Annual Report and Accounts 2004
Network Rail Infrastructure Limited

Principal operating subsidiary of
Network Rail Limited

Network Rail

Officers

Network Rail Infrastructure Limited

Directors
John Armitt
David Bailey
Robert den Besten
Jim Cornell
Iain Coucher
Peter Henderson
Ron Henderson
Charles Hoppe
Chris Leah
Ian McAllister
Adrian Montague
Ross Sayers

Secretary
Hazel Walker

Contents

Financial highlights

	2004 £m	2003 £m
Turnover	**2,606**	2,965
Operating (loss)/profit before exceptional items of £157m (2003: £23m)	**(601)**	103
Operating (loss)/profit after exceptional items	**(758)**	80
Net interest payable, including exceptional interest charge of £nil (2003: £106m)	**(352)**	(415)
Loss before taxation	**(1,070)**	(290)
Net cash inflow from operating activities	**1,078**	192
Net debt	**(12,600)**	(9,404)
Railway network fixed assets	**18,498**	12,764
Net assets	**3,592**	1,748
Capital expenditure	**3,858**	3,121
Maintenance expenditure	**1,408**	1,184

Chairman's statement

Last year was one of substantial progress. Significant strides were taken towards delivering Network Rail's vision of the safe, reliable and efficient railway we all wish to see.

The Chief Executive's review discusses the year's performance in greater detail, but there is no doubt that the reduction in Network Rail delay minutes is one of the year's most important achievements. The 7% reduction in delay minutes compared to the previous year means they now stand at their lowest level for four years. Most encouragingly, performance in the second half of the year was considerably better than that in the first half and this very welcome performance improvement is something for the Company to continue to build upon in the year to come.

In terms of financial performance, major steps forward have been made in bringing costs under control and through efficiencies, new investment appraisals and rigorous expenditure controls, debt levels in the Company are some £1.3bn less than projected in October 2002. In the year, Network Rail made an operating loss of £758m with over half of this the result of a change in the phasing of network grant income from the Strategic Rail Authority (SRA). The overall financial performance reflects the increases in costs which followed the Hatfield accident and were inherited from Railtrack and also the fact that the new income levels following the Interim Review did not become effective until 1 April 2004.

The Interim Review of Track Access Charges was concluded in December 2003, with the Office of the Rail Regulator (ORR) determining Network Rail's income for the five years from 1 April 2004 at £22.2bn. The successful conclusion of the Review was very welcome, giving Network Rail certainty and stability regarding its future income and putting the Company on a secure financial footing. It also requires the Company to deliver an unprecedented 31% improvement in efficiency over the next five years alongside the significant increases in train punctuality.

Investment in the railway has continued at record levels. Although most of the expenditure is directed towards replacement of track and signalling, we have made significant investment on several major projects. Throughout the year we have continued to tighten our grip on the West Coast Route Modernisation project. The forecast cost for modernising Europe's busiest railway has been reduced by £2.3bn and now stands at £7.6bn. In September 2004 the new timetable will see the fastest journey times from Manchester to London fall from 2 hours 41 minutes to 2 hours 6 minutes, with similar improvements for passengers travelling from London to Glasgow. Beyond September the work continues north of Manchester, leading to further improvements for passengers using the line between Manchester and Glasgow.

Of the many other major project successes, the programme of implementing the train protection and warning system (TPWS) has been completed below budget and the West Anglia Route Modernisation programme was also successfully completed, ahead of schedule and again below budget.

The most significant development during the last year was our decision in October 2003 to bring all rail maintenance in-house. This ground-breaking decision represents the most fundamental change to the railway since privatisation and its success is essential to Network Rail. By creating a unified maintenance function we will derive three key benefits: the consistent application of high standards of railway maintenance, significant efficiencies and continued improvement in trackside safety standards.

In the areas where rail maintenance has already been brought in-house the results have been very encouraging. The Thames Valley area, which came in-house in June 2003, has seen a 32% reduction in delay minutes over the second half of the year. The Wessex area, which came in-house in November 2003, has seen a 14% reduction in delay minutes since Network Rail took over direct control of maintenance.

By July 2004 we expect to have completed the challenge of bringing all maintenance contracts to a conclusion and transferring around 16,000 people into Network Rail from seven different companies. The first transfers have been completed and some 8,500 people have joined Network Rail from maintenance contractors.

The year has seen further improvement on many of Network Rail's key safety measures. During the year we experienced the lowest ever levels of significant train accidents and broken rails. Sadly, as the Chief Executive will discuss in greater detail, much of this good work was overshadowed by the tragedy at Tebay and a number of other incidents involving workforce fatalities. We will continue to work to eliminate fatal incidents on our infrastructure.

In January the Secretary of State for Transport announced that he would be reviewing the structure of the railway industry over the coming months. It was pleasing that Mr Darling noted the good progress Network Rail has made since our creation and Network Rail is now working with the Department for Transport on the Review and making positive suggestions for its consideration.

During the year the Company continued to develop the relationship we have with our Members. This included the Annual General Meeting in Glasgow in July 2003, during which Members discussed the management of the business and endorsed the Company's Management Incentive Plan. In addition the directors have met with Members at a series of nine meetings around the country to discuss continuing developments within the business.

There was one change at Board level during 2003-04. Sir Robert Smith departed the Board in September, having made a very important contribution during the first year of Network Rail's existence. Sir Robert was replaced on the Board by Robert den Besten, the former President of Netherlands Railways. Robert brings tremendous experience to Network Rail and he is already making an excellent contribution to the work of the Company.

Network Rail concluded the year on 31 March with the publication of our Business Plan. The plan details how we will modernise the railway, significantly reduce costs and make substantial improvements to train punctuality. Our target is that 90% of trains should run on time by the end of the five year period, with year-on-year improvements to reach this symbolic milestone.

Network Rail is undergoing huge change at an incredible pace. We have made excellent progress in the last twelve months and I thank our employees for that. There is, however, much still to do and over the next five years Network Rail's dedicated and highly skilled employees will be working tirelessly to meet the challenges of safety, performance and cost. The travelling public expects nothing less.

Ian McAllister Chairman
2 June 2004

Chief Executive's review

As the Chairman has outlined in his review, 2003-04 has been a year in which Network Rail has taken substantial steps towards achieving our objectives. It has been a year of change for our employees, but also a year in which they have delivered improvements in both punctuality and efficiency.

Performance

The most fundamental measures on which the performance of Network Rail is judged are the train punctuality index called Public Performance Measure (PPM) and the number of delay minutes caused by Network Rail's infrastructure.

I am pleased to report that on both indices the Company has achieved significant improvement in the last twelve months, with delay minutes falling from 14.7m minutes to 13.7m minutes, the best performance since before the Hatfield crash. This one million reduction in delay minutes came despite the effects of an exceptional summer period which led to the Company incurring 250,000 delay minutes due to the very hot weather. Thanks to this reduction in delay minutes, combined with the efforts of the train operators, the proportion of trains classified as having arrived on time on a rolling annual average rose from 79.2% to 81.2%.

Other underlying measures of performance also show movement in the right direction. Delays per incident, which had risen stubbornly for some four years, are now declining sharply with a 13% reduction over the last six months. All the time, of course, passenger train kilometres and volume of freight carried continue to increase.

This improvement is welcome, but we recognise it is only a first step. Train operators, passengers and the wider public rightly demand still more.

Our Business Plan published in March 2004 committed the Company to continue the improvements on this trajectory over the next five years. On this basis we are forecasting to reach 85% PPM by March 2006 and 90% PPM by March 2009. Improvement on this scale is a hugely demanding target, but one we are committed to delivering. To do this at a time when we are also committed to a 31% improvement in our efficiency makes the targets even more challenging.

Achieving reductions in infrastructure delay minutes requires close attention to detail, solving thousands of small problems which all contribute to infrastructure failures. To help us understand and analyse the infrastructure problems we face, we are rolling out Six Sigma methodology across the business at every level to tackle the root causes of problems.

Last year we launched the 100 Critical Junctions project which identified the junctions on the rail network which have the greatest effect on the overall performance of the system. By focusing resources on these key points on the network, we are already seeing significant benefits and expect to see more in the coming years.

At Waterloo we launched the Wessex Integrated Control Centre with South West Trains, which ensures the integrated control of train operations at that key London terminus. Network Rail is convinced that integrated control between itself and train operators offers significant advantages for train performance and we are currently discussing with other train operators the possibilities of rolling the model out across the country.

For the freight business the notable developments of the year include the opening of a number of new connections to the rail network, including one to the Jaguar terminal at Castle Bromwich. We are working with freight operators and their end customers to improve the attractiveness of rail as a freight transport option. Pleasingly we continue to see strong demand for new freight services within certain market sectors and we are working hard with the freight industry to help it realise its ambitions.

A final aspect of Company performance with which I have been pleased in the last year is the way we have improved our handling of public complaints which relate to disruption caused by maintenance and engineering works. A highly successful initiative during the year has been the introduction of quick response teams to address incidents of public concern across the country.

Cost control

When Network Rail was created the twin priorities were clear. Alongside improving train performance, it is vital that the Company gets a grip on costs which have increased substantially over the previous few years.

In this area too, I am pleased to report good progress. Whilst we have made a £758m operating loss in the past year, our debt levels are now some £1.3bn lower than forecast in October 2002, principally due to a rigorous approach to capital expenditure and cash management.

Under the Interim Review settlement we have agreed with the Regulator, we are committed to delivering a 31% efficiency improvement over five years. Whilst we will be delivering record investment onto the railway in the next five years, with some £26bn to be spent in the period, this is because we will be doing unprecedented volumes of work. The Regulator has funded us only for efficient expenditure and his efficiency targets are hugely demanding.

These demanding targets require difficult choices to be made and one decision we did make in the last year was to begin the process of personnel reduction. In the autumn, we reduced personnel numbers by 600 among managers and other non-operational employees. We are committed to a further 1,400 reduction over the next three years, with the wider objective of making Network Rail a more efficient and more effective business, whilst maintaining the vital focus on the frontline.

The value for money delivered by the Company is measured by the Financial Efficiency Index. This measures operating expenditure, maintenance expenditure and the unit cost of track renewals. For the year 2003-04 the target was exceeded.

Bringing maintenance in-house and restructuring Network Rail

As the Chairman discussed in his review of the year, the most high-profile decision we made in 2003-04 was the ground-breaking move to bring rail maintenance in-house.

Operations and maintenance go hand in hand and I believe it is essential that one organisation is directly responsible for the delivery of both. The process of bringing maintenance in-house is well under way and will be completed by the end of this summer. At that point the railway will have a single, integrated programme of rail maintenance for the first time in ten years, something I am convinced will contribute to improvements in safety, efficiency and performance.

It was clear that the structure of Network Rail needed to change to reflect the fact that the Company would more than double in size within less than a year. The new structure, functionally not regionally based, has been discussed extensively with our customers and will, we expect, make Network Rail a much more customer-focused organisation.

During the year, we made a number of changes that altered, fundamentally, the way in which we work. In June we completed the roll-out of "area-based delivery units", each under the leadership of a general manager. This has provided the catalyst for improved performance throughout the entire country.

Although I only briefly mentioned our employees in my introduction, it is clear that we will only succeed through their efforts. In December 2003 we carried out our second employee engagement survey, known as Q12. The survey showed a significant increase in the number of employees classified as engaged and committed. In the year ahead further improvements in efficiency and performance can only be delivered through a loyal and committed workforce and we will be working to engage our employees still further.

Asset condition

Measures of asset condition continue to demonstrate significant improvement, largely as a consequence of the sizeable increases in renewals volumes which have been carried out in recent years. In 2003-04 1,373km of rail and 380 units of switches and crossings were renewed compared with 1,010km and 254 units respectively in 2002-03.

During the year the number of broken rails fell from 444 to 334, whilst the number of temporary speed restrictions has reduced from 537 to 458. Due to our policy of prioritising the speed restrictions which have the greatest impact on train performance, the impact of temporary speed restrictions on train punctuality has fallen still further.

The way we manage our assets is being improved considerably by the new technology we are introducing across the rail network. The New Measurement Train runs at up to 125mph covering the entire high-speed network every two weeks and providing us with invaluable high-quality data about asset condition. We also now have ten high-output grinding machines which have transformed the productivity of our rail grinding and we are shortly to take delivery of a new track-laying machine which will do the same to our capability in that area. Finally, an asset information system known as MIMS (Maintenance Information Management System) is now in use across most of the country allowing us to manage our maintenance workload more effectively. The MIMS system will cover the entire country within the coming year.

The overall measure of asset condition is known as the Asset Stewardship Index. Despite having to deal with the considerable challenges caused by the extreme weather conditions in summer 2003, which placed significant strain on the assets, we are pleased to have exceeded our targets for this measure.

Chief Executive's review

Projects

Network Rail manages a large number of significant projects at any one time. We have seen good progress on many of these in the last twelve months.

The West Coast Route Modernisation project has continued with 200 miles of the route now ready for 125mph tilting trains from September this year. The new timetable will see substantial benefits for passengers including a 35 minute reduction in the fastest journey times from London to Manchester and a similar improvement on the London to Glasgow route. These benefits have been delivered by adopting a new strategy of long-term closures with major works carried out along the length of the route. Following the September improvements, the coming year will see the continued delivery of incremental linespeed enhancements between Crewe and Glasgow.

The Power Supply Upgrade project work to allow the introduction of 2,000 new train vehicles in the Southern region is now well under way. This work involves the construction of new electricity substations, the upgrade of depot facilities and the extension of some platforms across Kent, Surrey, Sussex and Hampshire. It is expected that the old slam-door trains will have been replaced with modern new rolling stock mid 2005.

The Felixstowe to Nuneaton project will provide a significant boost to rail freight allowing access for 9' 6" high containers from the ports of Felixstowe, Harwich and Tilbury to inland terminal destinations in the Midlands, North West and Scotland via the West Coast Main Line. We anticipate completing the project by the end of 2004.

One of the undoubted success stories of the last year is the West Anglia Route Modernisation project. The West Anglia route includes the lines out of Liverpool Street station and was the last network into a major London terminus controlled by a number of small, century-old signal boxes. In total, the project transferred 200 kilometres of signalling to a new "state of the art" centre at Liverpool Street, improving the route's reliability and efficiency. The project was completed on time and to budget.

Another project completed this year was the Cross Country Route Modernisation. The £200m project was finished in September 2003, delivered on time and to budget. The project involved the upgrading of 150 miles of infrastructure to allow Class 200 and Class 221 trains to run at speeds up to 125mph. It was commemorated in September with a journey from Sheffield to Birmingham in 57 minutes, creating a new record for the route.

Safety

The railway continues to be a very safe mode of transport, some eight times safer than road travel.

