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 29 days for the UK business.

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 2003 and the outline projections for the four 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
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.

Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership ('LLP') from 1 January 2003, PricewaterhouseCoopers resigned on 14 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the next annual general meeting.

By order of the Board

C Salamé
Company Secretary
Powergen Limited
53 New Broad Street
London, EC2M 1SL
7 April 2003

Financial review for the year ended 31 December 2002

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

Overview

2002 was another year of significant change and development for Powergen, with the completion of the acquisition of the Powergen Group by E.ON AG on 1 July 2002.

Within the existing Powergen businesses, 2002 has seen the transformation of the UK Operations with the acquisition of the TXU retail business which has enabled Powergen to become the UK's largest retail electricity supplier and number two in the retail energy sector. The acquisition also gave the UK business a much better balance between customer demand and generation output, reducing the impact on business profitability of future fluctuations in UK electricity wholesale prices. The UK business is also undergoing a restructuring programme to streamline costs in its central and service operations. The costs of this programme in 2002 of £32 million are included within exceptional items in these accounts. Further restructuring will continue during 2003 as the TXU business is fully integrated into the existing UK structure, and further exceptional costs may arise.

Within US Operations, profits in the non-utility businesses were hit both by the continuing economic and political uncertainties in Argentina, where the Group has stakes in three gas distribution businesses, and at Western Kentucky Energy Corp. (‘WKE’), its unregulated generation facility in western Kentucky, where rising fuel costs and other factors have adversely affected business results. In Argentina, results were affected by the devaluation of the Peso against the US Dollar. An exceptional charge of £75 million is recorded in these accounts reflecting the reduced worth of these investments in Argentina, together with an exceptional interest cost of £58 million in respect of the devaluation impact on US dollar denominated liabilities. There is also a partly offsetting benefit through minority interest of £42 million in respect of these items. At WKE, following a review of its sales contract obligations, a provision of £263 million has been recorded in these accounts.

Following the acquisition by E.ON a number of directors and senior executives of Powergen left the Group, and the Company's corporate centre was re-organised. The costs of this re-organisation, together with related change of control, loss of office and other payments, totalling £20 million, are also included within exceptional items in these accounts.

Following the sale of Powergen’s US Operations to E.ON US Holdings GmbH on 1 March 2003 for proceeds of $1.8 billion, US Operations are classified as discontinued. A significant profit arose as a result of this sale.

Financial review for the year ended 31 December 2002 (continued)

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 2002 was £332 million, compared to £313 million for the same period last year. The loss before tax was £99 million compared with a profit of £43 million for the previous twelve months.

Turnover

Group turnover grew by £645 million during the year to £6,304 million, an increase of 11 per cent. Turnover in the UK increased by almost 22 per cent, of which 20 per cent was due to the inclusion of two months sales from the TXU business acquired on 21 October 2002. Within the existing business there were small increases in both wholesale and trading and retail. Turnover in the US business in local currency increased in the utilities due to higher retail electricity volumes, partly offset by lower off-system sales. However, due to the movement in Dollar/Sterling exchange rates during the year, turnover in Sterling from US Operations fell slightly. Within Asian Asset Management, turnover fell by £151 million to £15 million. The £15 million of sales in 2002 came from GPEC in India for the two months for which it was a subsidiary prior to the disposal of Powergen's controlling interest in that company during February 2002.

Turnover is further analysed below:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**2,104**	1,969
Electricity – distribution	**289**	288
Electricity and gas – retail	**2,417**	1,738
Internal charges from distribution to retail	**(125)**	(146)
	4,685	3,849
US Operations		
Utilities	**1,223**	1,247
Non-utilities	**381**	397
	1,604	1,644
Asian Asset Management	**15**	166
	6,304	5,659

Financial review for the year ended 31 December 2002 (continued)

Operating Costs

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

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Fuel costs	**784**	799
Power purchases and other costs of sales	**3,676**	2,920
Staff costs	**341**	377
Depreciation, including exceptional charges	**379**	426
Goodwill amortisation	**169**	151
Other operating charges, including restructuring and other exceptional charges	**967**	805
	6,316	5,478

Total fuel costs within the Group fell slightly from £799 million to £784 million. This figure comprised £402 million in respect of US Operations, £381 million in respect of UK Operations and £1 million in Asian Asset Management. This overall fall was the net result of several factors. In the UK costs rose, as generation output increased from 29.0TWh in 2001 to 33.7TWh in 2002, including £17 million of costs for two months from TXU. In US Operations the figures also rose slightly, however Asian Asset Management costs fell significantly from £56 million to £1 million following the disposal of Powergen's controlling interest in GPEC. In 2001, the figures included a full year's fuel costs for GPEC.

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 for resale and related costs. The increase of £773 million in costs during the year again primarily reflected the inclusion of two months power purchases and other costs from TXU, which totalled £678 million. There was also a small increase in costs in the existing UK business due to higher volumes of purchases to supply the retail business.

Financial review for the year ended 31 December 2002 (continued)

Staff costs at £341 million were almost 10 per cent lower than in the previous year, despite the acquisition of 1,900 staff with the TXU business in October 2002. Costs in US Operations fell due to lower staff numbers and increased capitalisation of staff costs on projects. Staff numbers at 31 December 2002 totalled 11,591 of whom 7,034 were in the UK, 4,152 in the US and 405 in Asian Asset Management and the Corporate Centre.

The Group's depreciation charge for the year fell by £47 million compared with the previous 12 months. However, the figure for 2001 included £100 million of exceptional charges in respect of UK and US asset impairments whereas the figure for 2002 only included £94 million of exceptional costs relating to Argentina. The underlying annual charge in each year was therefore £285 million in 2002 compared with £326 million in 2001. This fall was principally in the UK business reflecting a full year's impact from prior year disposals and impairments.

Goodwill amortisation rose from £151 million in 2001 to £169 million in 2002. The increase was primarily due to the acquisition of TXU, which represented £22 million of the charge during the year.

Other operating charges included the costs of running the UK, US 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, and leasing costs in the US. The 2002 figure of £967 million included £170 million of exceptional costs. This figure comprised business restructuring in the UK, costs related to the E.ON acquisition and consequent corporate re-structuring, totalling £52 million, £18 million of further impairment charges in respect of LG&E's Argentine investments, and £263 million in respect of providing for a long-term electricity sales contract in the US.

Operating income

Other operating income was £111 million this year compared with £138 million in the year to 31 December 2001. The 2002 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 earned as Powergen has 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 2001 was £99 million. Other operating income in 2001 also included £33 million of income from the stations leased to Eastern in 1996. The comparable figure this year was only £1 million, as these arrangements came to an end.

Financial review for the year ended 31 December 2002 (continued)

Exceptional items

The Group's results include a number of exceptional items totalling £431 million that are fully disclosed in note 3 to the accounts. These exceptionals fell into five main categories:

- Business restructuring in UK and US Operations and the Corporate Centre
- Asset sales in US Operations
- International business disposals and write downs
- Impact of Peso devaluation and consequent asset impairment in Argentina
- Contract provision in the US

Operating profits

Operating profits including share of associates and joint ventures, but excluding exceptional items, totalled £603 million for the year compared with £735 million in the same period to 31 December 2001.

Within UK Operations, profits fell by £31 million to £408 million. Within this total, wholesale and trading profits fell by £77 million to £91 million, largely due to the impact of lower wholesale prices and lower profits from CHP.

The distribution business saw profits increase by £11 million to £129 million. This was due to cost savings delivered from process, system and technology improvements and the outsourcing of certain work streams.

Within the retail business, profits increased by £56 million from £49 million to £105 million. This was largely due to profits from the newly acquired TXU business of £32 million for the two month post acquisition period. In addition, the existing business saw an improvement in margins due to lower wholesale prices and a 2 per cent increase in customer numbers together with savings in servicing costs.

There was also a £21 million reduction in lease and other income and charges due to a £32 million reduction in income received under the Eastern lease arrangements partly offset by lower costs from various support activities including IT.

Within US Operations, profits fell by £34 million from £355 million to £321 million. The results from the utilities fell by 13 per cent to £257 million. Again, the figures were adversely affected by the impact of currency movements. In local currency there was only a 6 per cent fall. This was due to higher retail electricity sales due to warm summer weather being more than offset by lower off-system sales margins and higher operating costs. In the non-utilities businesses, results improved slightly.

Financial review for the year ended 31 December 2002 (continued)

Profits from Asian Asset Management totalled £65 million, compared with £111 million in the year to 31 December 2001. Results for 2002 were split between Paiton, contributing £55 million and GPEC, contributing £14 million, less central costs and overheads of £4 million. 2001 figures included £32 million from European assets that were sold by June 2001, and higher profits from GPEC, which was a subsidiary throughout 2001.

Corporate costs rose from £19 million in 2001 to £22 million in 2002. However, this was largely due to a poor performance from the Group's captive insurance company where higher claims and lower investment returns led to a loss making position. Underlying corporate costs fell significantly with a significant reorganisation and reduction in headcount following the E.ON acquisition.

