



**RESULTS FOR THE FINANCIAL YEAR ENDED 31 MARCH 2004 (FY2004)
AND THE FOURTH QUARTER ENDED 31 MARCH 2004 (Q4)**

Key Points – FY2004

- Progress has been made towards the completion of the restructuring, but it still remains subject to a large number of significant uncertainties and important conditions. In October 2003, British Energy exchanged contractual agreements with the Government, BNFL and certain creditors regarding the terms of the Proposed Restructuring. The Secretary of State for Trade and Industry now expects to receive notification of a decision from the European Commission on the Government's State aid application during the autumn.
- UK operating profit was £57m before exceptional items compared to £7m in the prior year. The improvement reflected the fact that, while average realised prices were £1.4/MWh lower at £16.9/MWh, total unit operating costs were reduced by £2.1/MWh to £16.5/MWh primarily as a result of higher output. The increase in profit did not include the potential P&L account savings of £58m from the revised BNFL back end contracts, which will not be recognised pre-restructuring. Restructuring costs of £43m were incurred during the year, compared to £35m last year.
- After net exceptional operating credits of £283m, total UK operating profit for continuing activities after exceptional items was £340m. This compared with a UK operating loss for continuing activities, after exceptional operating items, of £3,899m last year. The Group profit after tax and after total net exceptional credits of £403m was £234m. The UK loss before tax and before exceptional items for continuing activities was £194m.
- A summary of the results and the comparatives is set out in the table below:

(Year end 31 March - £m)	FY 2004	FY 2003
UK operating profit before exceptional items – continuing activities	57	7
Net exceptional operating credits/(charges)	283	(3,906)
UK operating profit/(loss) after exceptional items – continuing activities	340	(3,899)
Group profit/(loss) after tax and exceptional items	234	(3,924)
UK (loss) before tax and before exceptional items – continuing activities (1)	(194)	(274)

Notes :

1. The continuing activities described above exclude the results of Bruce Power and Huron Wind which were disposed of on 14 February 2003 and the share of profits from AmerGen which was disposed of on 22 December 2003. For FY2004, this loss includes the revalorisation charge of £187m. Post-restructuring charges to the P&L account will reflect payments to the new Nuclear Liabilities Fund.
- The Company conducted an asset impairment review at 31 March 2003 writing down fixed assets by £3,738m. The carrying value of fixed assets has been reviewed again as at 31 March 2004, and, as a result, there was a non - cash accounting upward adjustment of £295m for the partial reversal of the write-down of fixed assets in the prior year, principally due to an expectation of higher electricity prices.
 - Following the asset impairment review at 31 March 2003, no additions have been recorded to fixed assets in 2004. As a consequence the Company expensed an estimated £70m to the FY2004

P&L account that may have been capitalised in the absence of the impairment review. Expenditure previously treated as capital expenditure will continue to be fully expensed in the P&L account until it is possible to demonstrate that it enhances the value of the Company's fixed assets after taking into account the impairment review.

- Cash payments are being made to BNFL as if the revised back end contracts, which are contingent on the restructuring being implemented successfully, had become effective on 1 April 2003. The benefit of the revised BNFL back end contracts, £179m in FY2004, is reflected in the cash flow statements.
- EBITDA from continuing activities was £107m. After including potential P&L account savings of £58m from the revised BNFL back end fuel contracts, adjusted EBITDA would have been £165m in FY2004. Group operating cash flow from continuing activities was £156m, which includes the cash flow benefit of the revised BNFL contracts.

(Year end 31 March - £m)	FY 2004	FY 2003
EBITDA ⁽¹⁾ – continuing activities	107 ^{(2) (3)}	280
Adjusted EBITDA – continuing activities after including P&L savings from revised BNFL back end fuel contracts	165 ⁽⁴⁾	280
Capital expenditure (expensed to P&L)	70 ⁽²⁾	-
Group operating cash flow	156	336
Increase in total cash and liquid funds ⁽⁵⁾	240	204

Notes:

1. EBITDA is defined by the Company as operating income before interest expense, income taxes, depreciation and amortisation. The Company has included information concerning EBITDA because it believes that it is used by certain investors as one measure of the Company's financial performance. EBITDA is not a measure of financial performance under United Kingdom generally accepted accounting principles and is not necessarily comparable to similarly titled measures used by other companies. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with United Kingdom generally accepted accounting principles) as a measure of liquidity.
 2. EBITDA continuing activities for FY2004 does not include the potential P&L account savings from the revised BNFL back end contracts of £58m. Following the asset impairment review at 31 March 2003 (updated at 31 March 2004) all expenditure of a capital nature has been expensed through the P&L account. Capital expenditure in the table is shown for presentation purposes only. Capital expenditure will continue to be fully expensed in the P&L account until it is possible to demonstrate that it enhances the value of the Company after taking account of the impairment review. Based on UK GAAP, capital expenditure as referred to above cannot be added back to EBITDA. An amount estimated at £70m may have been capitalised in the absence of the impairment review.
 3. During FY 2004 there was a major unplanned outage at Heysham 1 with a resultant loss of output of some 3.2TWh, equivalent to some £71m of lost profit contribution.
 4. Adjusted EBITDA includes the potential P&L account savings of £58m from the revised BNFL back end contracts.
 5. Total cash and liquid funds is the sum of cash at bank and term deposits / bank balances.
- Total output for the year was 72.6TWh. Nuclear output was 65.0TWh, up from 63.8TWh last year, but below the Company's target of 67.0TWh. Eggborough output was up 1.9TWh to 7.6TWh. The realised price for the year was £16.9/MWh, with a total operating cost of £16.5/MWh resulting in a positive margin of £0.4/MWh, an improvement over the negative margin of £0.3/MWh in the prior year.
 - Total unit operating cost represents the average cost of generation of British Energy's entire output (both coal and nuclear), and includes depreciation and capital expenditure (expensed to the P&L account and estimated at £70m) but does not include the P&L account benefits of the revised BNFL back end contracts of £58m.

- A summary of output, realised prices and total operating unit costs is set out below:-

(Year end 31 March)	FY 2004	FY 2003
Output (TWh)		
- Nuclear	65.0	63.8
- Coal	7.6	5.7
	<u>72.6</u>	<u>69.5</u>
Realised price (£/MWh)	16.9	18.3
Total operating unit costs (£/MWh)	<u>16.5</u>	<u>18.6</u>
Margin (£/MWh)	<u>0.4</u>	<u>(0.3)</u>

After adjusting Total operating unit costs for the revised BNFL back end contract P&L account savings and depreciation, the adjusted unit operating cost in FY2004 was £15.0/MWh resulting in an adjusted margin of £1.9/MWh, as set out below:

(Year end 31 March 2004 £/MWh)	FY 2004
Total operating unit costs	16.5
Revised BNFL back end contracts	(0.8)
Depreciation	<u>(0.7)</u>
Adjusted operating unit cost	<u>15.0</u>
Adjusted margin	<u>1.9</u>

- Our investment in AmerGen was sold for US\$277m allowing the Government facility to be fully repaid. The year end cash and liquid funds balance was £573m of which £297m was deposited in support of collateral requirements. Cash increased by £240m in FY2004, with net debt of £310m as of 31 March 2004.

Details of cash and net debt are summarised in the table below, including an update as of 31 May 2004:

(£m)	As at 31 Mar 04	Update as at 31 May 04
Cash and term deposits not used for collateral	276	203
Cash and term deposits used for collateral	297	304
Total Cash	573	507
Total Debt: Pre restructuring	883	883
Less: total cash	<u>(573)</u>	<u>(507)</u>
Net Debt	<u>310</u>	<u>376</u>

- Following the implementation of the Proposed Restructuring, £700m of debt will replace the existing debt, the RBS letter of credit, and certain PPA's included in the restructuring. On this basis, proforma net debt would have been £127m at 31 March 2004 had restructuring become effective on that date.
- The Company is taking forward plans to improve the operational performance and reliability of its nuclear plants. A major part of the drive is the Performance Improvement Programme which is central to the operational plans designed to enhance the prospects of the Group. The cost implications of these plans are discussed below.

Key Points – Fourth Quarter

- No comparative data is available because the Company only commenced publishing quarterly reporting for the 3rd Quarter ended 31 December 2003. In reviewing these results, it is important to note that, in general, output and realised prices tend to be higher in the third and fourth quarters of the year.
- A summary of the results for the quarter ended 31 March 2004 is set out below:

(Quarter ended 31 March 2004)	£m
UK operating profit before exceptional items – continuing activities	51
Net exceptional operating credits	310
UK operating profit after exceptional items – continuing activities	361
Group profit after tax and exceptional items	316

The UK operating profit of £361m was achieved after net exceptional operating credits of £310m, which included a non-cash accounting upward adjustment of £295m for the partial reversal of the write-down of fixed assets in the prior year.

(Quarter ended 31 March 2004)	£m
UK operating profit before exceptional items	51
Add: Depreciation	14
EBITDA - Continuing activities (1)	65
Add: P&L savings of revised BNFL back end contracts	21
Adjusted EBITDA – continuing activities (1)	86

Note :

1. See notes on EBITDA above

- EBITDA from continuing activities was £65m. Adjusted EBITDA, after including P&L account savings of £21m from the revised BNFL back end contracts, was £86m.
- Cash inflow from operating activities in the period was £155m, which led to an increase in total cash and term deposits of £144m.
- Total UK output for the quarter was 19.8TWh, of which nuclear output was 17.0TWh and Eggborough output was 2.8TWh.
- The realised price was £18.2/MWh and the total operating cost was £16.1/MWh - this represents a positive margin of £2.1/MWh, significantly better than the margin in the first 9 months, largely due to seasonal factors and the effect high output has on unit cost.

Outlook

- The target nuclear output for FY2005 is 64.5TWh to take account of the replacement of cast iron pipework which is an important component of improving future reliability.
- FY2005 target nuclear output has been substantially contracted in order to hedge against price uncertainty. A large majority of these contracts are at fixed prices. As of the beginning of June, the average price of the fixed contracts for 2004/05 was £19.5/MWh.
- Market prices have continued to increase over the last six months. Prices for annual baseload power for FY2005 were trading at around £22/MWh at the end of March 2004. Since then the implied prices for annual baseload power have risen such that for the rest of the current year they have recently traded around £25/MWh.
- As part of the Company's plans to improve the condition and future reliability of the nuclear fleet, we are increasing year-on-year investment in major plant projects, repairs and strategic spares by some 34% to around £175m.