Many of the principal safety indices, such as significant train accidents, have shown improvement over the course of the year. One disturbing feature of the year, however, was the increase in workforce fatalities from four in 2002-03 to eight in 2003-04. Any fatality is unacceptable and we will continue to work to eliminate fatal incidents on our infrastructure.

The most high profile of these workforce fatalities occurred at Tebay on Sunday 15 February 2004. Four track workers were tragically killed by a runaway trolley. Network Rail has now introduced additional guidelines on top of the already stringent rules for the use of such equipment. Whilst the overall safety performance of the railway continues to improve, the fatalities at Tebay are a reminder of the need for constant vigilance.

On a more positive note the work to install the train protection and warning system was completed this year. The system greatly reduces the risk from signals passed at danger and is a real improvement in rail safety. Given the focus on cost control in the current environment, it is especially pleasing to note that the project was not only completed on time, but also under budget.

Outlook

There is still a long way to go, but train performance is improving. Costs are being brought under control. Steadily and surely the railway is delivering a better service to passengers and better value for money for the country.

But Network Rail is under no illusion – there is still a great deal more to achieve. Passengers demand much greater improvements in punctuality. We have to improve the efficiency of the Company considerably. Project management needs to be tighter and day to day management of operations more effective.

Further improvement is essential but I believe that people will look back on 2003-04 as the year when the railways turned the corner towards a future that delivers a much better service to passengers. In the year to come that improvement must continue.

John Armitt Chief Executive
2 June 2004

Group Finance Director's review

The year ended 31 March 2004, the second in the transition to a secure financial future, has been one of significant achievement. During the year the Company has worked constructively and successfully with the Office of the Rail Regulator (ORR) to reach a conclusion on our expenditure needs for the five-year period from 1 April 2004. In addition the Company has launched a medium term note programme and commercial paper programme in order to secure the medium-term financial requirements of Britain's railway network, both of which were well received by the market. The Company has also agreed a revised deed of grant with the Strategic Rail Authority (SRA) to secure our network grant funding for the whole of the next five years.

Operationally our focus has been on further understanding our cost drivers and using this understanding to make optimal use of every pound we spend, be it capital or revenue. We are significantly advanced on implementing a full unit costing structure for track renewals and are moving forward on understanding the unit costing for maintenance work. The focus on strong budgetary control is also being continued. Evidence of all this progress can be seen in the outturn of our controllable expenditure which is £1.3bn less than forecast in our business plan. Of this £1.3bn, over £400m is delivered cost savings and £900m is a result of deferring work because it was not satisfactorily planned and costed. This Company is determined to make inefficient spend a thing of the past.

The West Coast Route Modernisation (WCRM) project is no longer subject to a fundamental uncertainty. During the year the Company has accepted the findings of the ORR's final determination on the funding of West Coast. The final determination supported the SRA West Coast Main Line strategy and the proposed infrastructure works necessary to support the capacity and outputs of the strategy. The Regulator also allowed an extension of timescales for the delivery of some outputs for elements of the programme.

The SRA and Virgin Trains are currently negotiating the new franchise agreement for the West Coast Main Line. In due course Network Rail and Virgin Trains will agree a new track access agreement that will replace the current agreement (PUG 2) based on the model clauses published by the ORR.

Putting in place a sound financial footing and restructuring the organisation on a functional basis does not come without a cost. Following the Rail Regulator's statement of 27 June 2002 all additional expenditure in the year ended 31 March 2004 continued to be added to the Regulatory Asset Base (RAB). However, in future years additional expenditure above that assumed by the Regulator in the Review will only be included in the RAB where it represents an enhancement or where it arises from new obligations. The last twelve months have seen the Company record an operating loss of £758m. This compares to an operating profit of £80m recorded in the previous year and the reasons for this loss are an integral part of the transition to a more secure financial future.

First, following the interim determination in which it was concluded that future SRA revenue grant payments would be entirely in respect of control period 3, it was necessary for the Company to forego £544m of revenue grant that would have otherwise been accrued in these financial statements. This significantly increased our operating loss. Although this shortfall in income is added to the RAB, the appropriate accounting treatment is to recognise the shortfall through the profit and loss account for the year and recognise a corresponding increase through the revaluation reserve. The consequential effect is nil on net assets but an increased like for like loss of £544m.

Group Finance Director's review

In addition to this shortfall there has been an increase in depreciation of £187m as a result of a much increased RAB value. This is further increased by some exceptional write-off costs relating to the WCRM of £52m. These write-offs reflect the cost to date of work done which will now not proceed based on the revised strategy and output specification. A detailed review of all the Company's schemes has also contributed a further £18m to depreciation costs.

During the year under review tangible fixed assets rose to £18,576m from £12,835m. This significant increase reflects the substantial investment in the railway network, and includes £3,858m of renewals and enhancement expenditure. After depreciation of £695m, a revaluation of £2,578m has been recorded. This revaluation reflects the further uplift in the value of the RAB as determined by the Regulator in his December 2003 final conclusions.

This year has been one of substantial organisational change. During the twelve months covered by these financial statements we have taken the decision to restructure the Company along functional lines, including the step change of bringing infrastructure maintenance in-house and undertaking an exercise which removed 600 job positions. These changes resulted in exceptional transitional costs of £105m but will deliver significant benefits in the immediate future. Clearly the bringing in-house of maintenance has added significant employee numbers to our payroll. Overall employee numbers are up 13% year on year and this addition has been matched in employee costs.

Financial performance

- turnover was £2,606m, a reduction of £359m against prior year turnover of £2,965m
  - this included performance penalties of £348m (2002-03: £395m)
  - the fall was a result of the loss of network grant income for the year of £544m, partially offset by lower performance payments and increased franchise revenue
- operating costs totalled £3,364m, an increase of £479m on prior year costs of £2,885m
  - as disclosed above, the main factors in the increase are additional staff costs (£86m), depreciation (£257m) and restructuring costs (£105m)
- profits of £40m were achieved from the sale of properties (2002-03: £45m)
- interest charges have increased to £352m from £309m (excluding exceptional charges of £106m) in 2002-03
- net debt increased from £9.4bn to £12.6bn in the year
- total fixed assets have increased from £12.9bn to £18.7bn
- net assets at 31 March 2004 totalled £3.59bn (31 March 2003: £1.75bn)

Exceptional items

As outlined above exceptional charges for the year totalled £157m. These related to costs of the functional reorganisation of £105m and WCRM abortive costs of £52m.

Taxation

The Company recorded a taxation credit for the year of £336m compared to a credit of £35m last year.

Cash flow

- during the year the Company's operating activities generated cash of £1,078m (2002-03: £192m)
- net interest paid amounted to £421m (2002-03: £407m)
- spending on fixed assets totalled £3.8bn (2002-03: £3.0bn) while receipts from fixed asset sales and capital grants contributed £0.1bn (2002-03: £0.1bn)
- net debt increased by £3.2bn to £12.6bn

Changes in debt structure

Network Rail has established two major financing programmes over the last year to supplement its existing range of commercial facilities from banks, finance lessors and international lenders.

In July 2003 the Company launched a £4bn Commercial Paper programme through Network Rail CP Finance PLC to meet the Group's working capital requirements for the financial year. The programme has provided a dependable source of cost-effective, short-term financing in both the US and euro markets. In March 2004 the Company put in place a £10bn Medium Term Note (MTN) programme through a special purpose financing Company, Network Rail MTN Finance PLC. First issuance under the MTN programme raised £6.5bn in a range of sterling, euro and US dollar denominated issues. £3bn of the proceeds will be used to help meet the Group's working capital requirements over the coming year. The remainder (£3.5bn) has been used to partially refinance the Group's acquisition bank bridge facility.

Network Rail's financing facilities benefit from a £21bn package of standby support loans from the SRA, of which £14bn is allocated as security for specific facilities. The SRA standby support is undrawn.

Future funding

Network Rail's immediate working capital needs are met by committed short-term bank facilities. Over the next year, Network Rail expects to refinance much of its short-term debt through a long-term financing programme.

Accounting policies

There have been no changes to accounting policies in the year.

International accounting standards

The Company will be required, as part of its licence condition, to comply with accounting practices of publicly listed companies which will require implementation of international accounting standards by 31 March 2006. On the subject of achieving compliance within the required timescales we continue to manage our transition plan closely. This year we have identified the proposed international accounting standards which will have the most impact on our financial statements and we are preparing indicative numbers so that we can fully understand the impact of complete transition by 31 March 2005.

The standards currently at the forefront of our thinking are those relating to deferred taxation (IAS 12), leases (IAS 17), pensions (IAS 19), financial instruments (IAS 32), impairment of assets (IAS 36), financial instrument recognition (IAS 39) and investment properties (IAS 40).

Treasury operations

The Group's treasury operations are co-ordinated and managed in accordance with policies and procedures approved by the Board. Treasury is subject to regular internal audits and does not engage in trades of a speculative nature.

An annual funding plan approved by the Board sets out in detail the Group's twelve months' financing requirements and in broad terms the requirement for the next five years. It explains the options available together with their strengths and weaknesses and a recommended strategy. Group policy is to ensure that there are sufficient committed bank facilities and short-term investments to cover, as a minimum, the next twelve months' funding requirements.

The major financing risks that the Group faces are its interest rate fluctuation risk and liquidity risk. Treasury ensures sufficient liquidity is available to meet the Group's needs, while reducing financial risks and prudently maximising interest receivable on surplus cash.

Counterparty limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty and are monitored on a regular basis.

The Group's primary liquidity is provided by committed bank facilities. At 31 March 2004, the Group had £8.3bn in undrawn committed facilities.

Summary

Looking forward I am confident that the solid progress we have made since Network Rail became responsible for Britain's railway network will be built upon. The Regulator has set us a determination that is challenging and we are committed to delivering the target efficiencies in that determination in an environment of tight and efficient financial control and reporting.

Ron Henderson Group Finance Director
2 June 2004

Directors' report

Under its network licence the Company is required to publish such information as would be required if it were a listed company and comply with the principles of good governance and code of best practice under, or approved for the purposes of, the listing rules of the Financial Services Authority. As such, it is publishing this Report and Accounts.

Principal activities

Network Rail Infrastructure Limited is responsible for the management of the national rail infrastructure. Its principal activities are:

- providing train operators with railway track access
- managing train timetabling, train planning and signalling
- maintaining and renewing the infrastructure and undertaking major capital programmes

Business review

23 May 2003	Network Rail CP Finance PLC was formed as a special purpose wholly owned subsidiary of the Company's ultimate parent Network Rail Limited for issuing a £4bn sterling, US dollar and euro multi-currency Commercial Paper programme. The proceeds of issuance under this programme are being used to finance the operations of the Company.
2 August 2003	Network Rail MTN Finance PLC was formed as a special purpose stand-alone company outside the Network Rail Group for issuing a £10bn sterling, US dollar and euro multi-currency Medium Term Notes programme. The proceeds of issuance under this programme are also being used to finance the operations of the Company. At 31 March 2004 £6.5bn of debt had been issued. The accounts of this company are consolidated into the accounts of Network Rail Infrastructure Limited.
24 October 2003	Network Rail announced its decision to take in-house maintenance of the rail infrastructure previously outsourced to maintenance contractors.
9 March 2004	Network Rail Defined Contribution Pension Scheme Trustee Limited was formed for the purpose of providing a defined contribution pension scheme arrangement for employees.

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. This report should also be read in conjunction with the Corporate Governance Report and the Directors' Remuneration Report.

Results

The loss before tax and exceptional items was £913m (2002-03: loss of £161m) and the loss after tax including exceptional items was £734m (2002-03: loss of £255m).

Share capital

50,084,937 ordinary shares of 0.1p and 160,000,000 redeemable shares of £1 of the Company are held by its immediate parent company Network Rail Holdco Limited.

Health and safety

The health and safety of our employees, whilst working within the business, and the public, whilst travelling on the railway infrastructure, are of great importance to the Company. The Group's policies and procedures relating to health and safety at work recognise the requirements of current legislation and are kept under constant review with the aim of providing a safe working environment for all employees. Significant resource is committed to safety, health and environmental matters and the Company aspires to continuing improvement of its performance in the areas of health, safety and the environment.

Previous incidents

In July 2003 charges were made against the Company and certain of its then and current directors and senior managers in relation to the Hatfield derailment. The accidents that took place at Ladbroke Grove and Potters Bar are the subject of continuing police and/or Health and Safety Executive investigations, the outcomes of which are unknown at present.

Corporate social responsibility

Network Rail takes seriously the social, ethical and environmental impact of the activities of its business. As part of its stated objective of transparency, a report on these aspects within its business is currently being prepared and is due to be published later in 2004.

Research and development

During the year the Group charged to the profit and loss account £2m (2002-03: £8m) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

Directors and their interests

The present directors and brief biographical details can be found on page 13. The directors of the Company were appointed on the following dates:

Current directors

Name	Position	Date of appointment
Ian McAllister	Chairman	3 October 2002
Adrian Montague	Deputy Chairman	3 October 2002
John Armitt	Chief Executive	14 December 2001
Iain Coucher	Deputy Chief Executive	3 October 2002
Peter Henderson	Projects and Engineering Director	3 October 2002
Ron Henderson	Group Finance Director	3 October 2002
Chris Leah	Director, Safety and Compliance	5 October 1998
David Bailey	Non-Executive Director	3 October 2002
Jim Cornell	Non-Executive Director	14 December 2001
Robert den Besten	Non-Executive Director	24 September 2003
Charles Hoppe	Non-Executive Director	3 October 2002
Ross Sayers	Non-Executive Director	3 October 2002

Other directors who served in the year to 31 March 2004

Name	Date of appointment	Date of resignation
Sir Robert Smith	3 October 2002	24 September 2003

There were no other changes to the Board during the year.

Directors' interests
The directors have no interests in the shares of the Company.

Shareholder details
The Company is a wholly owned subsidiary of Network Rail Holdco Limited (itself a wholly owned subsidiary of Network Rail Limited).

Equal opportunities and employee involvement
Network Rail recognises the role of its employees in enabling the Group to achieve its business objectives. This is reflected in the Board's commitment to equal opportunities and effective employee communications.

A second survey of employee engagement within the Group was conducted by the Gallup organisation and involved the response by employees to a questionnaire in December 2003 following the first survey conducted in February and March 2003.

The results of this survey showed improvement in employee engagement against the first results. Further improvement is now being sought with a programme of communication of the results of the survey together with training and action plans to increase employee engagement. A third survey is scheduled to be conducted later in the year with further surveys planned for subsequent years to monitor progress in employee engagement.

Effective communication with employees is also important. The Group uses a wide range of communications media, encompassing local information cascades and briefings, videos, the company newspaper, email news bulletins, electronic data links and briefing roadshows by the directors to reach all our employees. Consultation on issues affecting the workforce also takes place at regular intervals through both national and local procedures with representatives from the Company and trades unions.

Our equal opportunities policy is communicated to all employees. We are committed to offering our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying.