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

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**91**	168
Electricity – distribution	**129**	118
Electricity and gas – retail	**105**	49
Lease and other income and charges	**83**	104
	408	439
US Operations		
Utilities	**257**	296
Non-utilities	**64**	59
	321	355
Asian Asset Management	**65**	111
Corporate costs	**(22)**	(19)
Goodwill amortisation	**(169)**	(151)
Operating profit before exceptional items	**603**	735
Interest costs	**(271)**	(422)
Exceptional items	**(431)**	(270)
(Loss)/Profit before tax	**(99)**	43

Interest costs

Interest costs including exceptional interest charges in respect of the Peso devaluation in Argentina totalled £329 million for the year. The underlying figure, excluding exceptional charges, was £271 million. Within this figure, Group interest costs fell by £130 million from £359 million to £229 million, reflecting both substantially lower UK and US interest rates and cheaper financing from E.ON in the second half of the year. This was despite higher levels of debt following the TXU acquisition. Interest costs in associates and joint ventures also fell by £21 million to £42 million, following the disposal of further international activities in 2001. The Group interest charge included £62 million of interest costs in respect of LG&E and £57 million of interest costs on the debt used to finance the purchase of LG&E.

Treasury management

In 2002 there were significant changes to the structure of treasury management within Powergen, following Powergen's integration into the E.ON Group.

For the first six months of 2002, Powergen had a central Group treasury department. It was responsible for treasury strategy, all funding requirements, the management of financial risks including interest rate and currency exposure, banking relationships, cash management and other treasury business throughout the Group.

In addition, there were operational treasury teams in the UK and the US which serviced the treasury requirements of the UK and US businesses. Powergen's treasury activities were carried out in accordance with Board approved treasury policies, and all treasury operations complied with detailed treasury procedures which were approved at Board level. All treasury interfaces with banks and other third parties were governed by dealing mandates, facility letters and other agreements. Within treasury there was segregation of front, middle and back office activities.

On 1 July 2002, Powergen became part of the E.ON Group, and immediately began operating in accordance with the E.ON financial management and treasury policies and procedures. Significant advanced planning for this integration had been carried out, and a contingency plan was available if the merger had not completed. Close liaison with E.ON's treasury department had allowed Powergen to continue to look ahead. Therefore Powergen and LG&E were able to easily fit into the well developed financial management and treasury structure of the E.ON Group.

E.ON has a central department that is responsible for financing and treasury strategy, policies and procedure throughout the E.ON Group. Major 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. Major subsidiaries within the E.ON Group also have their own treasury teams. These teams liaise closely with the local businesses to ensure that liquidity and risk management needs are met within the requirements of the E.ON policies and procedures. These treasury teams work closely with the treasury and corporate finance teams at E.ON AG.

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

Financial review for the year ended 31 December 2002 (continued)

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.

Since 1 July 2002, in accordance with its policy, E.ON has refinanced approximately £1.5 billion of short dated Powergen debt and in August 2002, injected £150 million of additional equity into Powergen. E.ON has also financed the acquisition of TXU by Powergen during October 2002 and Powergen's ongoing general funding needs. At 31 December 2002 Powergen had £3.3 billion of inter-group funding which is included in debt in these accounts.

As a result of the availability of inter-group funding Powergen cancelled its £1 billion and $1.7 billion bank facilities, and arranged formalised committed documented lines with E.ON AG for alternative sources of liquidity. Powergen has also cancelled and repaid the Powergen UK trade receivable securitisation programme (£300 million) and has ceased using the Powergen US Funding LLC US$ commercial paper programme and the Powergen UK plc ECP programme, both of which will shortly be terminated. Powergen has also bought back and cancelled $150 million of the Global US Dollar 2004 bond.

During the year LG&E have refinanced ten tax-exempt bonds with a total value of $296 million. Holders of these bonds do not pay tax on the interest income and therefore the bonds command very favourable rates. Consequently LG&E will continue to maintain this source of external financing.

The Powergen UK and LG&E treasury teams employ 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 and US businesses. They work in close liaison with the various 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 in that 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 new parent company of the Powergen Group.

Foreign exchange risk management

Powergen's principal currency exposure is to the US dollar, and there is a secondary exposure to the Argentine Peso. 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 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. The investment value of the LG&E acquisition has been hedged in this way. The ability to hedge the Argentine Peso was severely curtailed towards the end of 2001 by a lack of liquidity in the relevant foreign currency markets. As a result it has not been possible for Powergen to hedge its assets in Argentina.

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. E.ON requires subsidiaries to maintain a fixed and floating ratio between 20 per cent and 80 per cent. 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.

Financial review for the year ended 31 December 2002 (continued)

Off balance sheet finance

Powergen retains a securitisation facility for $125 million in LG&E. This facility provides additional liquidity and is 100 per cent backed up by separate committed bank facilities. This facility qualifies for off balance sheet treatment, that is, the debt can be offset against trade debtors in the balance sheet. Powergen has minority equity interests in a number of 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 at a lower cost that Powergen could achieve externally. Falls in electricity prices have had some impact on operating cash flows, and as electricity generation 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, 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.

Credit rating

Prior to the acquisition by E.ON, Powergen Limited's long term credit rating was BBB+ from Standard and Poors and Baa1 from Moodys. Following the E.ON acquisition, Powergen was upgraded to A from Standard and Poors and A2 from Moodys. However, following the acquisition of TXU by Powergen in October 2002 Powergen was put on negative credit watch by both agencies. A rating review is being conducted by both agencies and will be concluded shortly.

Borrowings and facilities

Details of the bank term facilities available to the Group at 31 December 2002, 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 2002, the Powergen Group had total borrowings of £6,326 million (31 December 2001 £5,278 million) including £2,452 million of long-term loans and £3,874 million of short-term loans and overdrafts.

At 31 December 2002, the Group had £111 million of cash and short-term investments (31 December 2001 £117 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 2002 was therefore £6,215 million, compared to £5,161 million at 31 December 2001. The average interest rate for the year, when compared to average net borrowings, was 4.6 per cent compared with 6.1 per cent in the previous year.

Gearing (net debt as a percentage of net assets plus net debt) was 77 per cent at 31 December 2002 compared with 71 per cent at the end of 2001. The increase year on year is largely due to additional borrowing taken on in order to finance the acquisition of TXU.

Commodity risk management

As part of its operating activities, Powergen in the UK 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 contracts, futures and option contracts traded on commodity exchanges and swaps and options traded in over-the-counter financial markets.

In the US, the two utilities, LGEC and KU have a limited exposure to market price volatility in prices of fuel and electricity, as long as cost based regulation applies to these businesses. US Operations also have a merchant energy trading and sales business that LG&E discontinued in 1998 that has an exposure to market volatility in electricity prices and load requirements.

Financial review for the year ended 31 December 2002 (continued)

Taxation

The pre-exceptional tax charge amounted to £130 million for the year compared with £58 million for the same period to 31 December 2001. The effective rate before goodwill amortisation and exceptional items was 25.9 per cent compared with 12.5 per cent in the year to 31 December 2001. The main reason for the increase in the effective rate was that in the current year the discount on the deferred tax balance led to an increase of 5.4% in the effective tax rate compared to a 3.9% reduction in the previous twelve month period. This is due to the change in the post tax yield (to maturity) on government bonds at the relevant balance sheet dates. The majority of the remaining difference arises due to adjustments to the corporation tax creditor in respect of prior year liabilities.

Dividends

Dividends totalling £121 million were paid during the year ended 31 December 2002.

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.

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 2002 and of the loss 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
7 April 2003

POWERGEN LIMITED
(formerly Powergen plc)

CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2002

		Year ended 31 December 2002			Year ended 31 December 2001		
	Note	**Before Exceptional Items £m**	**Exceptional Items (note 3) £m**	**Total £m**	Before Exceptional Items £m	Exceptional Items (note 3) £m	Total £m
Turnover		**6,759**	**-**	**6,759**	6,343	-	6,343
Group's share of associates' and joint ventures' turnover		**(455)**	**-**	**(455)**	(684)	-	(684)
Group turnover	1	**6,304**	**-**	**6,304**	5,659	-	5,659
- continuing activities		**3,948**	**-**	**3,948**	4,015	-	4,015
- acquisitions		**752**	**-**	**752**	-	-	-
		4,700	**-**	**4,700**	4,015	-	4,015
- discontinued activities		**1,604**	**-**	**1,604**	1,644	-	1,644
Operating costs	2,3	**(5,926)**	**(390)**	**(6,316)**	(5,163)	(315)	(5,478)
Other operating income	2	**111**	**-**	**111**	138	-	138
Group operating profit/(loss)	2	**489**	**(390)**	**99**	634	(315)	319
- continuing activities		**276**	**(48)**	**228**	232	(133)	99
- acquisitions		**10**	**-**	**10**	-	-	-
		286	**(48)**	**238**	232	(133)	99
- discontinued activities		**203**	**(342)**	**(139)**	402	(182)	220
Group's share of associates' and joint ventures' operating profit		**114**	**-**	**114**	101	-	101
Profits less losses on disposal of fixed assets and investments	3	**-**	**46**	**46**	-	79	79
Profits less losses on disposal of businesses (including provisions)	3	**-**	**(29)**	**(29)**	-	(34)	(34)
Net interest payable							
– Group	5	**(229)**	**(58)**	**(287)**	(359)	-	(359)
– Associates and joint ventures		**(42)**	**-**	**(42)**	(63)	-	(63)
Profit/(Loss) on ordinary activities before taxation	6	**332**	**(431)**	**(99)**	313	(270)	43
Tax on profit/(loss) on ordinary activities	7	**(130)**	**189**	**59**	(58)	76	18
Profit/(Loss) on ordinary activities after taxation		**202**	**(242)**	**(40)**	255	(194)	61
Minority interest	26	**(11)**	**42**	**31**	(17)	6	(11)
Profit/(Loss) attributable to shareholders		**191**	**(200)**	**(9)**	238	(188)	50

POWERGEN LIMITED
(formerly Powergen plc)

CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2002

Dividends	8	**(121)**	(240)
Loss for the year		**(130)**	(190)

The notes on pages 30 to 83 form part of these financial statements.