- In October 2003, the Company announced its projected three year average nuclear cost per MWh. As a result of the planned increase in investment in nuclear plant and other costs, the Company has revised upwards the projected three year average nuclear cash cost by approximately £1.30 per MWh, on an equivalent basis, excluding the effects of inflation.
- It is the intention of the Company to pay dividends when the requirements of the business permit, subject to the distributable reserves position and restrictions under the restructuring arrangements. No dividend is expected in respect of the two financial years ending March 2005 and March 2006, as the Board believes that investing in the business is a prerequisite for a successful turnaround.

Board / Management Changes

- Whilst the robustness of the Company's balance sheet depends on completing a successful financial restructuring, the long term success of the Company depends on achieving a comprehensive turnaround of the business, in particular its nuclear fleet. It is for this reason that the Board was determined to make a number of key appointments in critical areas.
- During the year, four new non-executive Directors were appointed - William Coley (USA), Dr Pascal Colombani (France), Sir Robert Walmsley (UK) and John Delucca (USA), have strengthened the Board. In addition, as previously announced, Martin Gatto was appointed as Interim Finance Director.
- In addition, since the year end, we have announced the appointments of Roy Anderson as our new Chief Nuclear Officer who joins the company on 5 July. Roy is currently President of PSEG and brings valuable experience from previous nuclear turnarounds in the USA. Neil O'Hara joined on 4 May as our new Trading Director. Neil was previously at RWE, Centrica and AEP and has a key role in implementing and developing our trading strategy.

Adrian Montague, Chairman, said:

"In the past twelve months we have made considerable progress in agreeing the shape of the proposed restructuring and the new British Energy with the Government and our creditors. In October, we reached agreements with our major creditors on the restructuring plan. The way forward is subject to a large number of conditions including approval by the European Commission, Court sanction and settling certain documents with creditors. We must also establish our viability to the satisfaction of the Secretary of State for Trade and Industry. It is intended that the Proposed Restructuring be implemented in the current financial year but there is a great deal to do in order to achieve this, and the size of the task should not be underestimated."

Safe Harbour

This document contains certain "forward-looking" statements as defined in Section 21E of the US Securities Exchange Act of 1934, including statements with respect to British Energy's business plans, the performance of its stations, electricity prices and other matters that are not historical facts concerning the business operations, financial condition and results of operations of British Energy. These forward-looking statements typically contain words such as "intends", "expects", "anticipates", "estimates", "aim", "believe", "assume", "should" and words of similar import, which are predictions of or indicate future events or future trends. These forward-looking statements involve known and unknown risks, uncertainties and other factors, which are in some cases beyond the control of British Energy and may cause actual results or performance to differ materially from those expressed or implied from such forward-looking statements. British Energy has identified some important factors that may cause such differences in British Energy's Form 20-F annual report for the year ended 31 March 2003 filed with the US Securities and Exchange Commission.

A copy of this release in Pdf file format can be found on the Company's web site at www.british-energy.com.

Conference Call

Management will host a conference call for analysts and investors at 4.00pm (UK time) today 17th June 2004.

The conference call can be accessed by dialling;

UK dial in:	0845 113 0049
International dial in:	+44 1452 542 303
US dial in:	1866 38 99778

Replay facility – 14 days, UK Dial in:	0845 245 5205
International dial in:	+44 1452 550 000
Pin:	1433421#

For further information please contact:

Paul Heward, British Energy:	01355 262201
Andrew Dowler, Financial Dynamics:	020 7831 3113

A copy of the investor presentation in connection with the above conference call will be published on the Company's website later this morning.

Chairman's Statement

In the past 12 months we have made considerable progress towards restructuring, with significant milestones being achieved.

In last year's Annual Report, I reported to you on the traumatic events of 2002. Over the past twelve months we have made considerable progress in agreeing the shape of the proposed restructuring and the new British Energy with the Government and our creditors (the Proposed Restructuring). In October, we reached agreement with our major creditors on the restructuring plan. The way forward is subject to a large number of significant uncertainties and important conditions including approval by the European Commission (the Commission), Court sanction and settling certain documents with creditors. We must also establish our viability to the satisfaction of the Secretary of State for Trade and Industry. It is intended that the Proposed Restructuring be implemented in the current financial year but there is a great deal to do in order to achieve this, and the size of the task should not be underestimated.

Total output for the year was 72.6 TWh. Nuclear output was 65.0 TWh, up from last year but less than the target we set for ourselves. The improved generation output helped lead to an operating profit of £57m which together with exceptional operating credits of £283m, resulted in a total Group operating profit for continuing activities of £340m compared to a £3,899m loss last year. It is the intention of the Company to pay dividends when the requirements of the business permit, subject to the distributable reserves position and restrictions under the restructuring arrangements. No dividend is expected in respect of the two financial years ending March 2005 and March 2006, as the Board believes that investing in the business is a prerequisite for a successful turnaround.

Restructuring

Since I reported to you last on the principles of our Proposed Restructuring we have reached formal agreement with our major creditors and the Government on the Proposed Restructuring plan and in October we exchanged a Creditor Restructuring Agreement and a Government Restructuring Agreement documenting these proposals.

The key features of these agreements are:

Certain creditors have agreed to extinguish their unsecured claims against the Group in exchange for £275m of new bonds, and at least 97.5 per cent of the issued ordinary shares of the restructured Group.

The Nuclear Liabilities Fund (NLF) will assume financial responsibility for discharging certain of the Group's uncontracted nuclear liabilities and costs of decommissioning the Group's nuclear power stations, and the Government will assume financial responsibility for certain of the Group's contracted nuclear liabilities and any shortfall in the NLF.

In consideration for this assumption of financial responsibility, the Group will issue £275m in new bonds to the NLF and will also make further payments to the NLF.

These payments to the NLF will include a proportion, initially (and not to exceed) 65%, of the Group's adjusted cash flow, which the NLF will be entitled to convert into a proportional equity shareholding in the Group.

The Eggborough Bank Syndicate have agreed to replace their existing secured claims with a right to payments having a payment profile equivalent to £150m of new bonds. In addition, they will have an option to acquire the Eggborough station in 2010 upon payment of a £104m break fee and the extinguishing of outstanding bond equivalent payments.

British Energy's existing shareholders will, if the Members' Scheme is implemented, receive new ordinary shares equal to 2.5% of the share capital of the Group immediately following implementation of the Proposed Restructuring as well as warrants to subscribe £28.95m for shares representing a further 5.0% of the Group's thereby diluted issued share capital immediately following implementation of the proposed restructuring.

The standstill arrangements agreed on 14 February 2003 have been extended and will continue while the Proposed Restructuring is being implemented (subject to certain termination events not occurring).

The restructuring plan has yet to be agreed by the Commission. Due to the need for the Company and the DTI to complete final assessments in relation to the financing of the Group, it will not be possible for the Secretary of State to present all the necessary information to the Commission to enable the Commission to take a decision before its summer break. The DTI now expects the Commission to take a decision this autumn. Thereafter we are required under our agreements with creditors and the Government to complete the restructuring by 31 January 2005 at the latest.

A condition of the restructuring principles we agreed in November 2002 was the disposal of our North American businesses. In February 2003, we sold our interest in Bruce Power. In December 2003, following a competitive sale process, British Energy sold its 50% interest in AmerGen to its joint venture partner, Exelon. The proceeds of US\$277m from the sale of our interest in AmerGen were applied in repaying all sums owing under the Government Facility. The remaining proceeds were used to fund ongoing collateral requirements. At the year end, the Company had a cash and liquid funds balance of £573m of which £297m was deposited in support of collateral requirements.

If the restructuring is implemented, the return, if any, to existing shareholders will represent a very significant dilution of their existing interests. However, the Board continues to believe that the Proposed Restructuring is in the best interests of the Company, and is working hard to ensure that all the necessary conditions are met. It must be recognised that the restructuring remains subject to a large number of significant uncertainties and important conditions and, that if, for any reason, the restructuring cannot proceed, the Board may have to seek the protection of insolvency proceedings. In this case the distribution to unsecured creditors may represent only a small fraction of their unsecured liabilities and it is highly unlikely that there will be any return to shareholders.

The Creditor Restructuring Agreement requires that, absent shareholder approval, the agreed restructuring will be completed by delisting the Company's shares from the Official List thus avoiding the requirement for shareholder approval under the existing Listing Rules. The UKLA has published a consultation paper proposing that a rule change should be made which would require shareholder consent for delisting. Even if the Proposed Restructuring is not approved by shareholders the Company does not believe that the timescale for this proposed rule change will prevent implementation of the agreed restructuring.

The Proposed Restructuring is only part of the story; the sale of our interest in AmerGen saw British Energy return to being solely a UK business, and much work has been undertaken to restructure our generation and trading businesses, including the planned relocation of our headquarters in Scotland and sale of the current premises at Peel Park. In his review, Mike Alexander outlines the significant steps taken over the year to put in place the foundations for improved performance and reliability from our stations and to change the culture in British Energy.

Industry Development

Over the past year, some commentators have voiced concerns over the availability of sufficient generation capacity to meet demand. This brought the need for investment in UK power generation into sharper focus. Much of the current debate has centred on whether future dependency on gas should be balanced by renewables or the replacement of existing nuclear generation. We regard a balanced portfolio of energy sources and addressing long-term decisions on the need for new power stations as fundamental to the future security of energy supply for the United Kingdom. Increases in wholesale prices for electricity during the year have started to improve the climate for investment in generation assets. The forthcoming Emissions Trading Scheme and other environmental legislation will aim to restrict the emission of greenhouse gases by generators. There is, however, some way to go before the UK has a stable market creating sufficient confidence for longer term investments. At the same time, progress needs to be made on the Government's initiative through the Committee on Radioactive Waste Management to develop a UK approach to nuclear waste disposal – this is essential to the future of nuclear power.

Safety

Safety as always remains our first priority and we recognise its importance to the continuing public confidence in our operations. Public confidence in our operations is in turn dependent upon our safety record. Our performance in the course of the year shows scope for further improvement, and we are working with the World Association of Nuclear Operators (WANO) to apply best practice from elsewhere in the world, especially the USA. We are appreciative of the support we have received from WANO and the international nuclear community in the last year. Our operational structure has already been revised to learn from this. As well as the reliability of our operations, our Performance Improvement Programme is intended to enhance both our safety performance and culture.