The Company is working with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business. It is also a member of the Employers' Forums on Age and Disability.

Employee review processes are in place to allow every individual manager to discuss key performance issues in a structured, fair and consistent way and to identify training and development needs.

Contributions for political and charitable purposes
During the year the Company donated £867,000 to charitable organisations (2002-03: £621,000). A further £611,000 (2002-03: £582,000) was used to sponsor charitable and community-related activities. No political donations were made in either year.

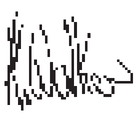
Creditors payment policy
It is our policy, with respect to payment of our suppliers, to settle the terms of payment when agreeing the terms of each transaction where standard terms are not used, to ensure that suppliers are made aware of the terms of payment and to abide by the terms of payment.

At 31 March 2004 the Group's creditor days compared with the value of suppliers' invoices received in the year was 31 (2002-03: 43).

Auditors
On 1 August 2003, Deloitte & Touche transferred its business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The Company's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect on 1 August 2003 under the provisions of Section 26(5) of the Companies Act 1989.

At the Annual General Meeting of Network Rail Limited, which will be held on 21 July 2004, a resolution will be proposed to reappoint Deloitte & Touche LLP as the Company's auditors and to authorise the directors to fix their remuneration. Details of the fees earned by Deloitte & Touche LLP during the period, for both audit and non-audit work, are set out in note 5 on page 34.

By order of the Board



Hazel Walker Secretary
2 June 2004

Board of Directors

Top row from left: Ian McAllister, Adrian Montague, John Armitt
Second row: Iain Coucher, Ron Henderson, Peter Henderson
Third row: Chris Leah, Ross Sayers, David Bailey
Bottom: Jim Cornell, Charles Hoppe, Robert den Besten

John Armitt CBE

Chief Executive (3, 5, 6 & 7)*

John Armitt, 58, is the Chief Executive of Network Rail having previously been appointed Chief Executive of Railtrack PLC after it was put into administration. A civil engineer by training, he was previously Chief Executive of Costain Group PLC, and before that Chief Executive of Union Railways.

David Bailey OBE

Non-Executive Director (1, 2, 4 & 6)*

David Bailey, 64, is the Strategic Rail Authority's Non-Executive Director on the Network Rail Board. With a procurement and logistics management background, he is the former Commercial Director for London Transport, having previously held various director-level roles within London Underground.

Robert den Besten

Non-Executive Director (1 & 2)*

Robert den Besten, 63, joined the Board on 24 September 2003 having previously been President and Chief Operating Officer of Netherlands Railways, President and CEO of Amsterdam Airport Schiphol, Permanent Secretary of the Ministry of Transport and Public Works and Managing Director of the Rotterdam Municipal Transport Corporation.

Jim Cornell

Non-Executive Director (2, 4 & 6)*

Jim Cornell, 64, joined British Rail (BR) in 1959 as a student civil engineer before taking up various positions in BR including General Manager of Scotrail between 1985 and 1987, Director of Civil Engineering between 1987 and 1992, Managing Director, Regional Railways in charge of one of the board's three passenger services and latterly as Group Managing Director of British Rail Infrastructure Services between 1993 and 1996. In addition to his non-executive position in Network Rail he is also now an Executive Director of the Railway Heritage Trust.

Iain Coucher

Deputy Chief Executive (3 & 5)*

Iain Coucher, 42, is Deputy Chief Executive with responsibility for operational matters. Previously, he was Chief Executive of Tube Lines, one of the successful bidders for the London Underground PPP. For 16 years, he worked for EDS and for three years was seconded to TranSys as Chief Executive.

Peter Henderson

Projects and Engineering Director (3 & 5)*

Peter Henderson, 50, is Network Rail's Projects and Engineering Director. Peter has over 20 years' rail experience, most recently at Bechtel where he was Projects Director, Rail, which included responsibility for engineering. He spent 16 years with the Hong Kong Mass Transit Railway Corporation, latterly as Head of Major Projects.

Ron Henderson

Group Finance Director (3, 5 & 7)*

Ron Henderson, 58, was formerly Group Finance Director of BICC plc, Finance Director of Balfour Beatty, and most recently Chief Executive of Tuberail.

Charles Hoppe

Non-Executive Director (2 & 6)*

Charles Hoppe, 69, is the former Vice President, Operations and Facilities Planning, United States Railway Association, Senior Vice President of Booz, Allen & Hamilton's worldwide rail consulting practice and President of the Long Island Rail Road.

Chris Leah

Director, Safety and Compliance (3)*

Chris Leah, 56, is responsible for safety, health and environmental management, having previously served as Railtrack Director, Operations from 1998. He has been on the Board of the Company since 1998 and was the Director, North West region, between 1994 and 1997.

Ian McAllister CBE

Chairman (2 & 4)*

Ian McAllister, 60, is the Company's Non-Executive Chairman having previously been Chairman and Managing Director of Ford Motor Company Limited. Ian is also Chairman of the Carbon Trust and Senior Independent Non-Executive Director of Scottish & Newcastle plc.

Adrian Montague CBE

Deputy Chairman (1, 2, 5 & 7)*

Adrian Montague, 56, is Network Rail's Deputy Chairman, a non-executive role. He is also Chairman of British Energy PLC and Michael Page International and a senior adviser at Societe Generale.

Ross Sayers

Non-Executive Director (1, 2 & 6)*

Ross Sayers, 62, is a former Chairman and Chief Executive of New Zealand Railways Corporation, Chairman and Chief Executive of the State Rail Authority of New South Wales, Australia, and was Chairman of Associated British Ports Holdings PLC until April 2004. He is currently Chairman of Macquarie European Infrastructure Fund Advisory Panel and Director of Arlanda Airport Express Train in Stockholm.

* Numbers against directors' names indicate the committees of the Board on which each of them serves as follows:

1 Audit Committee
2 Remuneration Committee
3 Executive Committee
4 Nominations Committee
5 Property Board
6 Safety, Health and Environment Committee
7 Treasury Committee

Directors' Remuneration Report

The Remuneration Committee

Given the importance of remuneration and incentivisation to the business the Remuneration Committee comprises all of the Company's non-executive directors including the Chairman of Network Rail. The Committee members are:

Jim Cornell – Chairman of the Committee
David Bailey
Robert den Besten*
Charles Hoppe
Ian McAllister
Adrian Montague
Ross Sayers

* Joined the Committee in September 2003

Sir Robert Smith was a member and Chairman of the Committee until September 2003 when he resigned as a non-executive director of the Company.

The Committee is required under its terms of reference to meet at least three times a year and during the year 2003-04 it met seven times, primarily due to the need to consider in depth the terms of the incentive arrangements for 2003-04 and 2004-05. The Group Company Secretary is the secretary to the Committee.

The Committee is responsible for determining all matters concerning the remuneration and incentivisation of the executive directors of the Company. This includes making decisions in respect of the framework of the executive directors' remuneration and its cost as well as determining, on behalf of the Board, specific remuneration packages for each of the executive directors. It decides the remuneration packages for each of the Chairman and the Deputy Chairman in their absence. It also decides upon the form and content of the executive directors' Management Incentive Plan (MIP) for each financial year (within the terms of the Incentive Policy).

Additionally the Committee determines the framework of certain senior executive employees' remuneration as well as the form and content of their MIP.

During the year the Committee's activities included:

- finalising the MIP 2003-04
- finalising the MIP 2004-05
- reviewing the benchmarking of basic salaries
- reviewing the policies on other elements of remuneration packages

The full terms of reference of the Committee are available on request and can be found on the Network Rail website www.networkrail.co.uk.

The Committee commissioned New Bridge Street Consultants LLP to provide independent expert advice on the management incentive schemes and remuneration generally. Mercers Human Resources Consulting Limited advises the Company in respect of pension related matters included in the remuneration policies. These advisers do not provide other services to Network Rail.

The Chief Executive and the Human Resources Director also attend meetings by invitation and assist the Committee in its considerations but do not participate in discussions or decisions relating to their own remuneration. The Human Resources Director is responsible for employees within Network Rail, is not a Board director, and is not appointed by the Committee.

Directors' remuneration policy

The Company has a network licence condition requirement to have a MIP for executive directors and senior executives and for that plan to be cascaded through Network Rail.

Under this condition Network Rail is required, when formulating its MIP, to have particular regard to:

- securing the operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency, economy and safety
- achievement of the licence requirement of dealing with dependent persons with due efficiency and economy and in a timely manner and compliance with Network Rail's Code of practice for dealings with dependent persons
- the extent to which Network Rail is subject to orders and to statements by the Rail Regulator on non-compliance with the licence
- infringement by Network Rail of any access contracts and safety factors

The Rail Regulator may also specify other objectives in connection with the MIP.

Taking into account these regulatory requirements the Committee has formulated Network Rail's remuneration strategy to attract and retain competent individuals and to create the potential to reward outstanding performance at a competitive market rate based on individual contribution and the overall success of Network Rail in meeting the objectives of the Business Plan.

The principles settled with the Strategic Rail Authority (SRA), prior to the acquisition of Railtrack PLC by Network Rail, are now reflected in the Management Incentive Policy which, following the formal implementation of the ORR's proposed network licence modifications, can be modified only with the consent of the ORR. Under the Incentive Policy the objectives and principles are to:

- provide strong incentives to deliver the actions and objectives specified in the Business Plan
- identify specific accountability for the achievement of the actions and objectives laid out in the Business Plan
- enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies

- draw on best practice for listed companies in the UK where appropriate given the unique mission and structure of Network Rail
- recognise that Network Rail is accountable for the public interest as a monopoly owner and operator of an asset of considerable public importance
- recognise that Network Rail is a company limited by guarantee founded on a not-for-dividend principle
- reflect the fact that the Company is unable to offer the traditional benefits of UK listed companies including stock options and other profit share mechanisms

These are structured within a total remuneration approach, defined as the sum of base salary, incentives and benefits. The use of variable pay through the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

Account is taken of information from internal and independent sources on the remuneration for comparable positions in relevant FTSE 350 companies. The strategy for executive directors' pay is for basic salaries broadly to reflect the relevant market median, for benefits such as car allowance and medical insurance to reflect market practice, for pensions to reflect the rail industry practice and for total direct compensation (i.e. basic salary and incentives) to be broadly competitive in the appropriate marketplace, provided always that performance justifies the amount. This strategy is consistent with the Company's belief that performance should determine a sizeable proportion of the total remuneration package for executive directors.

Through the following means the Company ensured that there was suitable transparency as to the principles upon which remuneration of the directors of the Company has been set during the year:

- publication of a statement in June 2003 detailing the contents of the executive directors' MIP for 2003-04 (pursuant to the terms of the Company's network licence)
- presentation at the Annual General Meeting of Network Rail Limited held in July 2003 by the then Chairman of the Remuneration Committee of the principles adopted by the Committee in setting the remuneration policy and the MIP for 2003-04
- briefing meetings with Members of Network Rail Limited during March 2004 when the Chairman of the Remuneration Committee discussed the MIP for 2004-05 including the long-term incentive element

Executive directors' reward package

The current package for executive directors under their service agreements with the Company comprises the following elements:

Base salary

This is a fixed cash sum payable over 13 periods during the financial year. The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution. The aim is to ensure that salaries are competitively set at broadly median levels in relation to similar roles in appropriate companies within the FTSE 350.

Current salaries for the executive directors, following the most recent salary review effective from 1 July 2003 are:

Executive director	Annual base salary as at 31 March 2004 £
John Armitt	468,000
Iain Coucher	416,000
Peter Henderson	312,000
Ron Henderson	312,000
Chris Leah	312,000

Incentive arrangements

The purpose of the MIP is to place additional emphasis on the delivery of the objectives of the Business Plan.

Details of the 2003-04 MIP were published in June 2003 as well as in the Annual Report for 2002-03.

The 2004-05 MIP applies to all the executive directors of the Company and senior executives.

MIP 2003-04 incentive awards

As detailed in last year's Annual Report the annual bonus for 2003-04 was to be calculated measuring actual company performance against the three equally weighted targets set in the MIP for 2003-04. These were Public Performance Measure (PPM), Asset Stewardship Index (ASI) and Financial Efficiency Index (FEI). Each measure had three achievement levels comprising target, enhanced and maximum, with the outcome:

- in respect of PPM the target level was not reached so no award was payable under this measure
- in respect of ASI the enhanced target level was reached (at which a potential bonus of 12% of basic salary is payable to executive directors)
- in respect of FEI the maximum target level was reached (at which a potential bonus of 20% of basic salary is payable to executive directors)

The resultant total potential award was 32%. The Committee then chose to use its discretion by reducing the overall bonus award for the executive directors to 24% of their basic salary. Details of the bonus payments awarded to each director are detailed on page 18 below.

MIP 2004-05 details

Annual incentive

Participants under the 2004-05 MIP are eligible to receive bonuses based on demanding business performance measures and targets. The 2004-05 MIP uses key performance indicators (KPIs) from the 2004 Business Plan as objectives.

Directors' Remuneration Report

The business and individual performance measures relate directly to the objectives set out by the Rail Regulator in paragraph 3 of Condition 28 of the network licence (including the achievement of the purpose of Condition 7 (stewardship) and Condition 25 (code of practice on dealing with dependent persons)), compliance with other licence conditions and with conditions of access agreements.

Business performance measures
The amount payable to executive directors is calculated by reference to performance against the following three output measures:

Network delay minutes (weight one-third) – this is the number of minutes of train delays attributable to Network Rail (rather than the train operating companies (TOCs)) as defined in the contractual performance regime with operators. This measurement of network operating efficiency is felt to be a more appropriate measure for inclusion in the annual incentive, replacing the PPM which is now one of the two key measures in the long-term incentive.

Financial efficiency (weight one-third) – this is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure.

Asset stewardship incentive index (weight one-third) – this is an index proposed by the Rail Regulator in his December 2003 access charges review. The components of this index and weightings are: track geometry index (20%), number of broken rails (15%), Level 2 exceedences (15%), total number of signalling failures (15%), wrongside signalling failures – hazard rating 20 or above (15%), structure and earthworks train speed restrictions (10%), and traction power supply failures AC and DC (10%).

Each of the above performance measures stands alone and is calculated independently. The total potential incentive award payable is then the sum of the outcomes of each measure.

Payments under each of the three measures can only be made if performance meets or exceeds the targets included in the 2004 Business Plan. If target levels are achieved payments are calculated for above-target performance on a "straight line" basis up to "maximum" target level; the maximum incentive could be earned by delivering one year early the 2005-06 performance on each measure as contained in the 2004 Business Plan.

The Committee may exercise its discretion and reduce the amounts payable if, over the year, the overall business performance of Network Rail, including the level of safety performance and net debt, is deemed unsatisfactory.