POWERGEN LIMITED
(formerly Powergen plc)

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 2002

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
(Loss)/Profit attributable to shareholders	**(9)**	50
Revaluation of fixed assets and investments on acquisition (see note 10)	**16**	-
Currency translation differences on foreign currency net investments	**(124)**	23
Total recognised (losses)/gains for the year	**(117)**	73
Prior year adjustment for the implementation of FRS 19	**-**	(121)
Total losses recognised since last annual report	**(117)**	(48)

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 2002

The notes on pages 30 to 83 form part of these financial statements

POWERGEN LIMITED
(formerly Powergen plc)

BALANCE SHEEETS
as at 31 December 2002

	Note	The Group 31 December 2002 £m	The Group 31 December 2001 £m	The Company 31 December 2002 £m	The Company 31 December 2001 £m
Fixed assets					
Goodwill	11	**4,133**	2,641	**-**	-
Tangible fixed assets	12	**5,014**	5,625	**-**	-
Investments	13	**380**	402	**2,580**	3,100
		9,527	8,668	**2,580**	3,100
Curre nt assets					
Stocks	14	**286**	273	**-**	-
Debtors: amounts falling due after more than one year	15	**80**	118	**-**	-
Debtors: amounts falling due within one year		**1,424**	1,021	**2,751**	144
Less: securitisation of trade debtors		**(69)**	(227)	**-**	-
Net debtors falling due within one year	16	**1,355**	794	**2,751**	144
Cash and short-term deposits		**111**	117	**-**	-
		1,832	1,302	**2,751**	144
Creditors: amounts falling due within one year					
Loans and overdrafts	17	**(3,874)**	(1,541)	**(2,550)**	-
Trade and other creditors	18	**(1,836)**	(1,423)	**(2)**	(60)
Net current (liabilities)/assets		**(3,878)**	(1,662)	**199**	84
Total assets less current liabilities		**5,649**	7,006	**2,779**	3,184
Creditors: amounts falling due after more than one year					
Long-term loans	19	**(2,452)**	(3,737)	**-**	-
Other creditors	20	**(326)**	(423)	**-**	-
Provisions for liabilities and charges	22	**(871)**	(568)	**-**	-
Deferred tax	23	**(162)**	(254)	**-**	-
Net assets		**1,838**	2,024	**2,779**	3,184
Capital and reserves					
Called-up share capital	24	**479**	327	**479**	327
Share prem ium account	25	**33**	21	**33**	21
Other reserves	25	**656**	656	**-**	-
Revaluation reserve	25	**16**	22	**-**	-
Profit and loss account	25	**568**	800	**2,267**	2,836
Shareholders' funds (including non-equity shareholders' funds)	27	**1,752**	1,826	**2,779**	3,184
Minority interests (including non-equity)	26	**86**	198	**-**	-
		1,838	2,024	**2,779**	3,184

Approved by the Board on 7 April 2003

POWERGEN LIMITED
(formerly Powergen plc)

BALANCE SHEEETS
as at 31 December 2002

E A Wallis	**M Söhlke**
Director	Director

The notes on pages 30 to 83 form part of these financial statements.

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 in the US is the generation of electricity and the transmission, distribution and sale of electricity and gas. Powergen's principal business overseas, other than in the US, is the generation of electricity and associated energy-related businesses. As set out in note 31, 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 (see note 10). 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.

Principal Accounting Policies

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. Under a three year rates order issued on 7 January 2000, Louisville Gas and Electric Company (LGEC) and Kentucky Utilities Company (KU) operated under an earnings sharing mechanism ('ESM') until 31 December 2002. Prior to its expiration, LGEC and KU initiated a proceeding to continue the arrangement until 2005. The regulator allowed the continuation of the ESM pending the outcome of an audit of its first three years of operation. With regard to electricity income under this mechanism, incremental annual earnings for each utility resulting in a rate of return either above or below a range of 10.5% to 12.5% will be shared between shareholders and customers in the ratio 60:40.

Principal Accounting Policies (continued)

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.

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:

Asset	*Life in years*
Generating assets	20-60
Distribution and transmission networks	30-65
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.

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 and 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.

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. The cash flows from forward purchase currency contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

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.

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.

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.

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.

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.

Principal Accounting Policies (continued)

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

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.

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
(formerly Powergen plc)

Notes to the financial statements
for the year ended 31 December 2002

1 Turnover

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

	Year ended 31 December	
	2002 **£m**	2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**2,104**	1,969
Electricity – distribution	**289**	288
Electricity and gas – retail	**2,417**	1,738
Internal charges from distribution to retail	**(125)**	(146)
	4,685	3,849
Asian Asset Management	**15**	166
Continuing activities	**4,700**	4,015
US Operations		
Utilities	**1,223**	1,247
Non-utilities	**381**	397
Discontinued operations	**1,604**	1,644
	6,304	5,659

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

	Year ended 31 December	
	2002 **£m**	2001 £m
UK Operations	**99**	84
Asian Asset Management	**120**	113
Continuing activities	**219**	197
US Operations – discontinued operations	**236**	487
	455	684

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

2 Operating costs

Operating costs were as follows:

	Year ended 31 December				Year ended 31 December		
	2002 Continuing activities £m	**2002 Acquisitions £m**	**2002 Discontinued activities £m**	**2002 Total £m**	2001 Continuing activities £m	2001 Discontinued activities £m	2001 Total £m
Fuel costs	**365**	**17**	**402**	**784**	411	388	799
Power purchases and other costs of sales	**2,635**	**661**	**380**	**3,676**	2,528	392	2,920
Staff costs (note 4)	**194**	**10**	**137**	**341**	200	177	377
Depreciation, including exceptional charges	**146**	**-**	**233**	**379**	267	159	426
Goodwill amortisation	**68**	**22**	**79**	**169**	68	83	151
Other operating charges, including restructuring costs	**423**	**32**	**512**	**967**	580	225	805
Operating costs, after exceptional items	**3,831**	**742**	**1,743**	**6,316**	4,054	1,424	5,478
Operating costs, before exceptional items	**3,783**	**742**	**1,401**	**5,926**	3,921	1,242	**5,163**
Exceptional depreciation charges (note 3)	**-**	**-**	**94**	**94**	80	20	**100**
Exceptional operating charges (note 3)	**48**	**-**	**248**	**296**	53	162	**215**

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.

Other than exceptional foreign exchange losses of £58 million disclosed in note 3, £3 million of foreign exchange gains were recognised in the profit and loss account (year ended 31 December 2001 £7 million loss).

Operating costs also include:	Year ended 31 December	
	2002 £m	2001 £m
Repairs and maintenance costs	**194**	184
Research and development costs	**3**	4
Operating leases (non-plant)	**41**	38
Profit on disposal of fixed assets	**2**	14
Auditors' remuneration for Group audit	**0.8**	0.6
Auditors' remuneration for non-audit services	**3.4**	6.0

Fees for non-audit services comprise due diligence, accounting advisory, tax advisory services and other general consultancy. Auditors' remuneration in respect of the Company was £nil for each of the two years ended 31 December 2002.

2 Operating costs (continued)

Other operating income includes £1 million (year ended 31 December 2001 £33 million) of income from operating leases. It also includes the recognition of £100 million (year ended 31 December 2001 £99 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. This figure represents £100 million of deferred income recognised less £nil of associated costs incurred (year ended 31 December 2001 £100 million less £1 million of associated costs).

3 Exceptional items

Exceptional items comprise:

	Year ended 31 December	
	2002	2001
	£m	£m
Charged against operating profit	**(390)**	(315)
Profits less losses on disposal of fixed assets and investments	**46**	79
Profits less losses on disposal of businesses (including provisions)	**(29)**	(34)
Charged against interest costs	**(58)**	-
	(431)	(270)

Charged against operating profit

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.

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 the year 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.

3 Exceptional items (continued)

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). The UK Operations reorganisation is still ongoing, and further costs will arise in 2003 following the TXU acquisition. A tax credit of £11 million arose as a result of these transactions.

Year *ended 31 December 2001*

US Operations and UK Operations

During the year ended 31 December 2001 the Group undertook a detailed review of its US Operations and established a business reorganisation and restructuring programme. £162 million was charged in that period in respect of that programme, which primarily comprises committed severance and related payments to approximately 1,200 employees. A tax credit of £65 million arose in respect of this programme. In addition, a business transformation and restructuring programme was established within UK Operations. £22 million was charged in respect of that programme, which primarily comprises committed severance and related payments to approximately 240 employees. A tax credit of £6 million arose in respect of this programme.