Board Changes

We have also strengthened the Board. The Non-Executive appointments in 2003 of William Coley, Pascal Colombani and Sir Robert Walmsley have greatly enhanced the Board's nuclear expertise while John Delucca, who joined us in February this year, brings us experience of finance and restructuring which is immensely valuable.

Having helped to secure creditor approval to the restructuring plan in October, Keith Lough stepped down as Finance Director and Martin Gatto was appointed as Interim Finance Director. Following the disposal of all our North American interests, Duncan Hawthorne stepped down from the Board in March. I would like to extend my thanks to both Keith and Duncan for their contributions to British Energy.

As well as bringing relevant expertise to the direction of our business, our new Board appointments considerably enhance the level of independent scrutiny of management's activities and will assist British Energy to meet the more stringent requirements expected under corporate governance developments. In the course of the year we have increased the comprehensiveness and frequency of our financial reporting.

I am also pleased to announce the appointment from 4 May 2004 of Neil O'Hara as Trading Director, and from 5 July 2004 of Roy Anderson as Chief Nuclear Officer.

Finally, the Board is very grateful to all our staff for their dedication during a difficult time. I would like to record my personal thanks for their continued professionalism and commitment to generating safe, reliable electricity for the UK.

Adrian Montague, CBE
Chairman

Review of Operating Performance and Financial Review

The challenge for British Energy is to improve efficiency and reliability in our stations.

Overview

Total output for the year was 72.6 TWh. Of this, nuclear output for the year was 65.0 TWh, an improvement on the 63.8 TWh produced last year, but short of our target of 67.0 TWh. Nuclear output was adversely affected by unplanned outages, particularly to both reactors at Heysham 1, described further below. Unplanned outages forced the Group into the market to buy back replacement power at a time of higher prices, costing an additional £24m. The output from Eggborough, the Group's coal-fired power station was increased by 1.9 TWh to 7.6 TWh.

The key results were the UK operating profit of £57m before exceptional operating credits of £283m giving a total Group operating profit for continuing activities of £340m compared to a £3,899m loss last year, and the Group profit before tax of £232m, which included exceptional credits of £403m. The Group profit before tax included a contribution of £21m from AmerGen prior to its disposal on 22 December 2003. After incurring a UK operating loss of £9m before exceptional costs of £24m in the first half of the year, the Group made a UK operating profit of £66m in the second half before operating exceptional credits of £307m. This resulted mainly from a higher realised price, largely reflecting seasonal factors, even though second half output was affected adversely by a series of unplanned outages. The realised price for the year was £16.9/MWh, down from £18.3/MWh in the prior year. However, at the same time our total operating costs were £16.5/MWh, down from £18.6/MWh in the prior year, mainly as a result of higher output.

The financial statements for the period have been drawn up on the basis of the historic BNFL contracts in respect of back end fuel costs, pending satisfaction of the restructuring conditions set out in the revised contracts. The consequence of this is that the result for the year does not reflect the profit and loss account savings that will arise under the revised BNFL back end fuel contracts, which amounted to £58m in the year excluding the impact of revalorisation. The saving will be recognised on the completion of the restructuring, together with other restructuring adjustments.

During the year the Group's interest in AmerGen was sold for US\$277m, subject to adjustment, allowing the Government Facility to be fully repaid. Part of the adjustment mechanism relates to the value of nuclear fuel. As a result of an accounting adjustment made by Exelon to the value of nuclear fuel contained in AmerGen's balance sheet dated 21 December 2003, British Energy may be required to make a payment to Exelon of up to US\$13.7m which is the subject of a formal dispute procedure. Further details can be found under Discontinued Activities.

There was a year end cash and liquid funds balance of £573m of which £297m had been deposited in support of collateral requirements. Net debt reduced by £240m to £310m.

Following the disposal of its interest in Bruce Power in February 2003, the Company received C\$20m on 28 April 2003 which had been retained in an escrow account at completion of the disposal of the Group's interest in Bruce Power in respect of a possible price adjustment relating to pensions. This followed confirmation that no such adjustment was required. We also received payment of C\$20m as a result of the restart of one unit at Bruce A (Unit 4 returned to service during the third quarter of the year). Subsequently Unit 3 returned to service in the fourth quarter. A further payment of C\$10m was received on 25 May 2004. In February 2004, we received a notice of warranty claims from the consortium which purchased our interest in the Bruce Power Station relating to the alleged condition of certain plant at the power station and to the treatment of expenditure at the Bruce plant during the period of the Group's ownership which is currently being considered by the Canadian tax authorities. The Company expects to defend the claim if it is pursued further.

In February 2004 we announced the settlement of a long-standing dispute with Siemens Power Generation Limited (Siemens) whereby Siemens agreed to pay the Company £18.3m, which was received in March. Further details are contained in note 4 to the financial statements.

The challenge for British Energy is to complete the Proposed Restructuring and focus on improving efficiency and reliability in our stations in order that we may compete in the very competitive UK electricity market. Clearly there is much to be done to ensure that British Energy achieves world class standards of reliability. The Company has already embarked on a number of programmes which are intended to tackle the causes of under-performance and reduce losses from unplanned outages to competitive levels, improve our trading performance and reduce our overheads. In doing so, we are seeking to harness the skills and experience of leading operators in various fields. A major part of the drive is the Performance Improvement Programme which is central to the operational plans designed to enhance the prospects of the Group.

A key appointment as part of our operational plans is that of Roy Anderson as Chief Nuclear Officer, responsible for the operation of our eight nuclear power stations. He joins us from PSEG Nuclear in the US where he was President. Mr Anderson was also previously Chief Nuclear Officer of Nuclear Management Company and prior to that of Florida Power Corporation. Mr Anderson has significant experience of nuclear turnarounds and his experience will be valuable as the Company progresses the Performance Improvement Programme and restructuring. David Gilchrist, currently Managing Director, British Energy Generation, will take on the new Group wide position of Technical Director, which will strengthen the technical and operational involvement in key regulatory and commercial support areas across British Energy.

The Group has continued to seek to reduce its exposure to volatility in market prices through a trading strategy which utilises diverse sales channels whilst minimising the amount of trading collateral required. Our direct sales business has continued to show strong growth, increasing volumes supplied during the year by almost 30%, to 29.1 TWh.

During the course of the year, the Company also continued to streamline overhead costs in various areas, for example the decision to sell its existing headquarters at Peel Park, East Kilbride and relocate to Livingston near Edinburgh. The company also announced in July 2003 that the nuclear power station support functions, currently split between Peel Park and Barnwood in Gloucester would be brought together to create a centre of excellence. As a result, around 150 operational jobs will be relocated to Barnwood, whilst the electrical and civil engineering support groups and some business support functions will remain in Scotland.

Business Review

British Energy has a total of eight nuclear power stations. Seven are Advanced Gas-cooled Reactor (AGR) power stations; Dungeness B; Hartlepool; Heysham 1; Heysham 2; Hunterston B; Hinkley Point B and Torness. The eighth station, Sizewell B, is the UK's sole Pressurised Water Reactor (PWR). The results for Eggborough, our coal-fired power station in Yorkshire, are discussed in the Power and Energy Trading section below.

Performance Improvement Programme

During the year, British Energy started its drive to focus on four fundamentals – human performance, equipment reliability, management of work and operational focus. In order to address these and as part of its efforts to reduce the level of unplanned generation losses to competitive levels, the Company announced the launch of its Performance Improvement Programme. The human performance element is a drive to implement and reinforce a standard set of error reduction tools used widely in the nuclear industry. The focus on equipment reliability aims to identify and rectify the root causes of equipment problems and therefore improve our performance. Management of work is concentrated on getting the best out of our investment in our work management tools and processes and finally, operational focus is about getting the whole British Energy organisation aligned to support our power stations in delivering a safe and reliable output.

To support the implementation of these programmes the Company has engaged a consortium of experienced consultants in conjunction with significant support from WANO. Through WANO, the Company's Performance Improvement Programme and power station management teams have been supplemented with additional experienced nuclear professionals.

British Energy's focus over the coming twelve months is to continue to improve infrastructure, including significantly improving training arrangements and focusing on the human performance aspect of our business. Already changes have been made to the power station organisation. In addition, a number of operationally experienced people have been appointed to senior positions in the Group's central support functions. A review of the condition of our generation assets is underway, and once the Company has the correct structures and operational processes in place, further emphasis will be put on improving the Materiel Condition of plant.

I am grateful to our staff, creditors, customers and shareholders for their support and understanding during the implementation of the restructuring and the other changes being undertaken by the Company to improve its performance. I recognise that this has been a very testing period for all concerned with the Company. However, I am convinced that full implementation of the restructuring and Performance Improvement Programme will allow the Company to play a key role in the UK's electricity generating mix.

Update on Unit Costs and Collateral

Over the past few months, the Company has been evaluating its business plan for the three years ending 31 March 2007. As a result British Energy's expected cost base post restructuring and anticipated collateral levels have been revised.

In relation to the current financial year ending 31 March 2005, British Energy expects that the investment in major plant projects, repairs and strategic spares across the whole Group, including incremental costs associated with the Performance Improvement Programme of approximately £25m, will be around £175m. Whether or not any of this expenditure will be capitalised or expensed depends on the future carrying value of fixed assets as a result of impairment and fair value reviews and whether the expenditure will enhance the value of the assets. The Performance Improvement Programme costs above include an increase in revenue expenditure relating to staff and support costs which will be expensed in any event.

The detailed budgets for each of the latter two years of the business plan will not be finalised until shortly prior to the commencement of the relevant financial year. The incremental expenditure of the Performance Improvement Programme will depend on the financial resources and prospects of the Group at the relevant time. Based on its current expectations of future electricity prices and output, and therefore financial resources, the Company believes that annual investment in major plant projects, repairs and strategic spares across the whole Group which includes incremental Performance Improvement Programme annual expenditure of £85m to £120m will be in the range £220m to £255m in the two years ending 31 March 2006 and 2007. This compares with the range of capital expenditure of £85m to £90m stated in the 1 October 2003 announcement which did not include any Performance Improvement Programme expenditure, nor the costs of repairs and strategic spares.

The Company anticipates that there may be a need to increase the level of its future annual contributions to the pension fund depending on the performance of financial markets, from a previously estimated £35m to approximately £65m per annum for the three years commencing 1 April 2005.