Personal performance measures
There are no individual performance measures set for the executive directors as the Committee continues to believe that collective accountability of the directors and the need to establish the stability of the organisation continues to necessitate a focus on collective performance incentives without individual performance measures for the executive directors. Other senior executives do have individual performance measures in addition to the business performance measures.

The potential annual incentive entitlement if all three measures achieve target level is 30%. The maximum possible entitlement is 60% of salary, achievable only if all three measures hit maximum performance, by delivering the 2005 Business Plan target one year early.

The remuneration potential has been benchmarked against external comparators with the aim to achieve competitive levels set at broadly median levels for comparable organisations.

Long-term incentive
Under the terms of the Management Incentive Policy there is a requirement to have a long-term incentive element within the MIP.

As Network Rail Limited, being the ultimate parent company of Network Rail Infrastructure Limited, is a company limited by guarantee it is not possible to use traditional long-term incentives due to the absence of shares as the reward method. In 2002 the Committee formed the view, therefore, that time needed to be taken for consideration of what form of long-term incentive arrangement was appropriate. Further, the Committee believed that in order for an effective long-term incentive scheme to be introduced any decision on this matter needed to reflect the outcome of the Rail Regulator's Interim Review. That review was published in December 2003 and as such Members will be asked to approve the long-term incentive at the Annual General Meeting of Network Rail Limited in July 2004.

In the Directors' Remuneration Report in 2003 it was explained that a long-term incentive would be introduced in the 2004-05 MIP and would cover the three-year period from the start of the 2003-04 financial year. The proposal now prepared by the Committee (if approved by Members) is for a long-term incentive based on a deferred cash payment in which awards are made after each three-year period triggered by relevant long-term improvement in business performance targets that are challenging and appropriate at the time. Further, the targets reflect the Business Plan and the funding determined by the Rail Regulator's Interim Review. The maximum amounts which could be earned under each three-year long-term incentive cycle will be a cash sum equivalent to that earned under the previous year's annual incentive.

The annual incentive awards made in the 2003-04 financial year will be used to set the maximum long-term incentive for that three-year scheme, running from 2003-04 to 2005-06, as well as for the scheme to run from 2004-05 to 2006-07. As such the long-term incentive will apply both to the three-year period commencing in 2003-04 and to that commencing in 2004-05.

Performance measures

The two performance measures which have been put in place for the long-term incentive running from 1 April 2004 to 31 March 2007 are:

Public performance: This measure, which in 2003-04 was included in the annual incentive, is felt to be the most appropriate measure of network performance for inclusion in this long-term incentive, reflecting delays attributable both to Network Rail and the TOCs. This measure is the percentage of trains arriving on time over each twelve month period to 31 March 2007 as published in "National Rail Trends". "On time" is defined as running as planned and arriving less than five minutes late at final destination or less than ten minutes late for inter-city operators. The target level of achievement for full payment to be made under this measure is a Public Performance Measure (PPM) at the level included in the 2006 Business Plan of 86.6%. No payment under the long-term incentive will be payable if PPM is below 85.6%.

Cost reduction: This measure will reflect the cumulative cost reductions made in the three-year period to 31 March 2007. For full payment under the long-term incentive the target is achievement of the level laid down by the Rail Regulator. No award under the long-term incentive will be payable unless at least 80% of the cumulative savings set by the Rail Regulator are achieved.

The Committee believes that these two measures provide an appropriately challenging framework for the long-term incentive. If these targets are achieved in full, significant improvement to the rail network will have been delivered. The two measures are free-standing and equally weighted.

For the period from 1 April 2003 to 31 March 2006 the same two measures (PPM and cost reduction) are being used. The targets are a PPM of 85.9% (reflecting the target at 31 March 2006 as described in our 2004 Business Plan) and the cumulative cost reductions for the two-year period to 31 March 2006 as recently set by the Rail Regulator.

The maximum potential cost of the long-term incentive for all the executive directors cumulatively for the period 2004-05 to 2006-07 will be £436,800 (this maximum amount is, as explained above, linked to the amount earned under the previous year's Annual Plan). This maximum sum would only be payable if the targets for the PPM and the cost reduction measure were both met in full.

The maximum potential cost for all the executive directors cumulatively under the long-term incentive for the period 2003-04 to 2005-06 will also be £436,800 as the 2003-04 outturn is being used for that performance period. Again, this maximum sum would only be paid if the targets for the two measures were met in full.

Regulatory MIP statement

As required under the Company's network licence, a statement will be published by the Committee detailing the contents of the executive directors' MIP for 2004-05.

Pensions

Executive directors are entitled to pensions based on salary and length of service with the Company with a maximum pension of two-thirds of final base salary. Details are set out on page 19.

Directors' service terms

The executive directors of the Company are also the executive directors of Network Rail Limited but their contractual service agreements are with this company i.e. Network Rail Infrastructure Limited. No other contractual provisions or remuneration arrangements exist in relation to their directorships of the Company or any other company within the Network Rail Group.

All the executive directors have service agreements. In drawing up these agreements the Committee took into consideration the UK Listing Authority's corporate governance code and the recommendations contained within the joint statement of the Association of British Insurers and the National Association of Pension Funds published in December 2002 to describe best practice on executive contracts and severance. These were applied as far as practicable having regard to the nature of the business and the corporate structure of the Company.

All the executive directors' agreements provide for notice periods from the Company of no greater than one year, to reflect current corporate governance best practice. Executive directors are required to give the Company not less than six months' notice if they wish to leave.

Taking the principles contained within current corporate governance best practice relating to compensation in the event of early termination of a director's service agreement, each such agreement contains an express provision requiring the departing director to exercise their duty to mitigate their loss. Network Rail will have regard to that duty and contractual requirement on a case-by-case basis when assessing the appropriate level of compensation which may be payable, including using phased payments.

Executive directors	Effective date of contract
J Armitt	14 December 2001
I Coucher	3 October 2002
P Henderson	3 October 2002
R Henderson	3 October 2002
C Leah	5 October 1998

Non-executive directors do not have service agreements and, in accordance with the Company's articles of association, their appointments may be terminated at any time on six months' notice without compensation.

The Chief Executive's service agreement and the letter of appointment of the Chairman also contain provisions for termination of their appointments without compensation upon the occurrence of certain significant financial failures of the Group unless a majority of the Board of the Company and the SRA (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Directors' Remuneration Report

Non-executive directors	Effective date of contract
I McAllister	3 October 2002
D Bailey	3 October 2002
J Cornell	3 October 2002
R den Besten	24 September 2003
C Hoppe	3 October 2002
A Montague	3 October 2002
R Sayers	3 October 2002

External appointments

It is recognised that executive directors may be invited to become non-executive directors of other companies and that such appointments can broaden their knowledge and experience to the benefit of the Company. An individual executive director will normally be required to account to the Group for all fees received in respect of such directorships unless otherwise approved by the Committee.

With the approval of the Committee, Ron Henderson is a non-executive director of Scipher plc and NHP plc. Both positions were held by him prior to joining Network Rail and as such the Committee considers it appropriate that he continues to hold these at the present time and that the fees from them are retained by him.

Non-executive directors' remuneration

The non-executive directors of the Company are also the non-executive directors of Network Rail Limited. Each non-executive director has a letter of appointment with either the Company or Network Rail Limited but not with both companies nor do other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group. For the purpose of this Remuneration Report and the Remuneration Report for Network Rail Limited, therefore, the following provisions of this report relate to letters of appointment of the non-executive directors of Network Rail Infrastructure Limited or Network Rail Limited as appropriate and they also appear in the Annual Report of Network Rail Limited.

Non-executive directors receive only a fee together with their reasonable expenses for attending meetings of the Board and other meetings and events. No additional fees are paid where a non-executive director is a member of or chairs a Board committee. Nor do they receive any other benefits from the Company. With the exception of the fees for the Chairman and the Deputy Chairman (which are determined by the Remuneration Committee), the fees of the non-executive directors are agreed by the executive directors of the Board and are designed to recognise the significant responsibilities of non-executive directors and to attract individuals with the necessary experience and ability to make an important contribution to the Company's business. The fees, which are neither performance related nor pensionable, are benchmarked against, and are in line with, those paid by other comparable private sector companies.

Current annual fees for the non-executive directors are:

Non-executive director	Fee £
D Bailey	35,000
R den Besten	35,000
J Cornell	35,000
C Hoppe	35,000
I McAllister	210,000
A Montague	70,000
R Sayers	35,000

Directors' emoluments (audited)

Disclosure of directors' remuneration by type

Name	Note	Salaries and fees £000	Bonuses £000	FURBS and AVC payments by the Company £000	Benefits £000	2003-04 Total £000
J Armitt		463	112	140	14	**729**
D Bailey		35				**35**
R den Besten	1	18				**18**
J Cornell		36				**36**
I Coucher		412	100	119	34	**665**
P Henderson		309	75	88	14	**486**
R Henderson		309	75	85	14	**483**
C Hoppe		35				**35**
C Leah		309	75	105	19	**508**
I McAllister		210				**210**
A Montague		70				**70**
R Sayers		35				**35**
R Smith	2 & 3	20				**20**

1 Covers period from 24 September 2003 (being the date of appointment as director) to 31 March 2004.
2 Covers period from 1 April 2003 to 24 September 2003 (being the date of resignation as director).
3 Includes £1,000 in respect of acting on Network Rail's Membership Selection Panel.

Directors' remuneration comparison: 2003-04 against 2002-03

Notes		2003-04 Total £000	2002-03 Total £000
Current directors			
J Armitt		**729**	761
D Bailey	1	**35**	21
R den Besten*	2	**18**	–
J Cornell		**36**	40
I Coucher	1	**665**	260
P Henderson	1	**486**	191
R Henderson	1	**483**	241
C Hoppe	1	**35**	22
C Leah		**508**	872
I McAllister	1	**210**	99
A Montague	1	**70**	22
R Sayers	1	**35**	22
Ex-director			
R Smith	1	**20**	25
Total		**3,330**	2,576

1 Joined Board on 3 October 2002 (thus comparison column represents only part of year 2002-03).
2 Joined Board on 24 September 2003.

The total amount of directors' emoluments for services provided solely to the Company during the year was £3,330,000 (2002-03: £4,135,000).

Directors' pensions (audited)

The table below shows the pension entitlement from the Network Rail section of the Railways Pension Scheme (RPS), and unapproved arrangements of each executive director of the Company during the year ended 31 March 2004, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

The increases in RPS benefits during the year represent the amount of the extra annual pension entitlement earned resulting from additional length of service or changes in salary.

The increase in accrued approved benefit during the year is shown in the table below. Values are shown before (column A) and after (column B) the exclusion of the effect of inflation. All benefit values shown exclude the effect of any additional voluntary contributions made by the director.

Directors participate in the RPS and benefit accrues at a rate of one-sixtieth for each year of membership. They contribute to the RPS at the same rate as other members of the Network Rail section. In addition, some directors are entitled to additional pension benefits that, as explained in last year's remuneration report, are now provided through a Funded Unapproved Retirement Benefits Scheme.

The following sections describe the pension benefits received by executive directors in 2003-04:

Core pension benefits

	Gross increase in accrued RPS pension £ (A)	Increase in accrued RPS pension net of inflation £ (B)	Total accrued RPS pension at 31 Mar 04 £ (C)	Transfer value of accrued RPS pension at 31 Mar 03 £ (D)	Transfer value of accrued RPS pension at 31 Mar 04 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
J Armitt	1,689	1,634	3,775	56,658	72,380	9,491	25,104
I Coucher	1,664	1,644	2,446	5,380	22,955	11,315	9,171
P Henderson	1,664	1,644	2,446	8,132	32,267	17,875	15,432
R Henderson	1,670	1,642	2,730	18,321	52,382	27,801	25,240
C Leah	10,757	5,876	197,581	3,147,311	3,765,539	598,071	91,826

1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.
2 Transfer values as at 31 March 2003 (D) and 31 March 2004 (E) have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as stock market movements. It is calculated after deducting the director's contribution.
4 The value of net increase (G) represents the incremental value to the director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the director's contribution.

Directors' Remuneration Report

In normal circumstances the earliest age at which the executive directors are entitled to receive their defined benefit pension without actuarial reduction is age 60. However, the directors can retire early on the same terms and conditions that apply to other members of the Network Rail section of the RPS from the age of 50. The actuarial reduction factors that apply under the RPS are a 2% per annum reduction between the ages of 60 and 55 and a 3% per annum reduction for ages below 55. In keeping with other members of the scheme, the right to take early retirement benefits is at the option of the individual, subject only to having left the Company's employment.

In addition to members' benefits, dependants' pensions are paid to a surviving spouse on death after retirement in line with those paid to all members of the RPS. The dependant's pension is payable at the rate of one-half of the member's pension accrued at the date of death, or in payment if death occurs after retirement, although on death after retirement the effect of any commutation for a tax free cash sum is ignored when calculating the dependant's pension. In addition, the scheme pays pensions to surviving children. Where two children survive, a pension additional to the dependant's pension is paid at the rate of ⅜ of the member's pension. Children's pensions are paid to the age of 18 or a later age, at the discretion of the Network Rail Section Pensions Committee, if the child is in full-time education or disabled. The RPS provides guaranteed increases to all pensions in payment and deferment in line with the retail prices index.

Additional pension benefits

As described above, some directors are entitled to additional pension benefits in which case the director can choose the extent to which the gross payment is made to the pension arrangement, or taken as cash. Future contributions are at a pre-determined level, and the amount has been notified to each director. The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown below.

The RPS also operates a matching additional voluntary contribution facility, whereby voluntary contributions paid by members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were "frozen" for all members of the Network Rail section of the RPS at the levels applicable on 6 November 2003, and this limit was applied to directors as to other members. Matching payments made in 2003-04 are also shown below.

	Company contributions to additional pension provision whilst a director during the year £ (H)	Company payments to additional pension provision in respect of prior year £ (I)	Matching Company additional voluntary contributions whilst a director during the year £ (J)
Current directors			
J Armitt	136,414	17,685	3,540
I Coucher	118,650	–	–
P Henderson	87,750	–	–
R Henderson	88,144	–	–
C Leah	96,933	–	7,974
Ex-director			
S Bull	–	17,500	–

1 The figures in column (H) include any contributions that were due to be paid during the year but have not as yet been paid.
2 None of the non-executive directors is a member of the Network Rail section of the RPS and they have no other pension entitlements.
3 The current directors were directors for the whole year. The directorship of S Bull ceased with effect on 3 October 2002.
4 For I Coucher and P Henderson the figures in column (H) are for contributions outstanding in respect of the current year. There are no contributions outstanding for the other directors in respect of the current year.
5 The contributions in respect of previous years are not included in column (H).

Performance graph

As the Company has no listed shares total shareholder return cannot be illustrated.

Directors' interests

As the Company has no listed shares directors have no interests in shares of the Company.