In the year ended 31 December 2001, a review of the Group's UK CHP plant portfolio was made. The cash flows used in this impairment review were discounted at Powergen's cost of capital for CHP Operations. An impairment provision of £80 million was consequently recorded. A tax credit of £16 million arose in respect of this item.

3 Exceptional items (continued)

An impairment provision of £20 million was recognised in the year ended 31 December 2001 in respect of the unregulated Western Kentucky Energy business within US Operations, in the light of changes in wholesale electricity and coal prices. The cash flows used in this impairment review were discounted at Powergen's cost of capital for US unregulated businesses. A tax credit of £6 million arose in respect of this item.

Corporate

On 9 April 2001, E.ON announced a pre-conditional cash offer for the whole of the issued share capital of Powergen plc. In anticipation of this acquisition, Powergen provided for the anticipated total cost of advisors' and other fees associated with the successful completion of the transaction, of £31 million. No tax credit arose on these costs.

Profit less losses on disposal of fixed assets and investments

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 arises on these disposals.

Year ended 31 December 2001

UK Operations

On 8 March 2001, Powergen's UK Operations completed the sale of Rye House power station and transfer of its associated gas contract to Scottish Power UK plc, for £217 million in cash. Net assets disposed of, together with disposal and other related costs, totalled £178 million giving rise to an exceptional profit of £39 million. A tax charge of £7 million arose on this disposal.

US Operations

In November 2000, LG&E entered into an option transaction with Dominion Virginia Power (Dominion) to sell its 50 per cent stake in three 63MW coal-fired cogeneration power projects in Virginia. During March 2001 Dominion exercised its call option on this plant, and on 23 March 2001 the sale was completed for proceeds of £26 million in cash. Net assets disposed of, together with disposal costs totalled £26 million, giving rise to a £nil profit on disposal. No tax charge arose on this transaction. LG&E Power Services Inc., a wholly owned subsidiary of LG&E provided certain O&M services under a separate contract with Dominion.

3 Exceptional items (continued)

Asian Asset Management

On 27 February 2001, Powergen completed the sale of its Australian interests to a company that is 80 per cent owned by CLP Power International (CLP) and 20 per cent owned by Powergen. This gave that company 92 per cent stake in the holding company for Yallourn power station. Powergen therefore retains an effective stake of 18.4 per cent in Yallourn. Sale proceeds totalled £69 million in cash. Net assets disposed of, together with disposal and related hedging and swap costs totalled £70 million, giving rise to an exceptional loss on disposal of £1 million. A £1 million tax charge arose on this disposal.

On 27 April 2001, Powergen completed the sale of its German assets to NRG Energy, Inc. Sale proceeds totalled £50 million in cash. Net assets disposed of, together with related disposal costs, totalled £112 million, giving rise to an exceptional loss on disposal charged against profits of £62 million. No tax charge arose on this disposal.

On 11 May 2001, Powergen completed the sale of its Portuguese assets to RWE Power for £131 million in cash. Net assets disposed of, together with related disposal costs totalled £27 million. After writing back £12 million of goodwill previously charged directly against reserves, this transaction resulted in an exceptional profit on disposal of £92 million. No tax charge arose on this disposal.

On 7 August 2001, CLP acquired an option for first refusal from Powergen to purchase Powergen's Indonesian assets, PT Jawa Power, at a future date. Powergen received £14 million in non-refundable cash for this option. After charging £3 million of associated costs, this transaction resulted in an exceptional profit of £11 million. A £4 million tax charge arose on this item. This option was subsequently terminated during 2002.

Profits less losses on disposal of businesses (including provisions)

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 CLP Powergen India Limited (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.

3 Exceptional items (continued)

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.

Year ended 31 December 2001

UK Operations

On 20 February 2001, Powergen completed the sale of its East Midlands Electricity metering business to Siemens Metering Limited for £40 million in cash. Net assets disposed of, together with disposal costs and unamortised goodwill totalled £25 million leading to an exceptional profit on disposal of £15 million. A tax charge of £6 million arose on this disposal. The sale excluded non half-hourly meters.

Asian Asset Management

On 29 June 2001, Powergen completed the sale of its Hungarian assets to NRG Energy, Inc. Sale proceeds totalled £80 million in cash. Net assets disposed of, together with related disposal costs, totalled £59 million, giving rise to an exceptional profit on disposal of £21 million. No tax charge arose on this disposal.

On 21 December 2001, Powergen finalised the terms of the sale of its 88 per cent stake in GPEC to CPIL as detailed above. During 2002, Powergen purchased the remaining 12 per cent stake in GPEC from the other minority shareholders, and this stake was then sold on to CPIL. During the year ended 31 December 2001 the value of Powergen's investment in GPEC was reduced by £66 million to reflect the value implicit in these sale arrangements. No tax credit arose on this item.

During the year ended 31 December 2001, Powergen incurred £4 million of costs in connection with the disposal of its International business, including office closure costs. Tax credits totalling £1 million arose on these costs.

3 Exceptional items (continued)

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 in these accounts.

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	
	2002	2001
UK Operations (including Corporate Centre)	**5,959**	5,530
US Operations	**4,137**	4,342
Asian Asset Management	**364**	543
	10,460	10,415

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

	Year ended 31 December	
	2002 £m	2001 £m
Wages and salaries	**326**	358
Social security costs	**26**	27
Other pension and retirement benefit costs (note 21)	**26**	17
	378	402
Capitalised in fixed assets	**(37)**	(25)
Charged in profit and loss account as staff costs	**341**	377

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	
All directors	**2002 £'000**	2001 £'000
Aggregate emoluments	**4,371**	3,502
Compensation for loss of office	**6,045**	-
	10,416	3,502

Retirement benefits are accruing to four directors under a defined benefit scheme (year ended 31 December 2001 four directors). During the year four (2001: one) directors exercised options over shares they were awarded for services to the Powergen Group.

	Year ended 31 December	
Highest paid director	**2002 £'000**	2001 £'000
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	**2,200**	1,418
Defined benefit pension scheme:		

–	Accrued pension at end of year	**290**	211

5 Net interest payable – Group

	Year ended 31 December	
	2002 **£m**	2001 £m
Investment income	**3**	1
Interest receivable from associates and joint ventures	**6**	4
Interest receivable from E.ON Group companies	**8**	-
Other interest receivable and similar income	**34**	19
Total interest receivable and similar items	**51**	24
Interest payable:		
Bank loans and overdrafts	**(61)**	(105)
Loans from E.ON Group companies	**(13)**	-
Other loans	**(190)**	(256)
Total interest payable and similar items	**(264)**	(361)
	(213)	(337)
Unwinding of discount in provisions	**(16)**	(22)
	(229)	(359)
Exceptional interest costs (note 3)	**(58)**	-
	(287)	(359)

Notes to the financial statements
for the year ended 31 December 2002 (continued)

6 Profit on ordinary activities before taxation

	Year ended 31 December	
	2002 £m	2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**91**	168
Electricity – distribution	**129**	118
Electricity and gas – retail	**105**	49
Lease and other income and charges	**83**	104
	408	439
Asian Asset Management	**65**	111
Corporate costs	**(22)**	(19)
Continuing activities	**451**	531
US Operations		
Utilities	**257**	296
Non-utilities	**64**	59
Discontinued activities	**321**	355
	772	886
Net interest payable:		
Group	**(229)**	(359)
Associates and joint ventures	**(42)**	(63)
Goodwill amortisation	**(169)**	(151)
Exceptional items (note 3)	**(431)**	(270)
	(99)	43

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

	Year ended 31 December	
	2002 £m	2001 £m
UK Operations	**16**	14
US Operations	**39**	51
Asian Asset Management	**59**	36
	114	101

Goodwill amortisation can be analysed as follows:

	Year ended 31 December	
	2002 £m	2001 £m
UK Operations	**90**	68
US Operations	**79**	83
	169	151

6 Profit on ordinary activities before taxation (continued)

The net assets of the Group are analysed as follows:

	As at 31 December	
	2002	2001
	£m	£m
UK Operations	**4,524**	2,683
US Operations	**2,291**	2,874
Asian Asset Management	**138**	342
Unallocated net liabilities	**(5,115)**	(3,875)
	1,838	2,024

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	
	2002	2001
	£m	£m
United Kingdom corporation tax at 30% (year ended 31 December 2001 30%):		
Current year	**26**	-
Prior year	**(86)**	(7)
	(60)	(7)
Overseas taxation	**1**	40
Current tax	**(59)**	33
Deferred tax (note 23)		
Origination and reversal of timing differences	**(51)**	(51)
Decrease/(Increase) in discount	**38**	(8)
	(72)	(26)
Associates and joint ventures	**13**	8
Tax credit on profit on ordinary activities	**(59)**	(18)

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

(a) the sale of the US Operations in 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.