The Company has therefore revised its projected nuclear unit cash operating costs for the three financial years ending 31 March 2007. These costs include maintenance, expenditures on plant and equipment and corporate overheads but exclude the impact of the NLF cash sweep. It excludes movements in working capital and all costs relating to Eggborough. An illustration of the projected nuclear unit operating costs is shown below.

Assuming an average nuclear output level for the three years commencing 1 April 2004 of 67.0 TWh, the average nuclear unit cash costs are expected to be as follows:

As announced in October 2003			Updated in June 2004	
Base reference price ⁽¹⁾⁽²⁾ per MWh	Average nuclear cost per MWh ⁽³⁾	Average nuclear cost per MWh increased by inflation ⁽⁵⁾	Average reference price per MWh increased by inflation ⁽⁴⁾⁽⁵⁾	Average nuclear cost per MWh ⁽⁴⁾
(£)	(£)	(£)	(£)	(£)
14.0	13.8	14.1	15.1	15.5
15.0	13.9	14.2	16.2	15.6
16.0	14.5	14.9	17.3	16.2
17.0	15.0	15.4	18.4	16.7
18.0	15.5	15.9	19.4	17.2
19.0	15.9	16.3	20.5	17.6
20.0	16.2	16.6	21.6	17.9
21.0	16.4	16.8	22.7	18.1
22.0	16.4	16.8	23.8	18.1

Note 1 : Reference price is the wholesale price of electricity upon which the price of nuclear fuel from BNFL is based.

Note 2 : Stated in 2002/03 money values

Note 3 : Average over the period 2003/04 to 2005/06.

Note 4 : Average over the period 2004/05 to 2006/07.

Note 5 : Inflation assumed at 2.5% pa.

The average nuclear costs per MWh as updated in June 2004 represents an increase of approximately £1.3/MWh, after eliminating the impact of inflation, in the Company's nuclear cash cost per MWh compared with the range stated in the 1 October 2003 announcement. This is attributable almost

entirely to increased investment in the plant and the costs of the Performance Improvement Programme.

It should be noted that, as British Energy's costs are primarily fixed, at different output levels these units costs would be different. In addition, under the terms of the revised arrangements with BNFL the reference price is based on 2002/03 prices and indexed to the RPI and therefore need to be escalated to take account of actual inflation. There is no change in nuclear cash cost above a baseload electricity price of £21.0/MWh (2002/03 prices).

In the announcement of 1 October 2003, British Energy provided its view of the level of collateral that it expects would be required to support its trading activities. The Company has updated its view of the expected range of future collateral reflecting the higher level and volatility of electricity prices, taking account also of increased sales through routes to market that generally have lower collateral requirements.

The Company now expects that the collateral required to support the trading activities will be in a range of £270m to £320m based on the current sales mix and no further undue volatility in the forward curve for electricity prices. Collateral amounts in this range would result in an increase in the target amount for cash reserves under the contribution agreement with the Government (see note 1 to the financial statements).

Nuclear Generation

Nuclear output for the year was 65.0 TWh (a load factor of 77%). This compared to a target of 67.0 TWh and the 63.8 TWh (a load factor of 76%) achieved in the prior year. The shortfall in the year compared to the target arose as a result of the significant impact of unplanned outages, in particular at Heysham 1. The outages of both reactors at Heysham 1 were due to a cast iron pipework failure in the seawater cooling system within the turbine hall. Following repairs, both units returned to service before the financial year end. The resultant loss of output was some 3.2 TWh, equivalent to some £71m of lost profit contribution inclusive of imbalance costs and associated fuel savings.

Following the unplanned outages at Heysham 1, the Company reviewed the implications for further cast iron pipework replacement at its other stations, and on 19 March 2004 announced that its indicative target for nuclear output for 2004/05 was 64.5 TWh. This indicative target takes into account an estimated loss of 2.5 TWh resulting from the Company's estimates of the work required to carry out cast iron pipework replacement at other stations in 2004/05. Some of this work may be moved to 2005/06 as the Company seeks to utilise planned outages to maximum effect.

Last year we carried out 5.5 statutory outages (with the half representing an overlap between two financial years), representing a total loss of output of 4.9TWh. A further loss of potential output of 3.0TWh was attributable to refuelling. In addition to the loss of 3.2TWh output resulting from the unplanned outage at Heysham 1, there were further losses of potential generation from unplanned outages of 7.5TWh. Of these, 4.8TWh was due to outages of 14 days or less.

Improvements in the performance of Dungeness B have continued. The station marked 21 years of supply to the National Grid by generating output of 6.7 TWh, a record for Dungeness B. The station also gained Nuclear Installations Inspectorate approval to adopt three year intervals, rather than two year, between statutory outages, bringing it in line with the rest of the British Energy AGR fleet.

The year's best performing station (by load factor) was Heysham 2 with a total output of 9.81 TWh (a load factor of 89%), exceeding the prior year by some 0.5 TWh. This was achieved despite having to replace part of a low pressure turbine at the start of the year.

Safety

The Company seeks to operate to world-class safety standards. However, during the year the Company's performance against certain key safety indicators deteriorated. These are discussed below. This is being addressed as part of the human performance aspect of the Performance Improvement Program. One of the reasons for the review of the Company's organisational structure, and the key appointments being made as part of the Performance Improvement Program is to implement the required changes to improve safety. The new organisational structure is designed to promote clarity of accountability for every aspect of the Company's safety performance. British Energy works closely with WANO, benefiting from the sharing of best practice and the secondment of personnel.

Nuclear Safety

The International Nuclear Event Scale (INES) is the standard scale measuring the significance of nuclear safety events. In 2003/04 one event occurred, the degradation of a feed pump system with no release of radioactivity either on or off site, which was registered at level two on the seven point INES scale – at Dungeness B on 11 July 2003. Level two is used to describe an incident with significant failure in safety provisions but with sufficient defence in depth remaining to cope with additional failures. There is no off-site impact associated with such an event. All other events were at or below level one (minor operating anomalies with no impact on staff or the general public). In 2003/04, the number of reportable minor events was 77, representing a disappointing increase on the 65 reportable minor events recorded in the prior year.

Radiological Safety

The collective radiation dose to workers at our UK stations was 0.09 manSv/reactor in 2003/04. This was a decrease from the collective dose of 0.12 manSv/reactor in the prior year. This represents approximately one-tenth of the worldwide median of the operators contributing to WANO and places British Energy in the top 10% of performers in this respect.

Industrial Safety

The Company encourages an open culture which promotes the reporting of all accidents, including those where no actual injury resulted. Over the last twelve months our accident frequency rate was 0.53 lost-time accidents per 200,000 man-hours of operation, an increase from 0.46 in the prior year.

Looking at the performance of our conventional plant, it was with deep regret that British Energy reported an accident at Eggborough power station last July, where one of our contractors lost his life. A full panel of inquiry was held to examine the circumstances and determine the cause of the accident. Its conclusion is pending.

Power and Energy Trading

Market Overview

At the end of March 2003, the forward price for baseload power for 2003/04 delivery was £17.0/MWh. Both spot and forward prices increased during the year, driven primarily by increases in fossil-fuel prices and tightening of capacity margins. International coal prices rose sharply during the year to unprecedented levels, and UK gas prices, which are partly linked to oil prices, also increased. The Group was protected against the rise in coal prices due to fixed price contracts that ended during the year. At the end of March 2004, the forward price for baseload power for 2004/05 delivery was £22.2/MWh, an increase of 30% compared with prices prevailing in March 2003 for 2003/04 delivery.

Short-term power prices were exceptionally volatile during July and August 2003, when an unusually large number of generating units were shut down for annual maintenance and high demand in France meant that power was exported via the England-France interconnector. During the summer period the operator of the National Grid was forecasting a tight margin of supply over demand for the winter

peak demand periods, and called for mothballed plants to be returned to service. Market prices rose in response to this and a number of oil-fired and gas-fired units were subsequently returned to service to meet forecast demand, thereby stabilising prices.

The forward market for electricity to be delivered in 2005 and beyond reflects in part the impact of the European Union's Emissions Trading Scheme (ETS), which is scheduled to start on 1 January 2005. Under the scheme, all large fossil-fired generators will be required to submit allowances to cover their emissions of carbon dioxide. The initial allowances will be allocated by the Government according to a National Allocation Plan, which must be approved by the European Commission. The Government has indicated that the scheme could increase wholesale electricity prices in the UK by some 10%. As the owner of a coal-fired power station, British Energy is seeking an equitable allocation of allowances and preparing to be an active participant in the carbon dioxide emissions market.

The Government announced an Energy Bill in November 2003, which includes provisions (amongst others) for extending the electricity trading arrangements operating in England and Wales to all of Great Britain. The Bill is expected to become law in summer 2004, and will enable the proposed British Electricity Transmission and Trading Arrangements (BETTA) to be implemented in April 2005. These new arrangements will create a much larger market for British Energy's Scottish generation once the Nuclear Energy Agreement (NEA), under which all of the Group's Scottish generation is currently sold to Scottish Power and Scottish and Southern Energy, ends in April 2006 or following the introduction of BETTA, whichever is earlier. However, the ending of the NEA will mean a loss of the guaranteed market for the output of our Scottish stations and other routes to market are being developed.

Trading Strategy

During the year the overriding concern of British Energy was to reduce the Group's exposure to potential falls in the market price of electricity. Therefore a prudent trading strategy was adopted to sell forward a high proportion of our output. As a result the Company has not fully benefited from the more recent rises in market prices. The Group has continued with its trading strategy to reduce exposure to volatility in medium term market prices, utilising diverse routes to market whilst minimising the amount of trading collateral required. The routes to market include direct sales to industrial and commercial customers, contracting in the wholesale market, and long-term contracts (such as the NEA), together with sales of balancing and ancillary services to National Grid. There are contracts in place for substantially all planned production in 2004/05. A large majority of these are fixed price contracts. As of the beginning of June the average price of the fixed price contracts for 2004/05 was £19.5/MWh.

The requirement to provide trading collateral arose when the Group lost its investment grade rating in September 2002. This loss of investment grade rating means that the Group now has to provide significant levels of collateral to counterparties in order to cover their trading exposures, to maintain trading arrangements, thereby substantially reducing the levels of liquid cash resources available to the Group. Given the financial circumstances of the Group, certain contracts may be capable of being terminated. Such termination may result in termination payments being payable as well as having an adverse effect on cash flows. British Energy intends to seek a new credit rating upon the issue of new bonds as part of the Proposed Restructuring of the Group.