On behalf of the Remuneration Committee

Jim Cornell Chairman, Remuneration Committee
2 June 2004

Corporate Governance Report

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. The Company is committed to high standards of business behaviour.

It is also a condition of the Company's network licence that, from 3 October 2002, it complies with the governance principles contained in the code annexed to the UK Listing Authority's listing rules ("the Code"). The Code includes a requirement for companies to make statements on corporate governance in their annual reports.

The directors confirm that for the year ended 31 March 2004 Network Rail complied with the provisions set out in Section 1 of the Code as issued in June 1998. This Corporate Governance Report, coupled with the Directors' Remuneration Report, explains how the Company has applied the governance principles set out in the Code.

In July 2003 the Financial Reporting Council published a revised version of part of the Code. This version of the Code applies to all listed companies with their reporting years beginning on or after 1 November 2003. Notwithstanding this, since July 2003 the Company has been substantially compliant with this new Code as evidenced by the commentary below and shall be fully compliant during the current financial year.

Board of Directors

The information on page 13 shows that the Company is led and controlled by a board comprising five executive and seven non-executive directors with wide experience both within the rail industry and generally.

The appointment of directors is considered by the Board. The Strategic Rail Authority (SRA) has rights under the articles of association to appoint a special director to the Board of the Company. Also under the articles of association of the Company the directors are not subject to retirement by rotation (as required under the Code), due to it being a wholly owned subsidiary of Network Rail Limited. Under the provisions of the articles of association of Network Rail Limited, however, all directors, save the Special Director, must retire by rotation, and may stand (together with any new director appointed since the last general meeting) for re-election by the Members of the Company at least every three years.

The responsibilities of the Chairman include leading the Board and ensuring its effectiveness. He sets the agenda for the meetings of the Board and, with the assistance of the Group Company Secretary, ensures that the directors receive timely, accurate and clear information before Board meetings and updates of issues arising between meetings. The recognised Senior Independent Director is Adrian Montague. The roles of the Chairman and the Chief Executive are distinct.

The non-executive directors constructively challenge and contribute to the development of the strategy of the Company as well as scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.

The Board considers that all the non-executive directors are independent of the Company. Given the definition of "independent" contained within the Code, however, it is appropriate to disclose that:

1 Jim Cornell was, until 1996, a director of British Rail. He currently receives a pension from the Network Rail section of the RPS. He is also a director of the Railway Heritage Trust. The Board considers, however, that as a non-executive director of Network Rail, Jim Cornell is independent as he was not an employee or executive director of Railtrack PLC. Furthermore the corporate structure of Network Rail Limited, being a not-for-dividend company, and its subsidiary Network Rail Infrastructure Limited eliminate any potential or perceived conflicts between his being a non-executive director of the Company and receiving a pension from the Company. Jim Cornell having held various senior roles within British Rail before retiring on the creation of Railtrack PLC, is a highly experienced and respected railwayman who contributes considerable knowledge to the Company. This enables him to challenge constructively and effectively operational matters within the Company as well as participating in the full range of responsibilities of a non-executive director.

2 David Bailey is the Special Director appointed to the Board of Network Rail Limited by the SRA pursuant to its rights under the articles of association of that Company.

None of the non-executive directors is a member of more than three committees of the Board except:

1 David Bailey, who is a member of the Nominations and Remuneration Committees of the Board due to his nomination to the Board in accordance with the articles of association of Network Rail Limited as the Special Director. Further by request of the SRA he is also a member of the Audit and Safety, Health and Environment Committees.

2 Adrian Montague is a member of the Audit Committee and Chairman of the Treasury Committee given his significant financial experience and the Remuneration Committee and the Property Board due to his particular knowledge in these fields.

There is a programme for induction for new directors to ensure that they are fully conversant with their responsibilities as a director and with the business of Network Rail. Additional personal development is also available to all directors.

Corporate Governance Report

Board processes

The Board is scheduled to meet ten times a year and a format is prepared and agreed which ensures that the directors are able to review corporate strategy regularly together with the operations and results of the business units within the Company and to discharge their other duties. Certain matters are formally reserved for decision by the Board including approval of the interim and year-end financial statements of the Company, the Business Plan, material changes to the network licence and pension matters. Matters delegated to Executive Committee or below are also subject to financial limits above which Board approval is required.

The Board has established seven standing committees with defined terms of reference as follows:

The **Safety, Health and Environment Committee** comprises four non-executive directors and the Chief Executive. The Committee's role is to monitor the safety, health and environmental responsibilities of the Company. In addition to this Committee, reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Moreover, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

The **Audit Committee** comprises four non-executive directors and its role is to satisfy itself that financial information is accurate and that financial controls and systems of risk management are robust and defensible. Details of the work of the Committee are set out on page 24.

The **Remuneration Committee** comprises all seven non-executive directors who determine appropriate levels of directors' and senior executives' remuneration including their incentive scheme. The Committee's report is contained in pages 14 to 20.

The **Nominations Committee** comprises three non-executive directors who are responsible for recommending the appointment of new directors and other significant functions. Details of the work of the Committee are set out on page 23.

The **Treasury Committee** was established in January 2004 and comprises three directors, including one non-executive director. This committee's role is to review and satisfy itself as to the appropriateness of proposed treasury transactions including banking, cash management, debt raising and management and investment management.

The **Executive Committee** is chaired by the Chief Executive and comprises all the executive directors and a number of senior executives. This Committee manages the functions of the business and implements the operational and financial objectives set by the Board.

The **Network Rail Property Board** comprises the Deputy Chairman as Chairman, four of the executive directors, the Company's Railway Estates Director and, selected for their expertise in property matters, three external non-executives and a special adviser. The Committee's role is to direct the Company's strategic development of its property portfolio.

The following table identifies the number of Board and main committee meetings held between 1 April 2003 and 31 March 2004 and the attendance record of individual directors:

	Board meetings	Nominations Committee	Remuneration Committee	Audit Committee	Safety Health and Environment Committee	Executive Committee	Treasury Committee	Property Board
Number of meetings held	10	4	7	4	6	10	1[2]	9
Directors								
J Armitt	10	–	7*	2*	5	8	1	7
D Bailey	10	4	7	3	5	–	–	–
R den Besten[1]	6 of 6	–	3 of 3	1 of 2	–	–	–	–
J Cornell	10	4	7	–	6	–	–	–
I Coucher	10	–	–	–	–	10	–	8
P Henderson	9	–	–	–	–	7	–	7
R Henderson	10	–	–	4*	–	10	1	7
C Hoppe	9	–	6	–	5	–	–	–
C Leah	9	–	–	–	5*	9	–	–
I McAllister	10	4	7	–	–	–	–	–
A Montague	10	–	7	4	–	–	1	9
R Sayers	10	–	7	4	5	–	–	–

1 Between 24 September 2003 (on which date Robert den Besten joined the Board of Directors) and 31 March 2004.
2 Established in January 2004.
* As attendee.

The Group Company Secretary is the secretary to the Board, the above Committees and the Property Board. All directors have access to the Group Company Secretary for advice on corporate governance, Board procedure and compliance matters. The Group Company Secretary is also responsible for facilitating the induction and professional development of Board members and ensuring that good information flows within the Board, its Committees and between the non-executive directors and senior management.

There is a procedure whereby directors, wishing to do so in furtherance of their duties, may take independent professional advice at Network Rail's expense.

Information about the directors' remuneration is given in the Directors' Remuneration Report on pages 18 and 19 of this report and details of how the Board reviews financial and operational controls and risk management generally are shown on page 24 and in the financial review on pages 7 and 8.

Nominations Committee

The Nominations Committee is chaired by Ian McAllister and comprises two further non-executive directors – Jim Cornell and David Bailey.

The role of the Committee includes:

- reviewing regularly the size, structure and composition of the Board (including use of suitable periodic performance evaluation processes)
- making recommendations to the Board on any adjustments that may be deemed necessary and feasible (including on matters such as succession planning)
- evaluating the balance of skills, knowledge and experience of the Board
- identifying and nominating candidates for appointment as director for approval by the Board
- satisfying itself that appropriate succession plans and processes are in place for the appointments to the Board and to senior management positions

During the financial year 2003-04 the Committee has met to consider performance evaluation of the Board, its committees and directors, succession planning and candidates for appointment as non-executive directors of the Company.

In particular the performance of the Board and each of its committees and directors has been reviewed during the year to assess whether each of these has been contributing effectively and demonstrating commitment to their role. The Nominations Committee commissioned consultants, Egon Zehnder International, to assist this review by conducting interviews with each director during which the function of each of the Board, the committees and each director was considered. The results of the interviews were presented by Egon Zehnder to the Board jointly and each director individually. The Chairman of the Board and the other members of the Nominations Committee have also reviewed the findings of the review and have satisfied themselves as to the performance of the Board, its committees and the directors.

The process for the selection of candidates for appointment to the Board included commissioning Egon Zehnder International to conduct a search for suitable candidates for a non-executive director, identifying the objective criteria on which the candidates were to be considered and interviewing candidates. Through this process Robert den Besten was selected and nominated by the Committee for approval by the Board. The nomination was approved and Robert den Besten took up the role on 24 September 2003.

Details of the number of times the Committee met during the year are set out on page 22 of the Corporate Governance Report above.

Relations with Members and stakeholders

The Annual General Meeting (AGM) for Members of the Company's ultimate parent company Network Rail Limited was held in July 2003, at which the Members were advised of developments within the Company. The Company also provided presentations on certain aspects of the business to assist Members in their understanding. In addition, other meetings, informal briefings and visits for Network Rail Limited's Members were held, to give them opportunities to discuss all aspects of the business. Members also receive periodic newsletters and press releases and other information relating to the Company.

The next AGM will be held in July 2004.

The Chief Executive, the Deputy Chief Executive and the other executive directors have regular meetings with representatives of the SRA, the ORR, train operators, freight operators and other rail stakeholders. Certain of the non-executive directors have also met with the SRA and the ORR.

Corporate Governance Report

Audit Committee's activities

The Audit Committee is chaired by Ross Sayers (a Fellow of the Institute of Chartered Accountants of New Zealand) and is composed exclusively of independent non-executive directors. The external auditors, the Group Finance Director, the Group Financial Controller and the Head of Internal Audit normally attend meetings of the Committee. The Committee also periodically meets with the external auditors without management present.

The main responsibilities of this Committee are to monitor the integrity of the financial reporting and the audit process and to monitor that an effective management and internal control system is maintained. The Audit Committee's work in fulfilling its responsibilities includes:

1 Reviewing the internal control framework and the register of financial and non-financial risks (so far as these are not reviewed by other Board committees such as the Safety, Health and Environment Committee);

2 Monitoring financial reporting practices including considering accounting policies and practices and compliance with accounting standards;

3 Reviewing significant accounting estimates and judgements;

4 Reviewing interim and annual financial statements before publication;

5 Considering and making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration;

6 Setting a policy whereby employment of the external auditors for work for Network Rail other than audit services or tax consulting services is prohibited, as is submission of tenders to the Network Rail Group in response to EU notices for other services without approval by the Audit Committee; and

7 Reviewing the internal and external audit process including the scope of its planned audit and subsequently its audit findings.

Following its recent review of the external auditors the Audit Committee has recommended to the Board that it proposes at the AGM in July 2004 the re-appointment of Deloitte & Touche LLP as auditors until the conclusion of the AGM in 2005.

Internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives providing reasonable (rather than absolute) assurance against material misstatement or loss.

The Board has formally established a policy, strategy and process for the identification, evaluation and ongoing review of the significant risks faced by the Group. The executive directors have identified and agreed the key risks faced by Network Rail in meeting its future business objectives and are developing further the control framework and management plans for the mitigation of key risks.

Ongoing steps are being undertaken to embed risk management into the Company's operations including:

- ensuring that the Company reorganisation programme provides a structure which supports further integration of risk management into the operations of the business
- the development of a revised training programme on management competency in identifying, evaluating and managing risk
- the implementation of an internal audit review process to confirm the effectiveness of the integrated risk management system

There are established internal control procedures for managing the risks faced by the Group, of which the key elements are:

- regular structured reviews of business units by the executive directors
- a framework of delegated authority and accountability
- the pre-approval of business plans, budgets and major investment
- the monthly reporting of financial results, safety and other operational key performance indicators (KPIs)

The Company also has an established process by which employees may, in confidence, raise concerns about possible improprieties (including whistle blowing procedures).

The Audit Committee receives regular reports from both the internal and external auditors who have direct access to the Chairman of the Audit Committee. Recommendations to improve the internal control framework are reported to the Audit Committee through this process.

The directors keep the system of internal control under review and have done so throughout the year. Actions to continue the improvement in the internal control framework referred to in last year's governance statement have been taken including:

- the implementation of a new suite of controls to manage investment including the Guide to Railway Investment Projects (GRIP)
- the complete review and reissue of the financial regulations and the implementation of a formal compliance review process
- the consolidation of standardised monthly business reviews with business units

Notwithstanding this the Board recognises that there is an ongoing need to build on these initiatives and, in particular, to improve further compliance with the control framework.

Moreover during the year the Company has been preparing a major restructuring programme, including bringing maintenance in-house that will continue into the next financial year. The Board recognises the risks that this change programme imports to the Group and has put in place an appropriate governance structure to ensure that the risks of transition are identified and managed. The new organisation structure will support and strengthen the Company's risk management policy and process.

Compliance with the Combined Code

Save as indicated in this report the directors believe that, where practical, having regard to its corporate structure, the Company has implemented compliance with the revised Code dated July 2003 and it has complied with the current 1998 Code provisions where the requirements are of a continuing nature.

Going concern

The directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future and are financially sound. For this reason they continue to adopt the going concern basis in preparing the accounts.

Statement of directors' responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report

to the Members of Network Rail Infrastructure Limited

We have audited the financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2004 which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses, and the related notes 1 to 31. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's Members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's Members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's Members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the Annual Report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

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

The directors have also asked us to review whether the Corporate Governance Report reflects the Company's compliance with the seven provisions of the Hampel Combined Code specified for our review as if the listing rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' Report and the other information contained in the Annual Report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 2004 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
2 June 2004

Consolidated profit and loss account

for the year ended 31 March 2004

	Note	2004 Before exceptional items £m	2004 Exceptional items (note 5) £m	2004 Total £m	2003 Before exceptional items £m	2003 Exceptional items (note 5) £m	2003 Total £m
Turnover	2	2,606	–	2,606	2,965	–	2,965
Operating costs	4	(3,207)	(157)	(3,364)	(2,862)	(23)	(2,885)
Operating (loss)/profit	5	(601)	(157)	(758)	103	(23)	80
Profit on sale of properties		40	–	40	45	–	45
Net interest payable	8	(352)	–	(352)	(309)	(106)	(415)
Loss on ordinary activities before taxation		(913)	(157)	(1,070)	(161)	(129)	(290)
Tax credit on loss on ordinary activities	9	298	38	336	3	32	35
Loss on ordinary activities after taxation and retained loss for the year	23	(615)	(119)	(734)	(158)	(97)	(255)

All amounts relate to continuing activities.