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	
	2002	2001
	£m	£m
(Loss)/Profit on ordinary activities before tax	**(99)**	43
Tax (credit)/charge on (loss)/profit on ordinary activities at 30%	**(30)**	13
Prior year adjustment	**(86)**	(7)
Expenses not deductible for tax purposes (mainly goodwill)	**65**	100
Non-taxable income	**(31)**	(91)
Impact of different rates of tax in overseas business	**(34)**	(31)
Origination and reversal of timing differences	**57**	49
Current tax (credit)/charge for the year	**(59)**	33

8 Dividends

	Pence per ordinary share Year ended 31 December		Year ended 31 December	
	2002	2001	**2002**	2001
			£m	£m
First interim dividend paid	9.2p	9.2p	**60**	60
Second interim dividend paid	9.2p	9.2p	**61**	60
Third interim dividend paid	**-**	9.2p	**-**	60
Fourth interim dividend proposed	**-**	9.2p	**-**	60
	18.4p	36.8p	**121**	240

9 Profit of the Company

The loss after taxation for the financial year of the Company is £448 million (year ended 31 December 2001 £296 million profit). The Company is not publishing a separate profit and loss account, as permitted by Section 230 of the Companies Act 1985.

10 Acquisitions

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. Net liabilities acquired were £138 million, leading to goodwill arising of £1,765 million. The transaction has been acquisition accounted.

On 18 October 2002 Powergen acquired an additional 50 per cent stake in Powergen Renewables Limited (PG Renewables), formally a joint venture with Abbot Group plc. This purchase, which has been acquisition accounted, gave Powergen full ownership of PG Renewables and subsequent to this acquisition, PG Renewables has been treated as a subsidiary undertaking by the Group. Cash consideration for the acquisition was £58 million and net assets acquired were £26 million, giving rise to goodwill of £32 million.

Details of the acquisitions during the year are set out as follows:

	Book value £m	Revaluation (1) £m	Other fair value adjustments (2) £m	Fair value to the Powergen Group £m
Net assets acquired:				
TXU				
Tangible fixed assets	13	5	-	18
Stocks	24	(9)	-	15
Deferred taxation	-	56	-	56
Other working capital	237	(245)	(38)	(46)
Provisions	-	(166)	(15)	(181)
	274	(359)	(53)	(138)
PG Renewables				
Tangible fixed assets	59	27	-	86
Investments	4	5	-	9
Other working capital	(17)	-	12	(5)
Net borrowings	(38)	-	-	(38)
	8	32	12	52
Share of net assets acquired (50%)				26
Total net liabilities acquired				(112)
Goodwill				1,797
Consideration, including costs of acquisition				1,685

(1) Revaluation adjustments principally comprise:
- Valuations of certain properties and generation plant at realisable amount.
- Other working capital provisions of £139 million of redundant debtor balances and associated write-off together with £57 million of pension provisions.
- Deferred tax on the above items.
- Provision for an out of the money outsourced retail service contract (£157 million).

(2) Other fair value adjustments principally comprise the release of pre-existing commitments with TXU cancelled as part of the acquisition.

10 Acquisitions (continued)

There was no adjustment required in order to align TXUs accounting policies with those of the Powergen Group.

Amortisation of goodwill for the two months to 31 December 2002 totalled £22 million and £nil in respect of TXU and PG Renewables respectively. Of the £1,765 million goodwill arising in respect of the acquisition of TXU, £1,315 million is being amortised over its expected useful life of 20 years. £450 million that is directly related to the value of the acquired customer base is being amortised over a shorter period of 10 years which represents the directors' view of its expected useful life. The total amount of goodwill in respect of PG Renewables is being amortised over its expected useful life of 20 years.

Key financial extracts from the unaudited management accounts for the two acquired businesses for the pre-acquisition period are as follows:

	TXU	PG Renewables
	1 January to 21 October 2002 £m	1 January to 18 October 2002 £m
Turnover	2,534	6
Operating profit	344	1
Profit/(Loss) before tax	344	(1)
Taxation	(103)	1
Minority interest	-	-

During the year ended 31 December 2001, TXU had profits after tax of £379 million and PG Renewables had profits of £nil. Neither business had any minority interest.

The figures for TXU for the period from 1 January to 21 October 2002 and for the year ended 31 December 2001 are derived from unaudited management accounts. They contain certain allocated costs from TXU's parent company for central costs and power purchases. These figures were therefore prepared on a different basis from the figures for the period from 21 October to 31 December 2002 when TXU was part of the Powergen Group. The tax figures for the pre-acquisition periods reflect the UK statutory tax rate of 30%.

10 Acquisitions (continued)

Prior to becoming a subsidiary undertaking, PG Renewables was accounted for as an associated undertaking. In accordance with Financial Reporting Standard 2 'Accounting for Subsidiary Undertakings', and in order to give a true and fair view, purchased goodwill has been calculated as the sum of the goodwill arising on each separate purchase of shares in PG Renewables. Goodwill arising represents the difference at the date of each purchase between the fair value of the consideration given and the fair value of the identifiable assets and liabilities attributable to the interest purchased. This represents a departure from the statutory method, under which goodwill is calculated as the difference between cost and fair value on the date that PG Renewables became a subsidiary undertaking. The statutory method would not give a true and fair view because it would result in the Group's share of PG Renewables' retained reserves, during the period that it was an associated undertaking, being re-characterised as goodwill. The effect of this departure is to create a revaluation reserve of £16 million and to increase purchased goodwill by £16 million. There was no impact on retained earnings.

11 Goodwill

The Group	£m
Cost	
At 31 December 2001	3,005
Foreign exchange movements	(150)
Sell-down of GPEC to associated undertaking	(52)
Acquisitions (note 10)	1,797
At 31 December 2002	**4,600**
Amortisation	
At 31 December 2001	364
Foreign exchange movements	(14)
Sell-down of GPEC to associated undertaking	(52)
Charge for the year	169
At 31 December 2002	**467**
Net book value at 31 December 2002	**4,133**
Net book value at 31 December 2001	2,641

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 2001	5,945	3,515	1,104	10,564
Foreign exchange movements	(250)	(172)	(39)	(461)
Additions	232	145	104	481
Acquisitions	99	-	18	117
Disposals	(613)	(7)	(117)	(737)
At 31 December 2002	**5,413**	**3,481**	**1,070**	**9,964**
Depreciation				
At 31 December 2001	3,071	1,335	533	4,939
Foreign exchange movements	(107)	(76)	(9)	(192)
Charge for the year	143	97	139	379
Acquisitions	13	-	-	13
Disposals	(167)	(7)	(15)	(189)
At 31 December 2002	**2,953**	**1,349**	**648**	**4,950**
Net book value at 31 December 2002	**2,460**	**2,132**	**422**	**5,014**
Net book value at 31 December 2001	2,874	2,180	571	5,625

Group assets include freehold land and buildings with a net book value of £319 million (31 December 2001 £368 million) and assets in the course of construction at a cost of £272 million (31 December 2001 £430 million).

At 31 December 2002 there are no assets held under finance leases included in assets in the course of construction (31 December 2001 £65 million cost and net book value).

13 Fixed asset investments

The Group	Net assets		Loans			
	Joint ventures £m	Associates £m	Joint ventures £m	Associates £m	Other investments £m	Total £m
Net assets excluding goodwill						
At 31 December 2001	81	182	27	15	83	388
Additions	-	44	9	3	25	81
Disposals	(18)	(44)	(1)	(6)	(9)	(78)
Acquisitions	-	9	-	-	-	9
Sell-down of GPEC to an associated undertaking	-	50	-	-	-	50
Reclassification of GPEC to a trade investment	-	(29)	-	-	29	-
Impairments	-	(28)	(3)	-	-	(31)
Retained profits	21	33	-	-	-	54
Foreign exchange movements	(3)	(94)	-	-	(2)	(99)
At 31 December 2002	**81**	**123**	**32**	**12**	**126**	**374**
Goodwill						
At 31 December 2001	14	-				14
Amortisation	(8)	-				(8)
At 31 December 2002	**6**	**-**				**6**
At 31 December 2002 – Net assets and goodwill	**87**	**123**	**32**	**12**	**126**	**380**
At 31 December 2001 – Net assets and goodwill	95	182	27	15	83	402

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

Other investments include investments listed on a recognised stock exchange of £61 million (year ended 31 December 2001 £52 million) set aside by subsidiary companies for certain medium and long-term insurance liabilities. At 31 December 2002 and 31 December 2001 the market value of these investments was £nil million in excess of cost. Other investments also includes a 20% stake in GPEC and a 18.4% stake in Yallourn. These are accounted for as trade investments as the directors consider that the Group does not have significant influence over their operations.

13 Fixed asset investments (continued)

The Company

The cost of investment in the Company balance sheet represents the 100 per cent ownership of Powergen Group Holdings Limited. This original investment of £3,100 million was impaired by £520 million during the year following a reassessment of the valuation of UK Operations, leaving a closing balance at 31 December 2002 of £2,580 million (31 December 2001 £3,100 million). The cash flows used in the impairment reviews were discounted at Powergen's cost of capital for UK Operations.

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.

All the subsidiaries listed have a December year end except for Powergen US Holdings which has a year end of 29 March.

