

P&O Scottish Ferries Limited

**Directors' report and financial
statements**

Registered number 71375

31 December 1999



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Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 1999.

Principal activities

The principal activities of the company are ship owning and the operation of passenger and freight ferry services together with holiday package deals.

Business review

In June 1997, the Secretary of State for Scotland announced that P&O Scottish Ferries Limited had been awarded a 5 year government grant contract to operate lifeline services to the Northern Isles. An annual block grant of £11.018 million would be paid from April 1997 to March 2002.

Passengers carryings were up significantly on 1998 with increases in both our Aberdeen - Shetland and Pentland Firth routes. Freight Carryings were down on 1998 due mainly as a result of low livestock prices resulting in a poor livestock season in the Northern Isles. A continued focus on costs was also instrumental in generating a profit for the year amounting to £2,441,000.

Year 2000

The company has addressed the impact of the Year 2000 on its business and operations by reviewing the major issues to assess exposure. Plans were put in place to seek to ensure the elimination of these exposures prior to the Year 2000 and the directors are confident that all internal systems have successfully made the transition into the Year 2000.

Given the potential nature of the problem, the directors will continue to monitor the systems over the forthcoming months and remain vigilant over the leap year period. The directors are confident that the company has achieved business as usual and will provide resources to deal promptly with any issues that might arise.

Euro

The first phase of the introduction of the Euro is not expected to have any significant implications for P&O Scottish Ferries Limited.

Dividend

The directors recommend that a final ordinary dividend of £566,000 (1998: *nil*) be paid.

Directors and directors' interests

The directors who held office during the year were as follows:

GDS Dunlop (Chairman)
TC Cairns
CS Colegate
C Cunningham
H Stapleton

None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company.

Directors' Report *(continued)*

Directors and directors' interests *(continued)*

According to the notifications received by the company relating to the interests of the directors and their families in the share capital and debentures of group companies, there were the following interests in the stock of the ultimate holding company, The Peninsular and Oriental Steam Navigation Company:

	Deferred Stock		Deferred stock under Option	
	31 December 1999 Number	31 December 1998 Number	granted (lapsed) Number	exercised Number
TC Cairns	1,352	1,180	3,700	-
CS Colegate	341	374	2,300	-
CH Cunningham	-	1,559	4,800	12,280
H Stapleton	-	274	-	-

The interests of Mr GDS Dunlop are disclosed in the directors' report of The Peninsular and Oriental Steam Navigation Company.

Employees

Disabled employees:

The company's policy is to give full and fair consideration to applications for employment made by disabled persons, to encourage the training, career development and promotion of disabled persons on the basis of their aptitudes and abilities and to retain and retrain employees who become disabled.

Employee consultation:

During the year the company maintained its arrangements for consulting with, and providing information to, employees about the progress of the company. Employee involvement in the company's performance is actively encouraged and, to this end, an employee profit incentive scheme is operated.

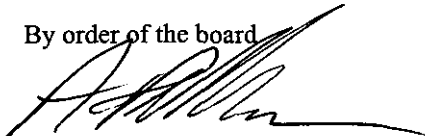
Creditors

The company has procedures for dealing promptly with complaints and disputes. The company had 54 days purchases outstanding at 31 December 1999.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditor of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board



A Robertson
Secretary

19 July 2000

Statement of directors' responsibilities

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 of the profit or loss for that year. 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, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.



KPMG Audit Plc

37 Albyn Place
Aberdeen
AB10 1JB
United Kingdom

Report of the auditor to the members of P&O Scottish Ferries Limited

We have audited the financial statements on pages 5 to 15.

Respective responsibilities of the director and auditors

The directors are responsible for preparing the directors' report and, as described on page 3, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 1999 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor

19 July 2000

Profit and loss account

for the year ended 31 December 1999

	Note	1999 £000	1998 £000
Turnover	2	30,338	30,191
Staff costs	5	(10,210)	(9,760)
Depreciation	9	(5,585)	(5,562)
Other operating charges		(11,952)	(12,192)
Operating profit		2,591	2,677
Interest receivable	6	163	151
Interest payable	7	(134)	(437)
Profit on ordinary activities before taxation	3-5	2,620	2,391
Tax on profit on ordinary activities	8	(179)	(1,309)
Profit for the financial year	19	2,441	1,082
Dividend on equity shares		(566)	-
Retained profit for year		1,875	1,082
Retained profit brought forward		4,471	3,389
Retained profit carried forward		6,346	4,471

There is no material difference between the profit for the financial year as reported and that calculated on an unmodified historical cost basis.