Consolidated statement of total recognised gains and losses

for the year ended 31 March 2004

	Note	2004 £m	2003 £m
Loss for the financial year		(734)	(255)
Revaluation of the railway network	11	2,571	935
Revaluation of investment properties	11	7	–
Total gains and losses recognised for the year		1,844	680

Historical cost profits and losses are disclosed in note 24 to the financial statements.

Balance sheets

31 March 2004

	Note	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
Fixed assets					
Intangible fixed assets	10	81	25	–	–
Tangible fixed assets	11	18,576	12,835	18,560	12,819
Investments	12	–	–	49	49
		18,657	12,860	18,609	12,868
Current assets					
Stocks	13	77	38	77	38
Debtors: amounts falling due within one year	14	659	1,693	850	1,883
Debtors: amounts falling due after more than one year	14	28	31	28	31
		687	1,724	878	1,914
Current asset investments	15	147	178	5	56
Cash at bank and in hand		8	8	8	8
		919	1,948	968	2,016
Creditors: amounts falling due within one year	16	(7,065)	(10,274)	(7,066)	(10,350)
Net current liabilities		(6,146)	(8,326)	(6,098)	(8,334)
Total assets less current liabilities		12,511	4,534	12,511	4,534
Creditors: amounts falling due after more than one year	17	(8,550)	(2,133)	(8,550)	(2,133)
Provisions for liabilities and charges	19	(369)	(653)	(369)	(653)
Net assets		3,592	1,748	3,592	1,748
Capital and reserves					
Called-up share capital	21	160	160	160	160
Revaluation reserve	22	3,917	1,339	3,917	1,339
Share premium reserve	22	85	85	85	85
Other reserves	22	1,209	1,209	1,209	1,209
Profit and loss account	22	(1,779)	(1,045)	(1,779)	(1,045)
Shareholders' funds		3,592	1,748	3,592	1,748
Attributable to equity shareholders		3,432	1,588	3,432	1,588
Attributable to non-equity shareholders		160	160	160	160

These financial statements were approved by the Board of Directors on 2 June 2004.

Signed on behalf of the Board of Directors:

John Armitt Director **Ron Henderson** Director

Consolidated cash flow statement

for the year ended 31 March 2004

	Note	2004 £m	2003 £m
Net cash inflow from operating activities	27	**1,078**	192
Returns on investments and servicing of finance			
Interest received		**7**	15
Interest paid		**(428)**	(422)
Net cash outflow from returns on investments and servicing of finance		**(421)**	(407)
Capital expenditure			
Purchase of tangible and intangible fixed assets		**(3,844)**	(3,043)
Sale of tangible fixed assets		**40**	47
Capital element of finance lease receipts		**7**	7
Capital grants received		**41**	55
Net cash outflow from capital expenditure		**(3,756)**	(2,934)
Acquisitions and disposals			
Purchase of subsidiaries		**–**	(38)
		(3,099)	(3,187)
Management of liquid resources			
Sale of short-term investments		**31**	40
Financing			
Issue of ordinary share capital		**–**	85
New loans		**10,351**	8,139
Capital element of finance leases repaid		**–**	(3)
Repayment of loans		**(7,283)**	(5,086)
Net cash inflow from financing		**3,068**	3,135
Decrease in cash in the year	28 & 29	**–**	(12)

Notes to the financial statements

for the year ended 31 March 2004

1 Basis of preparation and accounting policies

Principal accounting policies
The financial statements have been prepared in accordance with applicable United Kingdom accounting standards. The principal accounting policies adopted are described below.

Accounting convention and basis of consolidation
The financial statements have been prepared under the historical cost convention as modified by the revaluation of the railway network to the lower of its depreciated replacement cost (DRC) and value in use and the revaluation of investment properties to open market value.

The consolidated financial statements incorporate the financial statements of the Company and all of its subsidiaries.

Turnover
Turnover represents amounts due for the year derived from the management and provision of assets for the use in the operation of a railway and property rental income, and the sale of commercial and development properties net of value added tax, and takes account of any penalties or bonuses in respect of the year.

Performance regimes
Supplements to the access charges and bonuses receivable from, less penalties payable to, customers are included in turnover. Additional contract amounts and bonuses payable to, less penalties receivable from, suppliers and the Office of the Rail Regulator are included in operating expenditure.

Tangible fixed assets
Fixed assets – the railway network
The railway network is valued at depreciated replacement cost. A revaluation of the assets that comprise the railway network and their estimated remaining weighted average useful economic lives is performed annually with external verification of the valuation and asset lives carried out, where required at least every five years.

The railway network is written down in the financial statements to its value in use where there has been an impairment in value.

Depreciation
The railway network is depreciated on a straight line basis over its estimated remaining weighted average useful economic life.

The estimated remaining weighted average useful economic life of the network is currently 25 years.

Investment properties
Investment properties comprise offices and other non-specialist properties that are not occupied by the Company where the interest is completely separable from the railway infrastructure, and which are held for their investment potential. Investment properties are revalued periodically in accordance with SSAP19, "Accounting for Investment Properties". Any surplus or deficit on revaluation is transferred to the revaluation reserve unless a deficit below original cost, or its reversal, on an individual investment property is expected to be permanent, in which case it is recognised in the profit and loss account for the year.

No depreciation is provided in respect of freehold investment properties or leasehold investment properties with over 20 years to expiry. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated.

The directors consider that this accounting policy results in the financial statements giving a true and fair view. Such properties are held for investment and not for consumption. The directors consider that to depreciate them would not give a true and fair view. Depreciation is one of many factors reflected in the annual valuation and the amount that might otherwise have been shown cannot be separately identified or quantified.

Intangible fixed assets
Intangible fixed assets are valued at cost on acquisition and are amortised in equal annual amounts over their estimated useful life. Concessions are amortised over the length of their contractual agreement.

Fixed asset investments
Fixed asset investments including investments in subsidiaries are stated at cost less provision for impairment.

Notes to the financial statements

for the year ended 31 March 2004

1 Basis of preparation and accounting policies continued

Grants

Grants and other contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited to the profit and loss account over the estimated useful economic life of the asset. Revenue grants earned for the management and provision of railway network assets are credited to the profit and loss account in the period to which they relate.

Deferred taxation

Deferred taxation is provided on timing differences arising from the different treatments for accounts and taxation purposes of transactions and events recognised in the financial statements of the current year and previous years. Deferred taxation is calculated at the rates at which it is estimated that tax will arise. Deferred taxation is not discounted.

Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.

Long-term contracts

Long-term contract work in progress is stated at cost plus, where the outcome can be assessed with reasonable certainty, estimated profits attributable to the state of completion, less provision for any known or anticipated losses and progress payments receivable on account. Contract provisions in excess of amounts recoverable are included in provisions for liabilities and charges.

Advance and progress payments are included under creditors to the extent that they exceed the related work in progress. Work in progress is shown within stocks, except where it includes attributable profit when it is shown under debtors as amounts recoverable under contracts.

Stocks

Stocks and work in progress, other than on long-term contracts, are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and production overheads appropriate to the relevant stage of production. Net realisable value is based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

Current asset investments

Current asset investments are stated at the lower of cost and net realisable value.

Leases

The net investment in assets leased to third parties is included in debtors. Income from finance leases is allocated to accounting periods so as to give a constant rate of return on the net investment in the lease.

Assets obtained under finance leases and hire purchase contracts are included in tangible fixed assets. The finance charges are allocated over the period of the lease in proportion to the capital element outstanding. Operating lease rentals are charged to income in equal annual amounts over the lease term.

Pension costs

The expected cost of providing pensions, as calculated periodically by professionally qualified actuaries, is charged to the profit and loss account so as to spread the cost over the service lives of employees in the scheme in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll. Differences between the amount charged to the profit and loss account and payments made to schemes are treated as assets or liabilities in the balance sheet. Further details are given in note 7 to the financial statements.

Research and development

Research and general development expenditure is charged to the profit and loss account as incurred.

Expenditure on the development of specific projects is carried forward when its recoverability can be foreseen with reasonable certainty.

1 Basis of preparation and accounting policies continued

Debt

Discount of principal and fees associated with the issue of debt instruments are accounted for as a reduction in the balance outstanding of the debt and are amortised over the life of the debt. The amortisation charge is included within interest payable.

Derivative financial instruments

The Company uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Group does not hold or issue derivative financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are deferred and recognised in the profit and loss account only when the hedged transaction has itself been reflected in the Group's financial statements.

For an interest rate or cross currency swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the period of these contracts.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedge position is eliminated, the instrument is marked to market and any resulting profit and loss recognised at that time.

Capitalised interest

Interest is capitalised during the period of construction on all projects to the extent that the project is not financed by the contractor. The average rate used during the year was 4.09% (2002-03: 4.67%).

Foreign exchange

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates ruling on the dates payment takes place, unless related or matching forward foreign exchange contracts have been entered into, then the rates specified in the relevant contracts are used. All exchange differences are included in the profit and loss account.

Property clawback

Train operating companies are entitled to a share of any property gains and income (above certain thresholds). The total clawback is allocated between the profit and loss account and the statement of total recognised gains and losses according to the treatment of the excess gains.

2 Turnover

	2004 £m	2003 £m
Passenger franchise revenue	1,899	1,666
SRA revenue grants	452	996
Freight revenue	68	83
Property rental income	167	159
Other income	20	61
	2,606	2,965

All turnover relates to the UK.

All (losses)/profits arose from the Group's principal activity, the management of the national rail infrastructure.

Notes to the financial statements

for the year ended 31 March 2004

3 Performance regimes

The net effect of the performance regimes on the results of the Group for the year was as follows:

	2004 £m	2003 £m
Included in turnover		
Access charge supplements	48	47
Net penalty payable to customers	(396)	(442)
	(348)	(395)

4 Operating costs

	2004 Before exceptional items £m	2004 Exceptional items (see note 5) £m	2004 Total £m	2003 Before exceptional items £m	2003 Exceptional items (see note 5) £m	2003 Total £m
Employee costs (note 6)	647	–	647	561	–	561
Own work capitalised	(283)	–	(283)	(282)	–	(282)
Capital grants amortised	(10)	–	(10)	(13)	–	(13)
Other external charges	2,311	105	2,416	2,257	23	2,280
Depreciation and other amounts written off tangible fixed assets	643	52	695	438	–	438
Other operating income	(101)	–	(101)	(99)	–	(99)
	3,207	157	3,364	2,862	23	2,885

Included within other external charges are infrastructure maintenance costs of £1,408m (2002-03: £1,184m).

5 Operating (loss)/profit

	2004 £m	2003 £m
Operating (loss)/profit is stated after charging:		
Rentals under operating leases		
Plant and machinery	5	5
Other	72	68
Research and development	2	8
Depreciation and other amounts written off tangible fixed assets	695	438
Amortisation of intangible fixed assets	1	1
Auditors' remuneration		
Statutory audit services	0.4	0.4
Other compliance work	0.1	0.2
Other non-audit fees	0.2	0.3
Exceptional items		
Fees and costs payable to administrators	–	23
Transitional reorganisation costs	105	–
West Coast Route Modernisation abortive costs	52	–
	157	23

6 Employees

	2004 £m	2003 £m
Employee costs during the year (including directors)		
Wages and salaries	**532**	449
Social security costs	**48**	35
Pension costs	**67**	77
	647	561

	Number	Number
Average number of persons employed		
Management and operation of railway	**15,015**	13,240
Number of persons employed		
At 31 March	**16,574**	13,774

Included within the total employee cost above is the remuneration of the directors totalling £3.3m (2002-03: £4.1m) details of which can be found within the Directors' Remuneration Report on pages 18 and 19.

7 Pension costs

The principal pension scheme in which the Group participates is the RPS, which was established by statutory instrument, commenced on 1 October 1994 and is a funded defined benefit arrangement. The assets and liabilities under the predecessor scheme, the British Rail Pension Scheme (BRPS), were transferred to the RPS on that date. The RPS is an industry-wide scheme for all eligible employees within the railway industry. There are different sections within it for different employers. The assets and liabilities of each section are identified separately from those of the other sections. The Group has its own section, the Network Rail Shared Cost Section (the "Network Rail Section"). This scheme, the assets of which are held separately from the Group, is contributory and provides pensions related to pay at retirement.

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned amongst the various sections of the RPS in accordance with the methods and assumptions specified in The Railways Pensions (Transfer and Miscellaneous Provisions) Order 1994 (the "Transfer Order") which effected the transfer. The amount credited to the Network Rail Section included a share of the surplus at that time.

It was announced on 6 November 2003 that the Network Rail Section of the RPS would be closed to new members from 1 April 2004. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the closure of the Network Rail Section. In addition to closing the scheme to new entrants the Company announced its decision to cap its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees and to dispense with matching for new employees. The Company will continue to match regular contributions but will not increase them in cash terms in the future.

With effect from 1 April 2004 the Company introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). This scheme is the only Company-sponsored pension offered to all new employees of Network Rail, except those who have the legal right to join the RPS. Any employee who wishes to transfer from the Network Rail Section to the NRDCPS is entitled to do so.

On 2 October 2003 the Company announced a programme of redundancies aimed at reducing personnel in managerial grades. Approximately 600 employees left the Company following this announcement and pension benefits were provided for these employees until 31 December 2003.

During the year the Company brought three infrastructure maintenance contracts in-house. The result of this was the addition of 2,374 employees to the Network Rail Section of the RPS prior to 31 March 2004. On 24 October 2003 the Company announced its intention to bring all remaining maintenance contracts in-house. The Network Rail Section of the RPS was joined by 1,883 employees on 1 April 2004 and it is assumed that an additional 8,500 will join by 31 July 2004. It is anticipated that approximately 3,100 additional transferred employees are not currently members of the RPS in their current employer's section and thus will be offered membership of the NRDCPS.

7 Pension costs continued

Infrastructure maintenance contract staff currently in their employer's section of the RPS will be given the option to transfer their accrued benefits into the Network Rail Section of the RPS. If members agree to transfer their benefits to the scheme, then depending on the transfer value agreed, there may be a surplus or deficit generated in respect of past service.

The impact of all the above items other than the redundancies in December 2003 will be included in the accounts for the year ended 31 March 2005.

A full actuarial valuation of the Network Rail Section was carried out by the scheme actuary at 31 December 2001 and adjusted to 31 March 2003 by the Group's pension adviser, a qualified independent actuary. The total contribution rate payable under the RPS is normally split in the proportion 60:40 between the Group and the members. At the start of the year, the Group and members were paying contributions of 14.25% and 6.5% of section pay respectively. With effect from 1 January 2004 the members' rate changed to 8.0% and this is due to change to 9.5% on 1 January 2005. These rates were determined following the funding valuation carried out by the scheme actuary as at 31 December 2001. If a surplus or deficit arises, the provisions in the RPS rules mean that the Company and members usually benefit from or pay for this respectively in the proportion 60:40.