13 Fixed asset investments (continued)

	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 for US based activities
Powergen UK plc +	Sterling ordinary shares	100	England and Wales	Generation and sale of electricity
LG&E Energy Corp. (LG&E) +**	US Dollar common shares	100	United States	Holding company for US based activities
Louisville Gas and Electric Company (LGEC) +**	US Dollar common shares	100	United States	Generation and distribution of electricity and supply of electricity and gas
Kentucky Utilities Company (KU) +**	US Dollar common shares	100	United States	Generation, distribution and supply of electricity
LG&E Capital Corp. +**	US Dollar common shares	100	United States	Holding company for US based non-utility activities
LG&E Energy Marketing Inc. +**	US Dollar common shares	100	United States	Manages energy marketing contracts
Distribuidora de Gas Del Centro +**	Argentine Peso ordinary shares	45.9	Argentina	Sale and distribution of gas
Western Kentucky Energy Corp. +**	US Dollar common shares	100	United States	Leases from, operation and maintenance of coal-fired generation assets
EME Distribution 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
Ergon Insurance Limited +	Sterling ordinary shares	100	Isle of Man	Captive insurance company
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
TXU Europe (AHGD) Limited +	Sterling	100	England and	Sale of gas and electricity

	ordinary and preference shares		Wales

* direct interest + indirect interest ** disposed on 1 March 2003

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%
Distribuidora de Gas Cuyana+	30 November	Argentina	Argentine Peso ordinary shares	14.4%
Gas Natural BAN SA+	30 September	Argentina	Argentinean Peso ordinary shares	19.6%
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
+ disposed on 1 March 2003

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

PT Jawa Power	-	Generation and sale of electricity from coal-fired power station
Distribuidora de Gas Cuyana	-	Sale and distribution of gas
Gas Natural BAN SA	-	Sale and distribution of gas
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

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

	At 31 December 2002		At 31 December 2001	
	Joint ventures £m	**Associates £m**	Joint ventures £m	Associates £m
Share of assets:				
Share of fixed assets	**285**	**421**	290	546
Share of current assets	**44**	**79**	91	81
	329	**500**	381	627
Share of liabilities:				
Amounts falling due within one year	**(24)**	**(36)**	(36)	(52)
Amounts falling due after more than one year	**(218)**	**(341)**	(250)	(393)
	(242)	**(377)**	(286)	(445)
Share of net assets	**87**	**123**	95	182
Turnover	**276**	**179**	548	136
Operating profit	**40**	**74**	60	41

Notes to the financial statements
for the year ended 31 December 2002 (continued)

14 Stocks

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
Fuel stocks	**192**	172
Stores	**94**	101
	286	273

15 Debtors: amounts falling due after more than one year

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
Other debtors	**80**	118

16 Debtors: amounts falling due within one year

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
Trade debtors	**1,247**	803
Less: securitisation	**(69)**	(227)
Net trade debtors	**1,178**	576
Amounts recoverable on contracts	**12**	-
Other debtors	**76**	128
Prepayments and accrued income	**89**	90
	1,355	794

The Company has no debtors apart from £2,751 million (31 December 2001 £144 million) of inter-company balances due from subsidiaries.

16 Debtors: amounts falling due within one year (continued)

During 2002, Powergen had a revolving-period £300 million securitisation programme within the UK business. This programme sold all of Powergen's rights, title and interest in certain billed and unbilled trade debtors (for electricity, gas and telephony retail customers) to Kittyhawk Funding Corporation, a trust established for the purpose of purchasing trade debtors including those from Powergen. The trust issued commercial paper to investors and loaned the proceeds to Powergen. Interest was charged on the amounts borrowed under the securitisation programme at a margin above LIBOR, and was payable monthly. Powergen was not obliged to support any loss suffered by the trust or the related investors as a result of the securitisation programme. The trust had no right to seek recourse against any other assets, apart from the identified billed and unbilled trade debtors. Powergen had an option, but no obligation, to repurchase defaulted debt from the trust for a nominal sum.

At 31 December 2001, amounts advanced by the trust to the Group totalled £300 million, of which £166 million was loaned against billed and unbilled trade debtor balances. Powergen retained the responsibility for servicing these trade debtors. The remaining £134 million advanced by the trust against future trade debtor balances was included in bank loans and overdrafts within creditors due within one year (note 18). On 2 December 2002 this programme was cancelled and all balances drawn were repaid in full.

On 6 February 2001, LGEC and KU entered a three year programme to sell trade debtors to two wholly-owned subsidiaries, LG&E Receivables LLC ("LGE-R") and KU Receivables LLC ("KU-R"), respectively. Simultaneously, LGE-R and KU-R entered into two separate three-year accounts receivables securitisation facilities with two financial institutions and their affiliates whereby LGE-R and KU-R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to $75 million and $50 million, respectively, from an unrelated third party purchaser at a cost of funds linked to commercial paper rates plus a charge for administrative and credit support services. Furthermore, LGEC and KU retain the servicing rights of the sold receivables through two separate servicing agreements between the third party purchaser and each utility. Under these agreements, LG&E and KU receive a fee for servicing the sold receivables on behalf of the third party purchaser. At 31 December 2002, LG&E's total outstanding balance was £69 million (31 December 2001 £61 million).

17 Loans and overdrafts

	Weighted average interest rate			**The Group**
	Year ended 31 December 2002 %	Year ended 31 December 2001 %	**At 31 December 2002 £m**	At 31 December 2001 £m
Bank overdrafts	**-**	-	**12**	17
Short-term loans from E.ON Group companies	**2.3**	-	**3,305**	-
Other short-term loans	**4.4**	6.0	**557**	686
Commercial paper	**2.6**	4.6	**-**	838
	3.3	5.5	**3,874**	1,541

The Company has no loans and overdrafts apart from £2,550 million (2001 £nil) of inter-company balances owed to E.ON UK Limited (formerly E.ON UK plc), the immediate parent undertaking.

The Group has four commercial paper programmes, as follows:

	LGEC programme	LG&E Capital Corp. programme	Powergen UK plc programme	Powergen US Funding LLC programme
Maximum amount permitted	US $200 million	US $600 million	US $500 million	US $3,000 million
Repayment periods	1 – 270 days	1 – 270 days	7 - 364 days	1 – 270 days
Amount outstanding:				
31 December 2002	-	-	-	-
31 December 2001	£21m	-	£284m	£533m
Basis of interest rate	US LIBOR	US LIBOR	Currency of issue LIBOR	US LIBOR

Following the acquisition by E.ON, short-term funding has been provided through inter-company facilities rather than using external commercial paper programmes.

18 Trade and other creditors falling due within one year

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
Trade creditors	**957**	641
Corporation tax	**61**	136
Other taxation and social security	**8**	17
Accruals and other creditors	**710**	469
Deferred income	**100**	100
Proposed dividend	**-**	60
	1,836	1,423

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 £2 million (31 December 2001 £nil) and proposed dividends of £nil (31 December 2001 £60 million).

19 Long term loans

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
8.875% Sterling Bond 2003	**-**	250
4.5% Global US Dollar bond 2004	**653**	820
6.205% Medium term US Dollar notes 2004	**90**	99
US Dollar term facility expiring 2006	**-**	412
8.5% Sterling Bond 2006	**250**	250
7.45% US Dollar Yankee Bond 2007	**255**	281
Loan notes 2007	**3**	3
6.46% Medium term US Dollar notes 2008	**88**	96
5% Euro Eurobond 2009	**326**	326
5.75% Medium term US Dollar notes 2011	**94**	102
6.25% Sterling Eurobond 2024	**245**	245
First mortgage bonds 2006 – 2027 (secured)	**112**	190
Pollution control bonds 2007 – 2032 (secured)	**299**	361
Finance lease obligations	**-**	177
Other long-term loans	**37**	125
	2,452	3,737

19 Long term loans (continued)

None of the bonds outstanding at 31 December 2002 has any financial covenants except for dividend restrictions on the first mortgage and pollution control bonds. Substantially all of LGEC's and KU's utility plants are pledged as security for its first mortgage bonds.

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

	At 31 December 2002 £m	At 31 December 2001 £m
In one year or less, or on demand	**3,874**	1,541
In more than one year but not more than two years	**743**	341
In more than two years but not more than five years	**565**	1,835
In more than five years	**1,144**	1,561
	6,326	5,278

The Company loans of £2,550 million are all due within one year. The Company did not have any loans outstanding at 31 December 2001.

At 31 December 2002 there were £443 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 and expired within 12 months from the balance sheet date. These facilities comprise:

	Total Facility £m	Amount undrawn at 31 December 2002 £m	Expiry date	Fees
Powergen UK plc - 360 day committed facility from E.ON AG	400	275	7 July 2003	10 bps
Powergen US Holdings Limited - 360 day. committed facility from E.ON AG ($250m)	156	156	7 July 2003	10 bps
LG&E Energy Corp. short term facility from Fidelia Corporation, an E.ON company ($250m)	156	12	30 April 2003	10 bps
	712	443		

Since the year end LG&E has signed a 364 day short term borrowing facility with E.ON North America Inc., a fellow E.ON subsidiary company, for $150 million. This expires on 24 February 2004 and carries a commitment fee of 8bps.