It is inevitable that, in a period of rising prices such as has been seen in 2003/04, hedging forward against falls in price results in a realised price which is less than the market out-turn. However, a proportion of that output is contracted at variable prices and can benefit from the recent rise in forward prices.

Trading Development Programme

During the year we have undertaken a comprehensive review of our trading capabilities and embarked upon a development programme to improve and extend existing skills and asset utilisation. This involves recruiting to strengthen the analysis, risk management and back office functions and reviewing trading procedures and performance incentives. A new Trading Director, Neil O'Hara, has also been appointed. Neil O'Hara has over ten years trading and risk management experience in the energy sectors, including the power, coal and gas sectors. Neil brings experience from working at AEP, Centrica and RWE. In addition we will be upgrading the IT systems used within trading. These changes will enable better risk management and control and should enable us to increase the value of our trading activities. This trading development programme should be largely complete by April 2005.

Business Performance

The direct sales business (DSB) has once again shown strong growth, with the volume supplied during the year reaching 29.1 TWh, an increase of some 30% on 2002/03. The volume of power sold directly to customers through the DSB is now equivalent to approximately 40% of total output. This growth has been achieved through increasing the range of customers served, with a particular focus on multi-site groups. At the same time, the DSB has retained its number one overall ranking in the customer satisfaction survey of industrial and commercial customers carried out by the Energy Information Centre for the 20th successive quarter.

British Energy's realised price (which is calculated by dividing total UK turnover, net of energy supply costs and miscellaneous and exceptional income, by total output during the period) for 2003/04 was £16.9/MWh, a decrease of 8% compared with £18.3/MWh in 2002/03. The Company benefited from higher prices for variable priced contracts as the year progressed, but this was offset by a number of unplanned outages and earlier fixed price contracts at lower prices. Market purchases at higher prices were required to cover lost generation from the unplanned outages. Fixed price contracts provided protection against falls in market price, although certain of these were agreed at lower prevailing market prices to meet the requirements of the Proposed Restructuring.

Eggborough

Output from the 2000 MW coal-fired power station at Eggborough was 7.6 TWh during the year compared with 5.7 TWh for the prior year. As Eggborough is operated primarily as a flexible mid-merit plant, its output level is influenced by market prices, the Company's contracted trading position and the extent to which it is operated as cover for unplanned outages. In the draft National Allocation Plan published by the Government an indicative allocation of 4.9 million tonnes of carbon dioxide emissions allowances under the ETS for each of the calendar years 2005, 2006 and 2007 has been made for Eggborough (equivalent to output of approximately 5.4 TWh). However the allocation will not be finalised until autumn 2004. Additional allowances will need to be acquired if Eggborough is to maintain its output at 2003/04 levels.

Eggborough's future output will also be affected by the impact of the Large Combustion Plant Directive (LCPD), which is intended to limit the emissions of sulphur and nitrogen from fossil-fuel power stations. Good progress has been made with the project to fit flue gas desulphurisation (FGD) equipment to two of the four units at Eggborough. Since the year end, the first flue gases from one unit have been processed by the FGD equipment as part of the active commissioning of the plant. The work is scheduled to be completed within budget during the current year.

The Government has been in discussion with the electricity industry in recent months concerning the implementation of the LCPD. Discussion has focused on whether to limit future emission rates for fossil-fuel plants or to limit total emissions based on historic generation (through a National Emission Reduction Plan); and on whether a plant will be treated as being a whole power station, or an individual generating unit for the purpose of the LCPD - in which case Eggborough's four units would be treated as separate plants. Station owners will have the option to "opt-out" of the LCPD in which case they will be permitted to run plants for a total of 20,000 hours between 1 January 2008 and 31

January 2015. Clearly the details of the implementation of the LCPD may affect the level of generation from Eggborough and other fossil-fuel plants in the future.

Discontinued Activities

The disposal of the investment in Bruce Power was completed on 14 February 2003. In the prior year a loss on disposal of £35m was recognised by the Group and the results of Bruce Power were classified as discontinued activities.

C\$20m was retained in an escrow account at completion of the disposal of the Group's interest in Bruce Power in relation to a possible price adjustment relating to pensions. On 28 April 2003 the Company announced that this sum had been released following confirmation that no adjustment was required and was accounted for in the prior year results.

On 12 February 2004 British Energy received a notice of warranty claims from the consortium which purchased the Group's 82.4% interest in Bruce Power (the consortium) alleging breach of certain warranties and representations relating to tax and to the condition of certain plant at the Bruce power station. Further details can be found below.

Under the agreement with the consortium C\$20m is retained in trust to meet any representation and warranty claims, and this may be retained pending agreement or determination of the claims.

In addition to the consideration received at the time of the disposal of its interest in Bruce Power, British Energy was entitled to receive up to C\$100m, contingent on the restart of two of the Bruce A Units. On 22 March 2004 the Company received the sum of C\$20m in respect of the restart of Unit 4, and on 25 May 2004 received the further sum of C\$10m in respect of the restart of Unit 3 (which has not been accounted for in the results for the year ended 31 March 2004). Discussions are ongoing with the Ontario Provincial Government regarding the release of further sums (if any). The total amount that will be released will be significantly less than C\$100m.

Following the completion of the sale of the Group's 50% interest in AmerGen to Exelon, the Group received consideration of US\$277m upon financial close on 22 December 2003 prior to adjustments relating to working capital levels, stocks of unspent nuclear fuel, inventory, capital expenditures and low level waste disposal costs to be determined as at the time of closing. Finalisation of these adjustments is outstanding.

As a result of an accounting adjustment made by Exelon to the value of nuclear fuel contained in AmerGen's balance sheet dated 21 December 2003 British Energy may be required to make a payment to Exelon of up to US\$13.7m. This amount has not been provided for in the financial statements. British Energy served a Dispute Notice on Exelon on 4 June 2004 to preserve its rights. The agreement with Exelon for the sale of AmerGen requires that, prior to instituting any litigation or other dispute resolution procedure, the companies will in good faith seek to resolve any dispute.

In December 2003 the Company announced the sale of the Group's 50% interest in Offshore Wind Power Limited to GB Gas Holdings Limited for an up-front cash consideration of approximately £2m, with deferred consideration of up to £0.7m.

The combined gain on sales of the joint ventures and other businesses was £47m, of which the largest element was the profit on disposal of the Group's interest in AmerGen of £37m.

Financial Review

Group Results

In the following discussion the “period” or “year” refers to the year ended 31 March 2004 and the “prior period” or “prior year” refers to the year ended 31 March 2003. The “current year” refers to the year that will end on 31 March 2005.

The operating result after exceptional operating credits of £283m was an operating profit of £340m for the period compared with an operating loss of £3,802m for the prior year, after exceptional operating charges of £3,947m. Exceptional items for the period include a non-cash accounting adjustment for the partial reversal of £295m of the write-down of fixed assets in the prior year following a further review of fixed assets carrying values.

The profit before taxation was £232m for the period and a loss before taxation of £4,292m for the prior year.

AmerGen was sold and a provisional gain on sale was recorded at £37m. The sale of AmerGen contributed to the reduction in net debt which decreased in the year by £240m to £310m.

The discussion below will focus primarily on the results of continuing activities for the year compared to the prior year, both before exceptional items.

Turnover

Group turnover from continuing activities comprised generation sales, direct supply sales and miscellaneous income. Turnover for the period was £1,516m, a decrease of £12m on the prior year, as detailed below:

Increased/(Decreased) Turnover:	£m
– owing to increased output	57
– owing to lower electricity prices realised	(103)
– owing to increased energy supply costs recharged to customers	76
Decrease in miscellaneous sales	(1)
Decrease in exceptional turnover	(41)
	(12)

Output increased by a total of 3.1 TWh compared to the prior year, and comprised output increases of 1.2 TWh from nuclear operations and 1.9 TWh from Eggborough. Nuclear output was however affected by a number of unplanned outages and in particular the major outage at Heysham 1 where 3.2 TWh was lost due to cast iron pipework failure, equivalent to some £71m of lost profit contribution inclusive of imbalance costs and associated fuel savings. Output at Eggborough was higher than the prior year as it was operated primarily to take advantage of higher market prices and to provide cover for unplanned outages at nuclear plants.

The realised price (which is calculated by dividing UK turnover, net of energy supply costs and miscellaneous and exceptional income, by total output) for the period was £16.9/MWh compared with £18.3/MWh in the prior year. A discussion on the movement of prices and the Company’s strategy on trading is contained in the Power and Energy Trading section above.

Turnover from discontinued activities in the prior year was £375m and represented sales by Bruce Power prior to its disposal on 14 February 2003.

Operating Costs

The operating costs of continuing activities excluding exceptional items were £1,459m in the period, compared to £1,480m in the prior year, a reduction of £21m.

Total operating unit costs excluding revalorisation (which is calculated by dividing the total UK operating cost, net of the exceptional items and energy supply costs, by total output), was £16.5/MWh compared to £18.6/MWh, primarily as a result of higher output.

The component elements of the operating costs are discussed below.

Continuing activities excluding exceptional items:	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m
Fuel	413	371
Materials and services	512	425
Staff costs	224	227
Depreciation charges	50	273
Energy supply costs	260	184
	1,459	1,480
Continuing activities – exceptional items:		
Materials and services	25	94
Depreciation (credits)/charges due to impairment review	(295)	3,738
Amounts (credited)/charged to non-operational assets	(13)	115
	(283)	3,947
Continuing activities – total costs:		
Fuel	413	371
Materials and services	537	519
Staff costs	224	227
Depreciation (credits)/charges	(245)	4,011
Energy supply costs	260	184
Amounts (credited)/charged to non-operational assets	(13)	115
Total operating costs	1,176	5,427

Fuel costs in total amounted to £413m for the period compared with £371m. Nuclear fuel costs were £318m compared with £298m and coal costs were £95m compared with £73m.

The £22m increase in coal costs relates primarily to the increase in output from Eggborough over the period.

The costs of nuclear fuel increased by £20m in total, of which £7m was attributable to increased output, offset by savings and efficiencies of £1m. The main increase, however, was due to a non-recurring credit in the prior year costs of £14m following a one-off review of contract cost schedules with BNFL.

On 16 May 2003, the Company announced that it had exchanged contracts covering front end and back end fuel services required to give effect to the non-binding heads of terms entered into with BNFL. The front end contracts became effective on 1 April 2003 but may be terminated if the Proposed Restructuring is not completed. The revised back end contracts are conditional on completion of the Proposed Restructuring but payments are being made as if the revised back end contracts had become effective on 1 April 2003.