Based on the adjusted valuation, the Group's pension charge for the year ended 31 March 2004 was £67m (2002-03: £77m). The pension provision as at 31 March 2004 is £59m (2003: £41m).

The independent actuary has assessed the charge in respect of pension provision for the Group using the following market-related assumptions.

The principal assumptions used in establishing the pension cost for the year were inflation of 2.90% per annum, an investment return of 5.50% per annum and pay inflation of 4.65% per annum. Assets have been taken at market value. Liabilities and the contribution rate have been assessed using the projected unit credit method. The Network Rail Section's funding level was assessed on this basis to be 82.5% of its liabilities as at 31 March 2004.

FRS17 pension disclosures

The pension cost figures in these financial statements comply with the current pension cost accounting standard SSAP24, "Accounting for Pension Costs". A new pension cost accounting standard, FRS17, "Retirement Benefits", must be used for the figures that will be shown in the financial statements for the year ended 31 March 2006 and subsequent years. Under transitional arrangements the Group is required to disclose the following information about the scheme and the figures that would have been shown under FRS17 in the current balance sheet, profit and loss account and statement of total recognised gains and losses.

A full actuarial valuation of the approved scheme was carried out at 31 December 2001 and adjusted to 31 March 2004 for FRS17 disclosure purposes by a qualified independent actuary.

The major assumptions used by the actuary were (in nominal terms):

	At 31 March 2004 % pa	At 31 March 2003 % pa	At 31 March 2002 % pa
Real rate of increase in salaries	**4.65**	5.10	5.25
Rate of increase to pensions in payment	**2.90**	2.60	2.75
Discount rate	**5.50**	5.40	6.00
Inflation assumption	**2.90**	2.60	2.75

7 Pension costs continued

The assets in the scheme and the expected rate of return calculated on the basis of the above assumptions by the independent actuary were:

	Long-term rate of return expected at 31 March 2004 %	Value at 31 March 2004 £m	Long-term rate of return expected at 31 March 2003 %	Value at 31 March 2003 £m	Long-term rate of return expected at 31 March 2002 %	Value at 31 March 2002 £m
Equities	6.35	996	6.12	759	6.92	892
Bonds	4.35	177	4.12	103	4.92	238
Property	6.35	85	6.12	75	6.92	60
Total market value of assets		1,258		937		1,190
Present value of scheme liabilities		(1,525)		(1,430)		(1,327)
Deficit in the scheme		(267)		(493)		(137)
Company's share of the deficit (60%)		(160)		(296)		(82)
Related deferred tax asset		48		89		24
Net pension liability		(112)		(207)		(58)

If the entire pension liability was recognised in the financial statements, the Group's net assets and profit and loss reserve would be as follows:

	Value at 31 March 2004 £m	Value at 31 March 2003 £m
Net assets excluding SSAP24 pension liability	3,651	1,789
Net FRS17 pension liability	(112)	(207)
Net assets including FRS17 pension liability	3,539	1,582
Profit and loss reserve excluding SSAP24 pension liability	(1,720)	(1,004)
Net FRS17 pension liability	(112)	(207)
Profit and loss reserve including FRS17 pension liability	(1,832)	(1,211)

Analysis of amount that would have been charged in the profit and loss account:

	2004 £m	2003 £m
Current service cost	54	45
Past service cost	–	–
Total charge to operating profit	54	45
Expected return on pension scheme assets	57	78
Interest on pension scheme liabilities	(79)	(78)
Total charge to net finance cost	(22)	–

7 Pension costs continued

Analysis of the amount that would have been recognised in the statement of total recognised gains and losses:

	2004 £m	2003 £m
Actual return less expected return on assets	203	(360)
Experience gains and losses on liabilities	–	–
Changes in assumptions	50	(26)
Change in expected employee contribution towards shared cost of deficit	(90)	197
Actuarial gain/(loss)	163	(189)
Movement in deficit in the year		
Deficit in scheme at beginning of the year	(296)	(82)
Current service cost	(54)	(45)
Contributions	49	26
Net finance cost	(22)	–
Actuarial gain/(loss)	163	(189)
Adjustment due to shared nature cost	–	(6)
Company's share of the deficit in the scheme at end of the year	(160)	(296)

History of experience gains and losses:

	2004 £m	2003 £m
Difference between expected and actual return on scheme assets	203	(360)
Percentage of scheme assets	16.1%	(38.4)%
Experience gains and losses	–	–
Percentage of scheme liabilities	0%	0%
Total amount recognised in the statement of total recognised gains and losses	163	(189)
Percentage of scheme liabilities	10.7%	(13.2)%

8 Net interest payable

	2004 £m	2003 £m
Interest payable and similar charges		
On bank loans and overdrafts	55	177
Interest paid on loan from immediate parent company	265	163
Interest paid on loans from other group companies	100	–
On other loans	18	48
Exceptional interest payments on early termination of debt	–	106
Total	438	494
Interest capitalised	(72)	(63)
	366	431
Interest receivable	(14)	(16)
Net interest payable	352	415

9 Tax credit on loss on ordinary activities

	2004 £m	2003 £m
Analysis of credit in the year		
Current UK corporation tax at 30%:		
Overprovision in respect of prior years	–	6
Total current tax credit	–	6
Deferred tax at 30%:		
Credit in respect of prior years	98	–
Credit for timing differences arising in the year	238	29
Total deferred tax	336	29
Tax credit on loss on ordinary activities	336	35

Factors affecting the current tax credit for the year
The tax for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2004 £m	2003 £m
Loss on ordinary activities before tax	(1,070)	(290)
Loss on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2002-03: 30%)	(321)	(87)
Accelerated capital allowances	(249)	(171)
Tax losses carried forward	493	189
Tax losses carried back	7	–
Short-term timing differences	(6)	11
Adjustments in respect of prior years	–	(6)
Permanent differences	76	58
Total current tax credit	–	(6)

10 Intangible fixed assets

	Concessions £m
Cost	
At 1 April 2003	26
Additions	57
At 31 March 2004	83
Accumulated amortisation	
At 1 April 2003	(1)
Charge for the year	(1)
At 31 March 2004	(2)
Net book value	
At 1 April 2003	25
At 31 March 2004	81

On 26 September 2003 Network Rail (CTRL) Limited, a wholly owned subsidiary of the Company, acquired the assets of the Channel Tunnel Rail Link operations, maintenance and renewal business for cash consideration of £57m.

Notes to the financial statements

for the year ended 31 March 2004

11 Tangible fixed assets: Group

	At 1 April 2003 £m	Additions £m	Depreciation charge for the year £m	Revaluation during the year £m	At 31 March 2004 £m
The railway network at valuation	12,764	3,858	(695)	2,571	**18,498**
Investment properties at valuation	71	–	–	7	**78**
	12,835	3,858	(695)	2,578	**18,576**

In the year ended 31 March 2003 Ove Arup and Partners reviewed Network Rail Infrastructure Limited's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of all the assets that comprise the railway network and confirmed in writing to the directors that the basis upon which the assessment has been prepared is appropriate and that the resultant valuations and estimates are reasonable. The directors have reviewed the assessments in the current year and are satisfied that they remain valid and appropriate at 31 March 2004. External verification of the valuations and asset lives will be performed at least every five years.

The depreciation charge for any year is calculated using the average fixed asset net book value for the year and the estimated weighted average remaining useful economic life of the railway network. The estimated remaining weighted average useful economic life of the network is currently 25 years.

The depreciated replacement cost of the railway network materially exceeds its value in use and has therefore been impaired down to its value in use (which primarily comprises the discounted future cash flows expected to arise from the Regulatory Asset Base).

The revaluation in the current year represents an increase in the railway network value in use, as a result of the Regulator allowing certain adjustments to the Regulatory Asset Base to reflect the additional expenditure on operating, maintaining and renewing the network in the three years ended 31 March 2004.

As at 31 March 2004, the comparable net book value of the railway network according to the historic cost convention cannot be accurately determined as the information is not available.

The book value of the railway network in the Group financial statements includes £16m of railway arches held by the Company's wholly owned subsidiary Network Rail (Spacia) Limited.

The freehold, heritable, feuhold and long leasehold investment properties were valued as at 31 March 2004 at £78m (31 March 2003: £71m). The valuations were undertaken on the basis of open market value in accordance with the appraisal and valuation manual of the Royal Institution of Chartered Surveyors. External valuers CB Richard Ellis valued 14 of the 74 investment properties (representing 94% by value of the portfolio). The remaining properties were valued by the Director of Sales, Railway Estates, a chartered surveyor.

As at 31 March 2004, the comparable amount of the investment properties according to the historical cost convention is determined as £13m (31 March 2003: £13m).

12 Investments: Company

	At cost £m
Investments in subsidiaries at 1 April 2003 and 31 March 2004	49

The Company's subsidiaries are set out below:

Directly owned	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (CTRL) Limited	England	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail (Spacia) Limited	England	100%	Property letting
Network Rail (Stations) Limited	England	100%	Dormant
Network Rail (Projects) Limited	England	100%	Dormant
Network Rail (Property) Limited	England	100%	Dormant
Spacia (2002) Limited	England	100%	Dormant
Network Rail Defined Contribution Pension Scheme Trustee Limited	England	Company limited by guarantee	Administration of defined contribution pension scheme
Shares held by a trustee			
Network Rail MTN Finance PLC	England	Shares held by HSBC Trustee (C.I.) Limited	Administration of Medium Term Note programme

13 Stocks

	2004 Group and Company £m	2003 Group and Company £m
Raw materials and consumables	48	25
Properties in the course of development	1	1
Long-term contract balances		
Net cost	35	18
Applicable payments on account	(7)	(6)
	77	38

Notes to the financial statements

for the year ended 31 March 2004

14 Debtors

	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
Amounts falling due within one year				
Trade debtors	131	285	129	285
Capital grants receivable	3	1	3	1
Other debtors	231	191	427	381
Prepayments and accrued income	291	1,209	288	1,209
Net investment in finance leases	3	7	3	7
	659	1,693	850	1,883
Amounts falling due after more than one year				
Net investment in finance leases	28	31	28	31
	687	1,724	878	1,914
Net investment in finance leases comprises:				
Total lease payments receivable	45	54	45	54
Less: finance charges allocated to future periods	(14)	(16)	(14)	(16)
	31	38	31	38

Aggregate rentals receivable in respect of finance leases for the Group and Company were £10m (2002-03: £11m).

15 Current asset investments

	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
Short-term liquid investments including money market deposits	147	178	5	56

16 Creditors: Amounts falling due within one year

	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
Bank loans and overdrafts (see note 18)	37	11	37	11
Loan from immediate parent company (see note 18)	949	8,139	949	8,139
Loans from other group companies (see note 18)	3,926	–	3,926	–
Payments received on account	47	24	47	24
Trade creditors	583	687	579	687
Amounts owed to other group companies	5	11	5	11
Taxation and social security	27	–	27	–
Other creditors	106	48	112	124
Capital grants deferred income	–	10	–	10
Interest due on loan to immediate parent company	16	110	16	110
Other interest accruals	27	27	27	27
Other accruals and deferred income	1,342	1,207	1,341	1,207
	7,065	10,274	7,066	10,350

17 Creditors: Amounts falling due after more than one year

	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
Bank loans	**1,377**	1,399	**1,377**	1,399
Debt issued under Medium Term Note programme (less unamortised discount of £31m)	**6,425**	–	**–**	–
Loan from other group company	**–**	–	**6,425**	–
Finance leases and hire purchase contracts	**41**	41	**41**	41
Capital grants deferred income	**639**	596	**639**	596
SRA deferred development income	**63**	84	**63**	84
Other accruals and deferred income	**5**	13	**5**	13
	8,550	2,133	**8,550**	2,133

Bank loans are analysed as follows:

	2004 Group and Company £m	2003 Group and Company £m
HSBC Bank due 2017 repayable by instalments	**217**	221
Barclays Bank due 2017 repayable by instalments	**60**	62
Royal Bank of Scotland due 2017 repayable by instalments	**70**	71
European Investment Bank due 2007	**100**	100
6.42% European Investment Bank due 2009	**100**	100
6.42% European Investment Bank due 2011	**100**	100
5.77% European Investment Bank due 2012	**300**	300
5.57% European Investment Bank due 2013	**200**	200
Kreditanstalt für Wiederaufbau due 2013	**130**	145
Kreditanstalt für Wiederaufbau due 2015	**100**	100
	1,377	1,399

Debt issued under Medium Term Note programme is analysed as follows:

	2004 Group £m	2003 Group £m	2004 Company £m	2003 Company £m
4⅞% sterling Medium Term Note due 2009 (less unamortised discount of £15m)	**2,235**	–	**–**	–
2⅝% US dollar Medium Term Note due 2008 (less unamortised discount of £3m)	**685**	–	**–**	–
3⅛% euro Medium Term Note due 2009 (less unamortised discount of £11m)	**1,668**	–	**–**	–
Floating rate sterling Medium Term Note due 2006 (less unamortised discount of £1m)	**999**	–	**–**	–
Floating rate euro Medium Term Note due 2007 (less unamortised discount of £1m)	**838**	–	**–**	–
	6,425	–	**–**	–

Notes to the financial statements

for the year ended 31 March 2004

18 Financial instruments

The Group's funding and treasury operations ("Treasury") are co-ordinated and managed in accordance with policies and procedures approved by the Board. Treasury is subject to regular internal audits and does not engage in trades of a speculative nature. The market and legal limitations imposed as a result of the railway administration order have now been lifted.

Counterparty limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty.

The Group has a policy of immediately hedging all identified foreign exchange exposures over £250,000 or equivalent. Since the exit from administration, the Group has hedged its foreign exchange exposures in accordance with this policy.

Unless specifically stated, the following disclosures exclude short-term debtors and creditors. Debts are analysed by repayment date.

	2004 Group £m	2003 Group £m
Due within one year		
Bank loans and overdrafts	37	11
Loan from immediate parent company	949	8,139
Loan from other group company	3,926	–
	4,912	8,150
Due within one to two years		
Bank loans and overdrafts	24	22
Debt issued under Medium Term Note programme	999	–
Finance leases and hire purchase contracts	1	1
	1,024	23
Due within two to five years		
Bank loans and overdrafts	312	196
Debt issued under Medium Term Note programme	5,426	–
Finance leases and hire purchase contracts	2	2
	5,740	198
Due after five years		
Bank loans and overdrafts	1,041	1,181
Finance leases and hire purchase contracts	38	38
	1,079	1,219
Total		
Bank loans and overdrafts	1,414	1,410
Loan from immediate parent company	949	8,139
Loan from other group company	3,926	–
Debt issued under Medium Term Note programme	6,425	–
Finance leases and hire purchase contracts	41	41
	12,755	9,590

18 Financial instruments continued

Interest rates on borrowings

The interest rate exposure on gross borrowings at 31 March 2004 and 2003 was:

				Fixed borrowings	
	Floating borrowings £m	Fixed borrowings £m	**Total £m**	Weighted average interest rate %	Weighted average time for which rate is fixed Years
2004	9,820	2,935	**12,755**	5.12	5.7
2003	8,890	700	**9,590**	5.90	9.0

All borrowings are denominated in or swapped into sterling. The floating rate borrowings are all referenced to London Inter Bank Offered Rate (LIBOR).