20 Other creditors falling due after more than one year

	The Group	
	At 31 December 2002 £m	At 31 December 2001 £m
Accruals and other creditors	**286**	283
Deferred income	**40**	140
	326	423

21 Pension scheme arrangements and other post-retirement benefits

Pension scheme arrangements

At 31 December 2002, 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. The Group has three separate funds within the ESPS, the Powergen UK fund, the East Midlands Electricity fund, and since the acquisition of TXU during the year, 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, £116 million in respect of the East Midlands Electricity fund and £56 million in respect of the TXU fund. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these actuarial valuations were:

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

	At 31 March 2001		
	Powergen UK fund	East Midlands Electricity fund	TXU fund
Market value of assets*	£1,604m	£954m	£1,074m
Funding level	117%	114%	106%
– 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%, 100% and 101% of the market value of the assets for the Powergen UK, East Midlands Electricity, and TXU funds respectively.

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

For Powergen's US based employees, 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 year ended 31 December 2002 has 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

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

Pension costs for the Group

In the financial year ended 31 December 2002, the normal pension cost for the Group amounted to £26 million (year ended 31 December 2001 £17 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, the Group had a SSAP 24 creditor of £174 million (31 December 2001 £148 million).

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 financial year ended 31 December 2002, the cost in respect of post-retirement healthcare amounted to £5 million (year ended 31 December 2001 £5 million). This amount was only in respect of the LG&E Group. There was a creditor of £121 million in respect of post-retirement healthcare arrangements (31 December 2001 £97 million).

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. Current year values have been based on the valuation at 31 December 2001 and adjusted for any known movements during the year.

21 Pension scheme arrangements and other post-retirement benefits (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 2002. These updates were performed by independent, professionally qualified actuaries.

The major assumptions used in these calculations of liabilities were:

	At 31 December 2002		At 31 December 2001	
	UK funds	**LG&E funds**	UK funds	LG&E funds
Average nominal rate of annual increase in salaries	**3.75%**	**3.75%**	4.00%	4.25%
Average nominal rate of annual increase in pensions	**2.25%**	**-**	2.50%	-
Discount rate	**5.75%**	**6.75%**	5.50%	7.25%
Inflation rate	**2.25%**	**2.25%**	2.50%	2.75%

21 Pension scheme arrangements and other post-retirement benefits (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 2002 were:

	At 31 December 2002		At 31 December 2001	
	UK Funds £m	**LG&E funds £m**	UK Funds £m	LG&E funds £m
Bonds and gilts	**865**	**84**	424	96
Equities	**1,563**	**161**	1,831	236
Other	**221**	**5**	158	4
Total market value of assets	**2,649**	**250**	2,413	336
Present value of scheme liabilities	**(3,151)**	**(456)**	(2,285)	(481)
(Deficit)/Surplus in the scheme	**(502)**	**(206)**	128	(145)
Related deferred tax asset/(liability)	**81**	**82**	(38)	58
Net pension (liability)/asset	**(421)**	**(124)**	90	(87)

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

	At 31 December 2002		At 31 December 2001	
	UK funds %	**LG&E funds %**	UK funds %	LG&E funds %
Bonds and gilts	**5.20**	**7.00**	5.00	6.95
Equities	**8.25**	**10.00**	7.00	10.65
Other	**4.00**	**3.00**	4.00	4.00

Powergen also operates 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 were:

		LG&E Funds	
		At 31 December 2002	At 31 December 2001
		%	%
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

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:

	LG&E Funds	
	At 31 December 2002	At 31 December 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	**(77)**	(70)

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

	31 December 2002 £m	31 December 2001 £m
Net assets excluding SSAP 24 pension and SFAS 106 other post-retirement benefit liability	**2,024**	2,177
Pension and other post-retirement benefit liability under FRS 17*	**(622)**	(67)
Net assets including pension and other post-retirement benefit liability under FRS 17	**1,402**	2,110

Profit and loss reserve excluding SSAP 24 pension and SFAS 106 other post-retirement benefit liability	**754**	953
Pension and other post-retirement benefit liability under FRS 17*	**(622)**	(67)
Profit and loss reserve including other post-retirement benefit liability under FRS 17	**132**	886

*At 31 December 2002, all of the Groups schemes were in deficit with a gross balance of £836 million and deferred tax of £214 million. At 31 December 2001, the balance consists of £90 million in respect of schemes in surplus and £157 million in respect of schemes in deficit. At that time, LG&E had a deficit position of £261 million net of a deferred tax asset of £104 million, in their pension and other post-retirement benefit plans. The company continues to monitor the performance and balances in the plans and will take the necessary steps to ensure that it remains within the appropriate guidelines imposed by the 'Pension Benefit Guaranty Corporation'.

21 Pension scheme arrangements and other post-retirement benefits (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:

	Year ended 31 December 2002	
	UK Funds £m	US Funds £m
Operating profit		
Current service cost	18	8
Past service cost	48	1
Total operating charge	**66**	**9**
Other finance income		
Expected return on pension scheme assets	163	30
Interest on pension scheme liabilities	(131)	(41)
Net return	**32**	**(11)**

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

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

The movement from a surplus to a deficit in the year is analyses as follows:

	UK Funds £m	US Funds £m
Surplus/(Deficit) at the beginning of the year	128	(261)
Fair value on the acquisition of TXU	(188)	-
Current service cost	(18)	(8)
Employer contributions	19	20
Past service costs	(48)	(1)
Other finance income	32	(11)
Foreign exchange	-	33
Actuarial loss recognised in the STRGL	(427)	(106)
Deficit in the schemes at the end of the year	**(502)**	**(334)**

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

The details of experience gains and losses under FRS 17 for the year ended 31 December 2002 are as follows:

	UK Funds	US Funds
Differences between the expected and actual return on scheme assets:		
Amount	£(539)m	£(65)m
Percentage of scheme assets at year end	(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	£(427)m	£(106)m
Percentage of the present value of the scheme liabilities at the year end	(14)%	(18)%

Contributions in the year ended 31 December 2002 were £39 million. It has been agreed that contributions for the UK schemes will be 12% of pensionable salary over the next 2 years (the US Operations were disposed of on 1 March 2003).

22 Provisions for liabilities and charges

Movements on provisions comprise:

	31 December 2001 £m	Charged to profit and loss account £m	Acquisitions £m	Amortisation of discount £m	Provisions utilised £m	Exchange movements £m	**31 December 2002 £m**
US contract provisions	331	226	-	14	(64)	(29)	**478**
UK contract provisions	122	-	157	-	(27)	-	**252**
Liability and damage claims	61	1	-	-	(1)	-	**61**
Decommissioning	54	-	24	2	-	-	**80**
	568	227	181	16	(92)	(29)	**871**

US contract provisions includes two items. The first of which relates to onerous electricity contracts entered into by WKE in 1998 and takes account of costs (including fuel costs) to meet their obligations. The provision will be utilised over the period to 2023. The second contract provision relates to out of money fixed price energy marketing contracts entered into in 1996 and 1997 by LG&E and take account of costs (including purchased power costs) to meet these contractual commitments. These contracts were acquired by Powergen on the purchase of LG&E. The provisions will be utilised over the period to 2008.

22 Provisions for liabilities and charges (continued)

UK contract provisions includes two items. The first of which 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 on 21 October 2002 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 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.

23 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2002 is as follows:

	31 December 2002 £m	31 December 2001 £m
Accelerated capital allowances	**822**	840
Other timing differences	**(418)**	(306)
Undiscounted provision for deferred tax	**404**	534
Discount	**(242)**	(280)
Discounted provision for deferred tax	**162**	254
Provision at start of year	**254**	274
Deferred tax credit for year (note 7)	**(13)**	(59)
Acquisition	**(52)**	-
Revision to provisional fair values	**-**	35
Foreign exchange movements	**(27)**	4
Provision at end of year	**162**	**254**

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 2002 £m	31 December 2001 £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		
958,277,841 (31 December 2001 654,362,630) ordinary shares of 50p	**479**	327
49,998 redeemable preference shares of £1	**-**	-
	479	327

During the year 3,103,275 ordinary shares of 50p each were issued under the Powergen ShareSave Scheme realising £10,598,153. An amount of £9,046,515 has been credited to share premium account.

During the year 811,936 ordinary shares of 50p each were issued under the Powergen Executive Share Option Scheme realising £4,154,091. An amount of £3,748,123 has been credited to share premium account.

On 1 July 2002, the entire ordinary share capital of Powergen including share options was acquired by E.ON UK Limited, a wholly owned subsidiary of E.ON AG. The acquisition was effected by way of a Scheme of Arrangement between E.ON UK Limited, and Powergen and its shareholders under Section 425 of the UK Companies Act 1985 sanctioned by the High Court of Justice on 28 June 2002. Shareholders could opt for a loan note alternative (issued by E.ON UK Limited) to a cash payment for their shares.

All ordinary shares in Powergen, apart from those converted to loan notes, were cancelled. The credit arising as a result of the cancellation was applied in paying up new Powergen shares equal in nominal value to the shares cancelled and consequently the share capital of Powergen was restored to its former nominal amount. The new Powergen shares were issued to E.ON UK Limited which as a result became the immediate parent undertaking for the Group.