The financial statements for the period have been prepared on the basis of the historic BNFL contracts in respect of back end fuel costs, pending satisfaction of the restructuring conditions set out in the

revised contracts. This is the only element of the Proposed Restructuring that will have a retrospective accounting impact.

The consequence of this is that the result for the year does not reflect the profit and loss account savings that will arise under the revised BNFL back end contracts, which amounted to £58m in the year. The total saving under the revised contracts will be recognised on the completion of the restructuring, together with other restructuring adjustments. The benefit has been calculated using an average electricity price, as defined in the revised BNFL back end contracts, of £17.6/MWh.

As noted above and as part of the standstill arrangements, the Group has made payments during the year to BNFL as if the revised BNFL back end contracts were in place. The difference in the cash payments which include the profit and loss account savings under the revised contracts, means that included within current liabilities are amounts due to BNFL which will never be paid by the Group, provided the Proposed Restructuring is completed. These amounts totalled £306m at 31 March 2004, an increase of £193m from £113m at 31 March 2003.

This is also set out in note 31 to the financial statements.

Amounts in current liabilities due to BNFL but not expected to be paid by the Group provided the Proposed Restructuring is completed

	£m	£m
Opening balance at 1 April 2003		113
Amounts payable to BNFL under the historic back end contracts for the period	249	
Less: Amounts paid/payable for the period under the revised BNFL back end contracts, analysed as follows;		
– Amounts settled	(59)	
– Amounts included in accruals at year end	(11)	
Cash flow benefit arising within the year		179
Finance charges accrued on amounts stoodstill		14
Closing balance at 31 March 2004 (see note 31 to the financial statements)		306

The benefit under the revised BNFL back end contracts to the date of restructuring will be recognised in the balance sheet of the restructured Group upon implementation of the Proposed Restructuring together with other restructuring related adjustments. The ultimate benefit recognised will depend on a number of factors including the date of restructuring, the market price of electricity between 1 April 2004 and the date of restructuring as defined in the contract and the amount of fuel.

Materials and services costs comprise the operating expenses of the power stations and support functions excluding fuel costs, staff costs and depreciation. The costs during the year were £512m compared with £425m, an increase of £87m. The increase is largely explained by capital investment expenditure of £92m that was expensed as operating costs in the period. This arises because it was not possible to demonstrate that this expenditure enhanced the value of the Company's fixed assets after taking account of the impairment review. The Group has reviewed the capital investment expenditure of £92m incurred, primarily on the power stations, and concluded that of this, an amount estimated at £70m may have been capitalised in the absence of the impairment review. The balance of capital

investment expenditure of £22m has been classified as refurbishment cost within materials and services.

Staff costs decreased by £3m from £227m to £224m mainly due to reduced severance costs of £11m partly offset by salary inflation and increased headcount.

Depreciation charges were £50m for the period compared to £273m. The charges for depreciation in the period were significantly affected by the fixed assets write-down of £3,738m at 31 March 2003 (see note 12 of the financial statements).

Energy supply costs mainly comprise the costs incurred for the use of the distribution and transmission systems and are fully recovered through turnover. This year energy supply costs also include costs of £36m related to the purchase of Renewable Obligation Certificates (ROCs) which are also recovered through turnover. The Group is required to purchase ROCs as part of the regulations governing climate change. Total energy supply costs in the period were £260m compared with £184m in the prior year, an increase of £76m. This increase reflects the inclusion of ROC costs and growth in the Direct Sales Business since 31 March 2003 as discussed above.

Operating costs from discontinued activities in the prior year were £278m and represented the costs of Bruce Power prior to its disposal on 14 February 2003.

The exceptional operating items are analysed below.

Operating Profit/(Loss)

As shown below, Group operating profit before exceptional items for continuing activities increased by £50m to £57m for the period.

	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m	Variance £m
Operating profit before exceptional items – continuing activities	57	7	50
Exceptional items	283	(3,906)	4,189
Total operating profit/(loss) – continuing activities	340	(3,899)	4,239
Operating profit – discontinued activities	–	97	(97)
Group operating profit/(loss)	340	(3,802)	4,142

The increase in operating profit before exceptional items for continuing activities of £50m over the prior year is explained as follows:

	£m
Increased/(decreased) operating profit due to:	
Output increases – turnover impact	57
Output increases – operating cost impact	(31)
Price movements	(103)

Capital investment expenditure expensed	(92)
Depreciation reduction	223
Other	(4)
Increase	50

Share of Operating Profit of Discontinued Joint Venture

The Group's 50% share in AmerGen was sold to Exelon on 22 December 2003. The Group's share of the operating profit of AmerGen prior to the date of disposal was £21m. The Group's share of operating profit for the prior period was £43m. This reduction of £22m was due primarily to an extended outage at Three Mile Island and the contribution of only a part year result within the period.

Financing Charges, Net Interest and Revalorisation

The total financing charges were £176m made up of revalorisation and net interest of £249m, exceptional financing credits of £5m and an exceptional revalorisation credit of £68m. This compares with prior year financing charges of £498m made up of revalorisation and net interest of £277m, exceptional financing charges of £62m and an exceptional revalorisation charge of £159m.

The total financing charges are analysed below:

	Year ended 31 March 2004	Year ended 31 March 2003
	£m	£m
Revalorisation of nuclear liabilities	215	228
Revalorisation of decommissioning fund	(28)	(29)
Revalorisation of other provisions	–	10
Share of revalorisation of joint venture	(2)	(4)
Total revalorisation	185	205
Net interest expense	64	72
Financing charges before exceptional items	249	277
Exceptional interest (credit)/charge	(5)	62
Exceptional revalorisation (credit)/charge	(68)	159
Total financing charges	176	498

Revalorisation arises because nuclear liabilities are stated in the balance sheet at current price levels, discounted at 3% per annum real from the eventual payment dates. The revalorisation charge is the adjustment that results from restating these liabilities to take into account the effect of inflation in the year and to remove the effect of a year's discount. Similarly, a revalorisation credit arises in respect of the decommissioning fund that is calculated by applying an actuarial assessment of the long-term investment growth rate to fund contributions in order to determine the asset value to be recorded in the balance sheet. The growth rate used in the calculations is 3.5% per annum real.

The net revalorisation charge excluding exceptional items was £185m, a decrease of £20m from the prior year principally due to a reduction in inflation and discontinuation of revalorisation of onerous contract provisions. The weighted average of RPI and RPIX used to revalorise the Group's nuclear liabilities was 2.4% compared with 3.0% for the prior year.

The net interest expense charge of £64m for the period was £8m lower than the charge for the prior year. The reduction arises from a lower charge in respect of interest rate swaps and increased interest earned on deposits, partly offset by a full year charge for standstill interest in the period.

In the prior year there were exceptional interest charges of £62m resulting from the provision for the out of the money element of interest rate swaps which were no longer considered to be effective as hedges and the write-off of borrowing costs. The borrowing costs had been previously capitalised and were being amortised over the expected duration of loan financing in respect of the acquisition of the Eggborough power station. In the current year there were exceptional interest credits of £5m reflecting a partial reversal of the provision for interest rate swaps.

The exceptional revalorisation credit of £68m in the period results from the increase in the market value of the UK decommissioning fund and the AmerGen decommissioning fund. This partially reverses the exceptional charge of £159m in the prior year required as a result of decreases in the values of the funds.

Exceptional Items

The financial results of both years were affected by a number of exceptional items. The table below summarises the impact of exceptional items before tax.

	Year ended 31 March 2004	Year ended 31 March 2003
	£m	£m
(Reversal of write-down)/write-down of fixed asset carrying values	(295)	3,738
UK decommissioning fund (credit)/charge	(13)	13
Write-down of own shares held	–	102
Provision for slow moving stocks	–	57
Restructuring costs	43	35
Onerous trading contracts	–	2
Settlement of claim	(18)	–
Nuclear Energy Agreement	–	(41)
Exceptional items included within operating results	(283)	3,906
UK/AmerGen decommissioning fund (credit)/charge	(68)	159
(Credit)/charge for interest rate swap provision	(5)	56
Write-off of capitalised borrowing costs	–	6
Exceptional items included within financing costs	(73)	221
	(356)	4,127
Exceptional (gain)/loss on sale of joint venture and businesses	(47)	35
Total net exceptional (credits)/charges	(403)	4,162

Exceptional items are discussed more fully in notes 4, 5 and 8 to the financial statements.

Profit/(Loss) Before Tax

The profit before taxation was £232m compared with a loss before tax of £4,292m in the prior year. The main reason for the movement of £4,524m is the large exceptional costs in the prior year, some of which were partially reversed in the period.

Taxation

There was a £2m taxation credit on ordinary activities for the period relating to the release of an over provision of foreign tax in earlier years. The share of taxation for the discontinued joint venture was nil, comprising a tax charge on trading results to the date of the AmerGen disposal of £9m, offset by credits for overprovisions of £9m in earlier years.

In the prior year there was a net tax credit of £368m, comprising tax charges of £18m on North American activities, £10m share of taxation for joint ventures and a £396m credit for release of UK deferred tax provisions. The deferred tax credit in the prior year arose as a result of the large exceptional charges.

The deferred tax assets of £297m and £150m at 31 March 2004 and at 31 March 2003 were not recognised because there is insufficient certainty of recovery within the foreseeable future.

Earnings per Share

The earnings per share in the period was 38.9p compared to a deficit of 654.7p for the prior year, an improvement of 693.6p.

Review of Fixed Assets Values

In view of the ongoing restructuring, the Directors have reassessed the economic values and net realisable values of the Group's power stations and compared them to their book values as at 31 March 2004, in accordance with FRS11 "Impairment of fixed assets and goodwill". As a result of this review, the carrying value of fixed assets has been increased by £295m to partially reverse the impairment loss recognised in the prior year. Recognition of changes to asset impairment calculations is shown as a non-cash exceptional item in the year end financial statements, included within depreciation charges.

The fundamental objective of FRS11 is to ensure that fixed assets and goodwill are recorded in financial statements at no more than their recoverable amount. The recoverable amount is defined as being the higher of "net realisable value" (expected proceeds of sale less direct selling costs) or "value in use". Impairment is measured by comparing the carrying value of the fixed assets with their recoverable amount.