To protect further against movements in interest rates the Group has also entered into a number of forward starting sterling denominated interest rate swaps which have a notional amount of £3bn (2003: £nil).

Interest rates on other financial liabilities

The Group has £5m (31 March 2003: £13m) of long-term non interest bearing financial liabilities for which the weighted average period to maturity is 1.5 years (31 March 2003: 1.5 years).

Investment in financial assets

Interest bearing assets at 31 March 2004 and 2003 were:

				Financial assets with fixed rates	
	Floating rate investment £m	Fixed rate investment £m	**Total £m**	Weighted average interest rate %	Weighted average time for which rate is fixed Years
2004	24	162	**186**	5.14	2.7
2003	143	81	**224**	5.94	4.7

The rates achieved on the above floating rate investments are set at the time of investment with reference to indices such as LIBOR.

Included in the above analysis are assets belonging to Network Rail Insurance Limited of £142m (31 March 2003: £121m). Not included in the above analysis are monies held in escrow client accounts of £0.3m (31 March 2003: £1m).

The Group has no long-term non interest bearing financial assets (31 March 2003: £nil).

Committed facilities

At 31 March 2004 and 2003 the Group had the following undrawn committed facilities:

	2004 Drawn £m	**2004 Undrawn £m**	**2004 Total £m**	2003 Drawn £m	2003 Undrawn £m	2003 Total £m
Bridge facility from immediate parent company	**949**	**4,302**	**5,251**	8,438	562	9,000
SRA standby facility A	**–**	**4,000**	**4,000**	–	4,000	4,000
SRA standby facility B	**–**	**–**	**–**	–	3,000	3,000
	949	**8,302**	**9,251**	8,438	7,562	16,000

18 Financial instruments continued

Undrawn committed borrowing facilities expire as follows:

	2004 £m	2003 £m
Within one year	4,302	562
Within one to two years	–	3,000
In more than two years	4,000	4,000
	8,302	7,562

Not included in the above analysis are the £800m European Investment Bank and £245m Kreditanstalt für Wiederaufbau facilities as these were fully drawn as at 31 March 2004.

In addition, the SRA has provided support facilities in respect of the facilities listed below:

- £10bn Medium Term Note programme
- £5.25bn Bridge support facility
- £4bn Commercial Paper programme
- £800m European Investment Bank
- £245m Kreditanstalt für Wiederaufbau

The support facilities provided by the SRA cover amounts payable under the relevant facilities. Aggregate SRA-supported indebtedness under the above facilities may not exceed £17,050m at any given time.

A £1bn liquidity facility is provided by a consortium of banks in support of the £4bn Commercial Paper programme.

Uncommitted facilities

The Group has a £25m overdraft facility and a £25m money market line with its clearing bank.

Fair value

A comparison of current and book values of all the Group's financial instruments at 31 March 2004 and 31 March 2003 is provided below.

	2004 Book value £m	2004 Fair value £m	2003 Book value £m	2003 Fair value £m
Assets/(liabilities)				
Interest-bearing financial assets	186	187	224	224
Debt securities and finance leases	(41)	(41)	(41)	(41)
Short-term borrowings and current portion of long-term debt	(986)	(986)	(8,150)	(8,150)
Loan from other group company	(3,959)	(3,959)	–	–
Debt issued under Medium Term Note programme (before unamortised discount of £31m)	(6,434)	(6,403)	–	–
Cross currency swaps to hedge debt issued under Medium Term Note programme	(22)	(34)	–	–
Long-term bank loans	(1,377)	(1,423)	(1,399)	(1,443)
Forward starting interest rate swaps	–	(11)	–	–
Forward foreign currency contracts	(3)	(5)	–	3
Long-term non-interest-bearing financial liabilities	(5)	(5)	(13)	(13)

18 Financial instruments continued

The assumptions used to estimate fair values of debt and other financial instruments are summarised below:

i) Listed investments are stated at fair value based on their market price at 31 March.
ii) The carrying values of cash and liquid investments approximate to their fair values because of the short-term maturity of these instruments.
iii) For short-term borrowings (uncommitted borrowing, commercial paper and short-term borrowings under the committed facilities) the book value approximates to fair value because of their short maturities.
iv) The fair values of all quoted eurobonds are based on their closing clean mid-market price converted at the spot rate of exchange as appropriate.
v) The fair values of the fixed rate EIB loans have been calculated by discounting their future cash flows at market rates.
vi) For floating rate loans and finance leases, the book value approximates to fair value because of frequent reset of interest rates.
vii) The fair values of foreign currency forward contracts are estimated using market forward exchange rates on 31 March.
viii) The fair values of the sterling interest rate swaps have been estimated by calculating the present value of estimated cash flows.
ix) The fair values of the cross currency interest rate swaps have been estimated by adding the present values of the two sides of each swap. The present value of each side of the swap is calculated by discounting the estimated future cash flows for that side, using the appropriate market discount rates for that currency in effect at the balance sheet date.

Gains and losses on hedges

The Group immediately enters into forward foreign currency contracts to eliminate the currency exposures (in excess of £250,000 equivalent) that arise on purchases denominated in foreign currencies as soon as the exposure is known. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures.

These gains and losses are anticipated to be recognised as follows:

	2004 Gains £m	2004 Losses £m	2004 Total net gains/ (losses) £m	2003 Gains £m	2003 Losses £m	2003 Total net gains/ (losses) £m
Unrecognised gains and losses on hedges at 1 April	3	–	3	–	–	–
Gains and losses arising in the prior year that were recognised in the current year	(2)	–	(2)	–	–	–
Gains and losses arising in the prior year that were not recognised in the current year	1	–	1	–	–	–
Gains and losses arising in the current year that were not recognised in the current year	–	(26)	(26)	3	–	3
Unrecognised gains and losses on hedges at 31 March	1	(26)	(25)	3	–	3
Of which:						
Gains and losses expected to be recognised within one year	1	(14)	(13)	2	–	2
Gains and losses expected to be recognised after more than one year	–	(12)	(12)	1	–	1

Currency analysis of net assets

All material net assets are in sterling.

Market and credit risk

The Group holds a mixture of fixed and floating rate debt. The Group is exposed to upward movements in interest rates because it has floating rate debt in excess of floating rate assets. Interest rate derivatives are used to hedge against rises in interest rates.

The Group is also exposed to credit risk. The Group invests surplus cash and undertakes derivative and foreign exchange transactions with approved counterparties. Each counterparty has a credit limit which is set based upon published credit ratings. These limits are designed to mitigate the concentration of credit risk. They are monitored on a regular basis.

19 Provisions for liabilities and charges: Group and Company

	1 April 2003 £m	Utilised in the year £m	Provision raised £m	**31 March 2004 £m**
Deferred tax (note 20)	518	(336)	–	**182**
Pension	41	(49)	67	**59**
Environmental liabilities	38	(5)	–	**33**
Other	56	(72)	111	**95**
	653	(462)	178	**369**

The Group and Company have provided for the anticipated costs of remedial works on land inherited from the British Railways Board which has suffered contamination, and where contractual or other obligations require the Company to clear up these sites. Following a review of the planned expenditure, it is estimated that the provision will be entirely utilised within two to three years. In addition, the Group and Company have provided against a number of commercial claims from third parties for which settlement is expected to be achieved in the next one to two years.

20 Deferred taxation

	£m
At 1 April 2003	518
Deferred tax credited to the profit and loss account	(336)
At 31 March 2004	182

	2004 £m	2003 £m
Accelerated capital allowances	**1,377**	959
Short-term timing differences	**(19)**	(49)
Tax losses carried forward	**(1,176)**	(392)
Provision for deferred tax	**182**	518

The current rate of corporation tax of 30% (2002-03: 30%) has been used to calculate the amount of deferred taxation. Provision has been made for all deferred taxation assets and liabilities in respect of accelerated capital allowances, short-term timing differences and tax losses carried forward, arising from transactions and events recognised in the financial statements of the current year and previous years.

The amounts of deferred taxation not provided in the financial statements are as follows:

	2004 £m	2003 £m
Rolled over gains	**192**	184
Revaluation of fixed assets	**1,175**	414
Deferred taxation not provided at 30% (2002-03: 30%)	**1,367**	598

The £192m (31 March 2003: £184m) of tax in respect of rolled over gains relates primarily to the gains realised by the British Railways Board which have been deferred through the application of capital gains rollover relief into assets vested in Railtrack PLC (now Network Rail Infrastructure Limited).

There is insufficient historical information to calculate a provision for deferred taxation in respect of the revaluation of fixed assets. However the potential maximum provision would be £1,175m (31 March 2003: £414m).

No provision has been made in respect of deferred taxation in relation to these gains as no liability is expected to arise.

21 Called-up share capital

	2004 Number of shares	2004 £m	2003 Number of shares	2003 £m
Authorised				
Ordinary shares of 0.1p each	50,200,000	–	50,200,000	–
Redeemable shares of £1 each	500,000,000	500	500,000,000	500
		500		500
Called-up, allotted and fully paid				
Ordinary shares of 0.1p each	50,084,937	–	50,084,937	–
Redeemable shares of £1 each	160,000,000	160	160,000,000	160
		160		160

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2003. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect. A condition of the sale of Railtrack PLC to Network Rail Limited was that Railtrack Group PLC would waive all rights to redemption of these shares once the transaction was completed.

22 Group and Company reserves

	Revaluation reserve £m	Share premium £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 April 2003	1,339	85	1,209	(1,045)	1,588
Revaluation of the railway network	2,571	–	–	–	2,571
Revaluation of investment properties	7	–	–	–	7
Retained loss for the financial year	–	–	–	(734)	(734)
At 31 March 2004	3,917	85	1,209	(1,779)	3,432

The loss for the Company for the year was identical to that of the Group.

The revaluation reserve includes £65m relating to investment properties.

23 Reconciliation of movement in shareholders' funds: Group and Company

	2004 £m	2003 £m
Loss for the year	(734)	(255)
Revaluation of the railway network	2,571	935
Revaluation of investment properties	7	–
New share capital subscribed	–	85
Net addition to shareholders' funds	1,844	765
Opening shareholders' funds	1,748	983
Closing shareholders' funds	3,592	1,748

Notes to the financial statements

for the year ended 31 March 2004

24 Historical cost profits and losses

	2004 £m	2003 £m
Loss on ordinary activities before taxation	(1,070)	(290)
Reduction in profit on sale of properties on an historical cost basis	–	(7)
Realisation of property revaluation gains of previous years	–	2
Historical cost loss on ordinary activities before taxation	(1,070)	(295)
Historical cost loss for the year accumulated after taxation	(734)	(260)

The additional depreciation charge on an historical cost basis cannot be accurately determined as the information is not available.

25 Capital commitments

	2004 £m	2003 £m
Capital expenditure commitments contracted for (including the capital value of finance lease commitments) not provided for in these financial statements	2,298	1,873

26 Operating lease commitments

	2004 £m	2003 £m
Land and buildings		
Leases which expire:		
Within one year	1	2
Within two to five years	5	7
After five years	16	16
	22	25
Other		
Leases which expire:		
Within one year	41	40
Within two to five years	7	8
After five years	–	–
	48	48
Total		
Leases which expire:		
Within one year	42	42
Within two to five years	12	15
After five years	16	16
	70	73

27 Reconciliation of operating (loss)/profit to net cash inflow from operating activities

	2004 £m	2003 £m
Operating (loss)/profit	(758)	80
Depreciation and amortisation (net of capital grants amortised)	686	426
(Increase)/decrease in stocks	(39)	10
Decrease/(increase) in debtors	1,033	(499)
Increase in creditors	104	168
Increase in provisions	52	7
Net cash inflow from operating activities	1,078	192

The cash outflow in respect of the exceptional operating items in the year was £7m (2002-03: £nil).

28 Analysis of changes in net debt

	At 1 April 2003 £m	Cash flows £m	Amortisation of discount £m	At 31 March 2004 £m
Cash at bank and in hand	8	–	–	8
Borrowings due within one year	(8,150)	3,335	(97)	(4,912)
Borrowings due after one year	(1,440)	(6,403)	–	(7,843)
Current asset investments	178	(31)	–	147
	(9,404)	(3,099)	(97)	(12,600)

29 Reconciliation of net cash flow to movement in net debt

	2004 £m	2003 £m
Decrease in cash in the year	–	(12)
Cash inflow from increase in debt and lease financing	(3,068)	(3,050)
Cash inflow from decrease in liquid resources	(31)	(40)
Change in net debt resulting from cash flows	(3,099)	(3,102)
New finance leases	–	(2)
Amortisation of discount	(97)	(1)
Movement in net debt in the year	(3,196)	(3,105)
Net debt at 1 April	(9,404)	(6,299)
Net debt at 31 March	(12,600)	(9,404)

Notes to the financial statements

for the year ended 31 March 2004

30 Ultimate parent company and controlling entity

The Group's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee incorporated in Great Britain and registered in England and Wales. The largest and smallest group of undertakings of which the Company is a member and for which Group accounts are drawn up is Network Rail Limited. Copies of that company's financial statements can be obtained by contacting Network Rail Limited at 40 Melton Street, London, NW1 2EE.

31 Related party transactions

During the year the Company met the exemption requirements of FRS8, "Related Party Transactions", in that 90% or more of its voting rights are controlled by Network Rail Limited. The Company has, therefore, not separately disclosed transactions with other Group companies and investments of the Group qualifying as related parties for that period.

The results of Network Rail Limited (the ultimate parent company) are consolidated by the SRA. Transactions with the SRA include receipt of grant payments and rental payments for leasehold buildings. David Bailey, a director of the SRA, is also a director of the Company.

Company information

Network Rail Infrastructure Limited

Financial calendar 2004-05

31 March 2004	Publication of 2004 Business Plan
2 June 2004	Preliminary results announcement
21 July 2004	Annual General Meeting of Network Rail Limited in Cardiff
November 2004	Results for half year to 30 September 2004 announcement
31 March 2005	Publication of 2005 Business Plan

Registered Office:
40 Melton Street
London
NW1 2EE

Registered in England and Wales No. 2904587
www.networkrail.co.uk

Engineering excellence

for Britain's railway