24 Share capital (continued)

On 16 August 2002, a further 300,000,000 shares were issued to E.ON UK Limited for consideration of £150 million.

The redeemable preference shares are held by Powergen UK plc and are redeemable at par at the option of the Company. The holders of the limited-voting redeemable preference shares are not entitled to receive or participate in any of the profits of the Company available for distribution by way of dividend or otherwise.

Share option schemes

Prior to the E.ON acquisition, the Company had two share option schemes under which options to acquire shares were granted to employees; the Powergen ShareSave Scheme, which was available to all eligible Group employees, and the Powergen Executive Share Option Scheme, which was available to executive directors and other senior executives and managers selected by the Remuneration Committee.

Options granted, exercised and lapsed under these share option schemes during the two years ended 31 December 2002 were as follows:

	Powergen ShareSave Scheme		Powergen Executive Share Option Scheme	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding at 31 December 2000	8,649,409	£3.28	10,266,210	£5.39
Granted	1,215,313	£5.74	1,386,284	£6.97
Exercised	(1,914,795)	£3.70	(1,551,720)	£5.58
Lapsed	(1,028,763)	£3.65	(1,802,720)	£5.52
Outstanding at 31 December 2001	6,921,164	£3.54	8,298,054	£5.59
Exercised	(3,103,275)	£3.42	(4,391,140)	£5.92
Lapsed	(3,817,889)	£3.63	(3,878,626)	£5.22
Outstanding at 31 December 2002	**-**	**-**	**28,288**	**£4.90**

Following the acquisition of Powergen by E.ON all outstanding grants of Powergen options in the UK expired on 28 December 2002. In the US, options over 28,288 Powergen shares remain outstanding. These options expire, at the latest, in 2011.

E.ON AG operates a stock appreciation rights programme that has been in existence since 1999. During 2002, certain directors and senior managers of Powergen were invited to join the fourth tranche of this programme. This tranche is not exerciseable 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 2001	21	656	22	800
Premium on shares issued	12	-	-	-
Currency translation differences on foreign currency net investments	-	-	-	(124)
Transfer on sell down of GPEC to associate	-	-	(22)	22
Acquisitions (note 10)	-	-	16	-
Loss for the year	-	-	-	(130)
At 31 December 2002	**33**	**656**	**16**	**568**

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	Profit and loss account £m
At 31 December 2001	2,836
Loss for the financial year attributable to shareholders	(448)
Dividends	(121)
At 31 December 2002	**2,267**

Of the £2,267 million profit and loss reserve at 31 December 2002, £2,255 million is not distributable as a result of an internal group reconstruction in 2000.

26 Minority interests

	31 December 2002			31 December 2001		
	Equity £m	**Non-equity £m**	**Total £m**	Equity £m	Non-equity £m	Total £m
Opening minority interests	**105**	**93**	**198**	110	90	200
Revision to provisional fair values	**-**	**-**	**-**	(1)	-	(1)
Acquisition of GPEC minorities	**(34)**	**-**	**(34)**	-	-	-
Exchange movements	**(34)**	**(9)**	**(43)**	2	3	5
Dividends paid to minority parties	**-**	**(4)**	**(4)**	(12)	(5)	(17)
Profit and loss account – pre-exceptional	**7**	**4**	**11**	12	5	17
Profit and loss account – exceptional	**(42)**	**-**	**(42)**	(6)	-	(6)
Closing minority interests	**2**	**84**	**86**	105	93	198

Non-equity minority interests include 100% of the cumulative preferred stock of LGEC and 100% of the cumulative preferred stock of KU, the utility subsidiaries of LG&E. The majority of these preference shares are redeemable at 30 days’ notice by each utility subsidiary. Preference shareholders have first preference in the event of a liquidation of each utility subsidiary and first rights to dividends. The holders of these shares only have rights against the US utility subsidiaries.

27 Reconciliation of moveme nts in shareholders' funds

	31 December 2002 £m	31 December 2001 £m
(Loss)/Profit attributable to shareholders	**(9)**	50
Shares issued	**164**	13
Dividends	**(121)**	(240)
Currency translation differences on foreign currency net investments	**(124)**	23
Goodwill transferred to the profit and loss account related to disposals of fixed assets and investments	**-**	15
Revaluation reserve arising on acquisition	**16**	-
Net decrease in shareholders' funds for the period	**(74)**	(139)
Opening shareholders’ funds	**1,826**	1,965
Closing shareholders' funds	**1,752**	1,826

Opening and closing shareholders’ funds include 49,998 limited-voting redeemable preference shares of £1 fully paid up.

Of the £124 million currency translation losses on foreign currency net investments shown above £81 million is attributable to associates and joint ventures (31 December 2001 £5 million gain).

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 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 2002 £m	31 December 2001 £m
US Dollars	**(1,071)**	(198)
Euros	**-**	1
Australian dollars	**(17)**	(17)
	(1,088)	(214)

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 2002 £m	31 December 2001 £m
Euros	**-**	1
Indian rupees	**(22)**	(34)
	(22)	(33)

The weighted average time to maturity of foreign exchange contracts is five months (year ended 31 December 2001, three months).

The notional amounts of foreign currency swaps are as follows:

	31 December 2002 £m	31 December 2001 £m
Foreign currency swaps into Sterling	**325**	326
Foreign currency swaps into US Dollars	**-**	165

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 2002 £m	31 December 2001 £m
Interest rate swap contracts	**2,056**	2,577

The weighted average time to maturity of interest rate swap contracts is 3.7 years (year ended 31 December 2001, 4.1 years).

28 Financial instruments (continued)

Interest rate risk profile of financial liabilities

	Total	Floating rate financial liabilities	Fixed rate financial liabilities		
				Weighted average interest rate	Weighted average period for which rate is fixed
	£m	£m	£m	%	Years
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**
At 31 December 2001					
Sterling	**1,523**	1,216	307	9.1	8.3
US Dollar	**3,612**	1,705	1,907	6.1	4.3
Deutschmark	**118**	118	-	-	-
Indian Ruppee	**25**	4	21	20.0	5.6
	5,278	3,043	2,235	6.6	4.9

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 following rates:

Currency	**Rate**
Sterling	LIBOR
US Dollar	LIBOR, Bond Market Association Index

In addition to the above, the Group's provisions include £730 million (31 December 2001 £453 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 2002, the Group held £86 million of financial assets in the form of Sterling bank deposits (31 December 2001 £40 million), £22 million in the form of US Dollar deposits (31 December 2001 £10 million), and £3 million in other currencies (31 December 2001 £67 million). These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID and short-term US Treasuries, for the Sterling and US Dollar deposits respectively.

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 2002 £m	31 December 2001 £m
Foreign currency contracts	**(4)**	(2)
Foreign currency swaps	**(3)**	(25)
Interest rate swaps	**21**	(32)

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

		31 December 2002		31 December 2001	
	Note	**Carrying amount £m**	**Fair value £m**	Carrying amount £m	Fair value £m
Assets:					
Cash and short-term deposits	1	111	111	117	117
Investments	2	126	126	83	83
Liabilities:					
Short-term debt	3, 5	(3,874)	(3,874)	(1,541)	(1,541)
Long-term debt	4, 5	(2,452)	(2,582)	(3,737)	(3,775)

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 short-term debt approximates to the carrying value as the balance represents short-term loans and bank overdrafts.
4. The fair value of the long-term debt at the reporting date has been estimated at quoted market rates.
5. 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.

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 2001	23	(82)	(59)
(Gains)/Losses on hedges arising in previous periods that were recognised during the year	(4)	3	(1)
Gains/(Losses) on hedges arising before 31 December 2001 that were not recognised during the year	19	(79)	(60)
Losses on hedges arising during 2002 that were not recognised during the year	33	41	74
Unrecognised gains/(losses) on hedges at 31 December 2002	**52**	**(38)**	**14**
Of which:			
Gains/(Losses) expected to be recognised in 2003	6	(4)	2
Gains/(Losses) expected to be recognised in 2004 or later	46	(34)	12

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 2002, the Group had commitments contracted but not provided of £57 million (31 December 2001 £129 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.

The directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions held, that it is unlikely that the matters referred to above will, in aggregate, have a material effect on the Group's financial position, results of operations or liquidity.

29 Commitments and contingent liabilities (continued)

c) 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 2002 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £788 million (31 December 2001 £990 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 £3,279 million (31 December 2001 £2,906 million).

d) 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.

e) The Group has non-cancellable operating lease commitments for generating and other assets. The future minimum annual lease payments at 31 December 2002 under these non-cancellable agreements, are analysed as follows:

	At 31 December 2002			At 31 December 2001
	Land and buildings £m	**Other operating leases £m**	**Total minimum payments £m**	Total minimum payments £m
2003	7	19	26	25
2004	7	19	26	25
2005	6	19	25	23
2006	4	19	23	22
2007	3	19	22	21
In more than five years	20	311	331	342
	47	406	453	458

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

31 Post balance sheet event

As part of the acquisition process, E.ON undertook to transfer Powergen's US Operations to another part of the E.ON Group within twelve months of the acquisition. On 1 March 2003 Powergen sold its US Operations to E.ON US Holdings GmbH for proceeds of $1.8 billion. A significant profit arose as a result of this sale.