The outlook for electricity prices is the single most significant factor in assessment of the carrying values of fixed assets. The Directors have considered market views on future prices of wholesale electricity and also the commercially available forecasts. They have considered the impact on future prices of the increases in market electricity prices which occurred in the past year, the outlook for coal and gas fuel prices, potential for changes in generation capacity in the UK, and the potential effect on the market of changes in Government policy particularly in the area of environmental legislation.

The outlook for prices in the UK electricity market has improved since the Directors carried out their review for the 2003 financial statements, which resulted in a £3,738m write-down of the carrying value of fixed assets. However, in determining the price assumptions for the valuation the Directors

have taken a cautious view on whether there has been a significant long-term recovery in market prices. Actual prices may differ from those forecast.

The carrying value of the nuclear stations has been calculated by discounting the expected future cash flows from continued use of the assets, having made appropriate assumptions regarding future operating performance. These assumptions are based on the Directors' best estimates. The discount rate used was 15% nominal pre-tax, the same as used at 31 March 2003, which is an assessment of a rate of return that the market would expect for a similar risk investment. The basis of the valuation of Eggborough is unchanged from the previous year, that is net realisable value and is based on the value attributed as part of the Proposed Restructuring.

The calculation of fixed asset carrying values at 31 March 2004 includes cash flow estimates regarding the level of increase in pension fund contributions required to repair the actuarial pension fund deficit at 31 March 2004. The payments included in the fixed asset calculation amount to approximately £207m after being discounted at 15% and are equivalent to a pension fund deficit calculated on an actuarial basis in the range of £330m to £440m. Formal triennial valuations of the British Energy Generation Group or British Energy Combined Group (together, the Schemes) pension schemes at 31 March 2004 are currently being undertaken, but the results of these valuations will not be finalised until later in 2004.

These financial statements do not incorporate the key elements of the restructuring, which is still subject to EU State aid approval and a large number of other significant conditions and uncertainties. As a result, the carrying value of fixed assets in the March 2004 financial statements do not reflect, for example, the new BNFL contracts or the proposed nuclear liabilities fund cash sweep arrangements which we anticipate will be included in future asset impairment tests for financial statements purposes when there is reasonable certainty of their becoming legally effective.

Net Liabilities

Group net liabilities decreased from £3,383m to £3,164m due to the profit after tax of £234m and exchange rate translation losses of £15m.

Capital Expenditure

There have been no additions to fixed assets recorded in the period as a consequence of the fixed asset write-down carried out in the prior year. It has not been possible to demonstrate that the capital investment expenditure enhanced the value of the Company's fixed assets after taking account of the impairment review. Included within material and services, an element of operating costs, in the period were amounts of capital investment expenditure of £92m. Of this amount estimated at £70m may have been capitalised in the absence of the impairment review, with the balance of £22m being classified as refurbishment costs. In the prior years expenditure of £112m was capitalised within fixed assets.

Current Assets

Total current assets increased in the period by £323m to £1,737m, from £1,414m in the prior year. The largest component of this rise was the £240m increase in cash and liquid funds from £333m in the prior year to £573m in the period.

Total stocks reduced by £10m. Nuclear fuel stocks reduced by £18m in part as a result of a supply chain review. This reduction was partly offset by an increase in stores of £7m mainly due to the acquisition of certain key strategic spares at Eggborough following a risk review and an increase in coal stock of £1m.

The level of total debtors reduced by £13m to £374m. This is due to a decrease in the taxation and social security balance recorded in debtors of £65m, which was reallocated to current liabilities in the

current year. This decrease is offset by an increase in the pension prepayment of £29m and there was also an increase of £23m in trade debtors and other prepayments.

The Nuclear Decommissioning Fund will be used to fund post-defuelling decommissioning costs. The balance sheet carrying value of the fund has been restated to a market value of £440m compared to £334m. The increase in market value reflects the upturn in equity market values that occurred in the period and further contributions made by the Company of £19m.

Current Liabilities

The level of creditors due within one year (excluding borrowings) has increased from £1,033m to £1,250m. The main movement is an increase in the level of nuclear liabilities classed as due within one year from £355m to £554m. The difference arises principally because the liability continues to be recorded under the historic BNFL back end contracts while payments are based on the revised BNFL back end contracts.

The other movements within creditors comprise a net increase in the other taxes and social security balances of £40m relating to the reallocation from debtors of £65m, a reallocation of VAT from trade creditors of £86m and an increase in the amount during the period of £19m. Trade creditors decreased by £18m due to a reallocation of £86m, as mentioned, to the other taxes and social security balance and an increase in trade creditors of £68m. There were other decreases of £4m in retentions, accruals and other creditors.

Provisions

Included in provisions at 31 March 2004 were accrued nuclear liabilities of £1,776m, an increase of £103m over the prior year. The liabilities increased due to additional fuel burnt in the Group's power stations, revalorisation (inflation and removal of one year's discount to restate the provision at balance sheet money values) and reduced by cash payments made during the year and the part release of the provisions for the out of the money element of the Groups interest rate swaps.

Pensions

The financial statements have been prepared applying SSAP24 in respect of pensions. Note 24 to the financial statements provides the disclosures required under the transitional requirements of FRS17, the UK accounting standard dealing with retirement benefits. The FRS17 valuation is based on a valuation of assets and liabilities at a particular point in time and does not necessarily take account of the long-term nature of pension schemes. Movements in equity markets and bond yields can create considerable volatility in the FRS17 valuation at different points in time.

Under FRS17, the net pension deficit was £352m for the UK Schemes as at 31 March 2004, unchanged from 31 March 2003. However, the value of the Schemes' assets has increased with the rise of the equity markets, but this was offset by increased liabilities due to future higher inflation rate assumptions and improved actuarial information.

The interaction of the pension deficit and the valuation basis for fixed assets is discussed in note 4 to the financial statements.

The Trustees of the Schemes follow an investment policy whereby a high proportion of the Schemes' assets is invested in equities. One consequence of this investment policy, and the methodology and assumptions used for determining the Schemes' liabilities under FRS17, is that the difference between the market value of the Schemes' assets and its FRS17 liabilities (i.e. its FRS17 "surplus" or "deficit") is expected to be volatile. Indeed, the amount of any surplus or deficit could change significantly over periods as short as a day (in the event of significant market movements). The results reported should

not, therefore, be taken as an indication of the Schemes' financial position in accordance with FRS17 on any date other than 31 March 2004.

The funding of the Pension Schemes is based on the results of three-yearly valuations by independent actuaries rather than on the results of the FRS17 valuation. A valuation will be carried out as at 31 March 2004, however, the result of the valuation will not be concluded until late autumn 2004.

Whilst the final determination of the actuarial valuation will not be complete for some months a deficit is expected in the range of £330m to £440m. The actual level of increase in future employer contributions will only be agreed with the Trustees of the Schemes when the valuation is completed.

During the prior year, the actuary of the British Energy Generation Group Scheme (the main UK pension scheme) carried out an interim review of Scheme assets and liabilities in order to assess the appropriateness of continued use of the surplus that arose at the 31 March 2001 valuation. As a result of that review, the employer's contributions to that Scheme were increased from 10% to 17.1% with effect from 1 November 2002. The employer's contributions to the British Energy Combined Group Scheme (the smaller UK pension scheme) were increased from 12% to 15.3% with effect from 1 April 2002. In total, cash contributions by the Group were £34m for the period and £31m for the prior year.

There were no changes to the contribution rates in the period.

The Company recognises that the funding of the Pension Schemes is a matter of concern to Scheme members, to shareholders and to other stakeholders. The Company will keep the funding issues under close review in the coming year and will aim to safeguard the interests of scheme members.

The Group balance sheet reported at 31 March 2004 and 31 March 2003 does not include the FRS17 deficits.

Total Recognised Gains and Losses

In addition to the profit after tax of £234m, exchange translation losses on foreign currency net investments arose amounting to £15m. These were all in relation to the investment in the AmerGen joint venture and its subsequent disposal.

Liquidity and Capital Resources

Government Facility

Following the sale of AmerGen, the drawings under the Government Facility were fully repaid. The amount available under the Government Facility reverted back to £200m on 24 December 2003. Further details of the Government Facility are included in note 1 to the financial statements.

Cash Flow

A reconciliation of profit after tax and exceptional items to earnings before interest, tax, depreciation and amortisation (EBITDA) is shown in the following table. EBITDA is a measure commonly reported and widely used by analysts, investors and other interested parties, as well as a measure used internally by the Group. The EBITDA calculations are shown for the total results and also exclude the disposals during the period and exceptional items for the continuing business. The EBITDA calculation for the continuing activities is further reconciled to the operating cash flow from continuing activities and then to the increase in cash.

	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m
Profit/(loss) after tax and	234	(3,924)

exceptional items		
Interest (including exceptional items)	59	134
Revalorisation (including exceptional items)	117	364
Tax (including exceptional items)	(2)	(368)
Depreciation charges	50	273
Exceptional depreciation (credits)/charges due to impairment review	(295)	3,738
EBITDA	163	217
(Gain)/loss on sale of businesses	(47)	35
AmerGen profit	(21)	(43)
Bruce Power contribution	–	(97)
Net exceptional charges other than depreciation, interest, tax and revalorisation	12	168
EBITDA - continuing activities	107	280
Nuclear liabilities charged to operating costs	130	105
Nuclear liabilities discharged	(59)	(115)
Regular contributions to decommissioning fund	(19)	(18)
Other provisions discharged	(3)	(45)
Exceptional operating cash costs	(25)	(154)
Working capital movements	25	191
Operating cash flow from continuing activities	156	244
Capital expenditure	–	(112)
Taxation (paid)/received	(12)	3
Disposal of investments	171	262
Net interest paid	(75)	(84)
Net cash outflow of discontinued activities	–	(78)
Increase in cash (before equity dividends)	240	235
Equity Dividend	-	(31)
Increase in total cash (after equity dividends)	240	204

The operating cash flow from continuing activities was £156m, £88m lower than the prior year after excluding the cash generated by Bruce Power (see note 28 of the financial statements). Included in the period cash flows are capital investment expenditure amounts totalling £92m that are expensed as part of materials and services costs. Of this, an amount estimated at £70m may have been capitalised in the absence of the impairment review, with the balance of £22m being classified as refurbishment costs.

In the prior year capital expenditure of £112m was not deducted in calculating operating cash inflow from continuing activities.

When adjusted for the capital expenditure, the taxation paid or received, the receipts from sale of investments, the net interest paid and discontinued activities, the free cash flow position was £240m in the period compared to £235m (before equity dividends paid of £31m) in the prior year.

Net cash outflows for interest payments reduced by £6m.

Net receipts from disposals of £171m (see note 5 of the financial statements) mainly represented the proceeds from the sale of AmerGen. In the prior year there were net receipts of £262m from the sale of Bruce Power.

Capital Resources

At 31 March 2004, total debt of £883m comprised:

A project finance loan of £475m secured on the assets of Eggborough Power Limited (EPL), a subsidiary company that operates the Eggborough coal-fired power station. At 31 March 2004 the effect of the Group's interest rate contracts is to classify the borrowings as fixed rate. Amounts owed by EPL are not guaranteed by British Energy but British Energy guarantees the payment of amounts by British Energy Power and Energy Trading Limited (BEPET) to EPL under the Capacity and Tolling Agreement (CTA) between BEPET and EPL. The contractual amounts payable by BEPET under the CTA are calculated so as to cover EPL's borrowing requirements and operating costs. British Energy also provides a subordinated loan facility to EPL. The final installment of loan principal will be repaid in 2011. The loan currently bears interest at LIBOR plus 1.3%. It is proposed that these arrangements will be restructured as part of the Proposed Restructuring of the Group. For further details of the Proposed Restructuring see note 1 to the financial statements.

An aggregate principal amount of £408m sterling denominated bonds due between 2003 and 2016. The bonds bear interest at a rate of between 5.9% and 6.2%. An aggregate principal amount of £110m matured in March 2003 but payment has been stoodstill as part of the arrangements in the Proposed Restructuring.

There were no drawings under the Government Facility at 31 March 2004 and 31 May 2004 and the conditions applying to the facility are more fully discussed in note 1 to the financial statements.

Net debt decreased in the year by £240m to £310m. This was mainly as a result of the proceeds from the sale of AmerGen, cash flow benefits from the revised BNFL back end arrangement and improved cash management procedures.

Future Liquidity and Collateral

At 31 March 2004 and 31 May 2004 the Company had cash and liquid resources, including amounts posted as collateral, amounting to £573m and £507m respectively, of which £297m and £304m were deposited as collateral in support of trading activities.

The Group's main source of liquidity is its operating businesses. Cash generation by the operating businesses is dependent upon the reliability of the Company's power stations in producing electricity, the realised selling price for electricity, operational risk and capital investment expenditure (expensed in the profit and loss account since 1 April 2003) and maintenance requirements.

The Group lost its investment grade rating in September 2002. British Energy intends to seek a new credit rating prior to the issuance of new bonds as part of the Proposed Restructuring. The loss of investment grade rating has meant that the Group now has to provide significant levels of collateral to

counterparties in order to cover their trading exposures, to maintain trading arrangements, thereby substantially reducing the levels of cash resources available to the Group. Given the financial circumstances of the Group, certain contracts may be capable of being terminated. Such termination may result in termination payments being payable as well as having an adverse effect on cash flows.

The Government Facility will mature on the earliest of (1) 30 September 2004, (2) the date on which the Proposed Restructuring becomes effective and (3) any date notified by the Secretary of State to British Energy on which repayment of amounts outstanding under the Government Facility are required as a result of a Commission decision or an obligation under EU law.

The Company faced short-term pressures on liquidity during the third quarter resulting from the combined effect of seasonality, the major unplanned outage at Heysham 1 and the increased levels of collateral and costs of unplanned outages brought about by the increased level of volatility in electricity prices. During the period collateral peaked at £355m, in January 2004.

The Company's strategy for securing part of its income through fixed price contracts means that in a volatile and rising electricity market the collateral requirements are also volatile.

The Board remains of the opinion that the working capital available to the Group is not sufficient for the present requirements of the Group. The Company is taking steps with a view to improving this situation. The receipt of the proceeds from the disposal of AmerGen significantly increased the Group's financial flexibility. The Group is continuing to explore initiatives to reduce the demand for trading collateral and to achieve sufficient liquid resources to implement the Proposed Restructuring.

The Proposed Restructuring and, therefore, the working capital available to the Group, remain subject to a large number of significant uncertainties and important conditions. These include settling certain documents with creditors, approval of the Scottish Courts, listing of the new shares and new bonds and receipt by the Secretary of State of notification of a satisfactory decision by the Commission that, insofar as the proposals involve the grant of State aid by the UK Government, such aid is compatible with the common market. The Secretary of State now expects to receive this notification during this autumn. The Proposed Restructuring is also conditional on there being no material adverse change affecting the Group as a whole or Eggborough Power Limited and no material adverse effect on the value of the creditor's entitlements under the Proposed Restructuring. Furthermore, the Secretary of State is entitled not to proceed with the Proposed Restructuring if, in her opinion, the Group will not be viable in all reasonably foreseeable conditions without access to additional financing beyond that which is committed and will continue to be available when required. Also, for listing purposes, the restructured Group will need to have sufficient working capital for its present requirements from listing of the new shares and new bonds. Some uncertainties which may affect the Group's cash flow position, performance or outlook are described in the Review of Operating Performance and Financial Review.

If the conditions to the Proposed Restructuring are not fulfilled, or if the Company's cash generating initiatives are not achieved, in each case, within the time scales envisaged or required, or if there is a material deterioration in the Group's cash flow position, performance or outlook, or if the Government Facility ceases to be available or if the restructuring and standstill arrangements which the Group has entered into with certain of its creditors are terminated, British Energy may be unable to meet its financial obligations as they fall due and consequently the Company may have to take appropriate insolvency proceedings, in which case the distributions to unsecured creditors may represent only a small fraction of their unsecured liabilities and there is unlikely to be any return to shareholders. Further details on the Proposed Restructuring are contained in note 1 to the financial statements.

Post Balance Sheet Events

On 25 May 2004 the Group received the sum of C\$10m in respect of the restart of Unit 3 of the Bruce power station as disclosed in note 34 to the financial statements.

Contingent Liabilities

On 12 February 2004 British Energy received a notice of warranty claims from the consortium which purchased the Group's 82.4% interest in Bruce Power alleging breach of certain warranties and representations relating to tax and to the condition of certain plant at the Bruce power station.

The claim relating to the condition of the plant is based upon alleged erosion of some of the steam generator support plates, through which boiler tubes pass, which it is alleged resulted in an extended outage of one unit at the plant to carry out repair works and loss of net revenues and costs of approximately C\$64.5m. The consortium also claims that the alleged erosion may reduce the operating life of the unit and/or result in further repairs involving further losses. British Energy has rejected the claim and expects to defend it if it is pursued further. In accordance with accounting standards, no provision has been made in the financial statements at 31 March 2004.

The principal tax claim relates to the treatment of expenditure at the Bruce plant during the period of the Company's ownership that is currently being considered by the Canadian tax authorities. The treatment proposed by British Energy could result in a rebate of a material amount of tax to the Group that has not been recognised in the financial statements of the period. The consortium claims that allowance of the expenditure for that period would cause it to lose future deductions. British Energy has rejected the claim and expects to defend it if it is pursued further. On the basis of advice received, the Company is confident that the amount of the claim should not, in any event, materially exceed the amount of the rebate, and that the claim should have no material cash flow impact on the Group.

Under the Bruce Power sale agreement with the consortium C\$20m is retained in trust to meet any representation and warranty claims, and this may be retained pending agreement or determination of the claims.

As a result of an accounting adjustment made by Exelon to the value of nuclear fuel contained in AmerGen's balance sheet dated 21 December 2003, British Energy may be required to make a payment to Exelon of up to US\$13.7m. British Energy served a Dispute Notice on Exelon on 4 June 2004 to preserve its rights to commence litigation. The agreement with Exelon for the sale of AmerGen requires that, prior to instituting any litigation or other dispute resolution procedure, the companies will in good faith seek to resolve any dispute.

Further contingent liabilities of the Group are described in note 32 to the financial statements for the period.

Dividend Policy

The Board intends to distribute to shareholders as much of the Company's available cash flow as prudently possible, but not prior to the completion of restructuring, and not until the operational requirements of the business permit. In addition, under the terms of the Proposed Restructuring, there are certain restrictions on the Board's ability to pay dividends, including:

British Energy is required to fund a cash reserve out of the Company's post-debt service cash flow in order to support the Group's collateral and liquidity requirements post-restructuring. The initial target amount for the cash reserve is £490m plus the amount by which cash employed as collateral exceeds £200m (Target Amount). It is expected that, when the Proposed Restructuring is completed, the level of the cash reserves will be below the Target Amount and therefore there will be no distributions to shareholders until such times as the cash reserve is at the required level. As a result of the requirements to fund the cash reserves, the Board is not paying a dividend in respect of the financial year ended 31 March 2004 and does not expect to pay a dividend in respect of the financial years ending 31 March 2005 and 2006;

the terms of the Nuclear Liabilities Agreements to be entered into as part of the Proposed Restructuring also require that once the cash reserve is funded to the Target Amount, British Energy must make Cash Sweep Payments to the Nuclear Liabilities Fund (NLF). The NLF Cash Sweep Payment is initially defined as 65% of the movement in cash, cash equivalents and other liquid assets during the year after adjusting for, among other things, certain payments made to the NLF or dividends paid in the year. The requirement to make the NLF Cash Sweep Payment will greatly reduce the amount of cash that would otherwise be available for distribution to shareholders;

the terms of the new bonds to be issued as part of the Proposed Restructuring contain certain covenants, including a restriction that allows British Energy to pay a dividend only if no event of default has occurred; and

the Company must have distributable reserves.

Mike Alexander
Chief Executive

Independent Auditors' Report

The Independent Auditors' Report on the financial statements for the year ended 31 March 2004 was not qualified, but contained an explanatory paragraph in respect of a fundamental uncertainty as follows:

“In forming our opinion, we have considered the adequacy of the disclosures made in note 1 concerning the preparation of the financial statements on the going concern basis. The validity of this depends on the fulfilment of the conditions of the Proposed Restructuring and achievement of the Group's cash generation initiatives, in each case within the time scales envisaged or required and the continuation of the restructuring and standstill arrangements with certain creditors and financial assistance from the Secretary of State pursuant to the Government Facility and there being no material deterioration in the Group's cash flow position, performance or outlook. In view of the significance of the uncertainties concerning these matters, we consider that it should be drawn to your attention but our opinion is not qualified in this respect.”