There are no recognised gains or losses other than the profit for the financial year.

Balance sheet

at 31 December 1999

	Note	1999 £000	1998 £000
Fixed assets			
Tangible assets	9	15,385	20,707
Investments	10	403	403
		<u>15,788</u>	<u>21,110</u>
Current assets			
Stocks	11	211	180
Debtors	12	2,873	4,781
Cash at bank and in hand		5,517	1,164
		<u>8,601</u>	<u>6,125</u>
Creditors: amounts falling due within one year	13	<u>(6,291)</u>	<u>(8,413)</u>
Net current assets/(liabilities)		<u>2,310</u>	<u>(2,288)</u>
Total assets less current liabilities		<u>18,098</u>	<u>18,822</u>
Creditors: amounts falling due after more than one year	14	(6,218)	(6,993)
Provisions for liabilities and charges	15	(2,953)	(4,381)
Deferred income	16	(494)	(890)
Net assets		<u>8,433</u>	<u>6,558</u>
Capital and reserves			
Called up share capital	17	2,000	2,000
Revaluation reserve	18	87	87
Profit and loss account		6,346	4,471
Equity shareholders' funds	19	<u>8,433</u>	<u>6,558</u>

These financial statements were approved by the board of directors on 19 July 2000 and were signed on its behalf by:



TC Cairns
Director

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements:

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules, modified to include the revaluation of certain land and buildings.

The company is exempt by virtue of s228 of the Companies Act 1985 from the requirement to prepare group financial statements. These financial statements present information about the company as an individual undertaking and not about its group.

Under Financial Reporting Standard 1, the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of The Peninsular and Oriental Steam Navigation Company, the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties). The consolidated financial statements of The Peninsular and Oriental Steam Navigation Company, within which this company is included, can be obtained from the Registrar of Companies, Companies House, Crown Way, Cardiff CF4 3HZ.

Land and buildings

Properties occupied by the company are included in fixed assets at their latest valuations plus subsequent additions at cost and surpluses and deficits on valuation are included in the revaluation reserve. The properties are valued triennially by The Peninsular and Oriental Steam Navigation Company Group chief surveyor. Profits and losses on sale of these properties are calculated by reference to their net carrying amount.

Freehold and leasehold properties

No depreciation is provided on freehold properties and leasehold properties with more than twenty-one years to the termination of the lease occupied by the company where such depreciation (using residual values estimated at the time the properties were acquired or at the time of a later revaluation) would not be material in these accounts.

The book value of leasehold properties with less than twenty-one years to the termination of the lease is written off over the remainder of the lease period on a straight line basis.

Freehold land is not depreciated.

Notes (continued)

1 Accounting policies (continued)

Ships and other fixed assets

Depreciation is provided by the company to write off the cost or valuation less the estimated residual value of ships and other fixed assets by equal instalments over their estimated useful economic lives, as follows:

Ships in service	- 15 to 20 years (see below)
Plant and machinery	- 4 to 10 years

The useful economic lives of the ships were amended in 1998 to write off the remaining net book value up to March 2002. This is the date of expiry of the current Scottish Office contract but it also represents the introduction of new IMO regulations under which the current fleet will become obsolete without substantial capital expenditure which is currently considered uneconomic.

Interest incurred in respect of payments on account of assets under construction is capitalised in the cost of the asset concerned.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Goodwill

Purchased goodwill (both positive and negative) arising on business combination in respect of acquisitions before 1 January 1998, when FRS 10 *Goodwill and intangible assets* was adopted, was written off to reserves in the year of acquisition and would have been fully amortised prior to the application of FRS10. When a subsequent disposal occurs any related goodwill previously written off to reserves is written back through the profit and loss account as part of the profit or loss on disposal.

Government grants

Capital based government grants are included within deferred income in the balance sheet and credited to operating profit over the estimated useful economic lives of the assets to which they relate.

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Pension costs

The company contributes to a group contributory defined benefit pension scheme.

Stocks

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

Notes (continued)

1 Accounting policies (continued)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Provision is made for deferred tax only to the extent that it is probable that a liability will crystallise.

2 Analysis of turnover

Turnover represents the value of passenger and freight ferry services supplied (excluding value added tax) principally on the routes to Orkney and Shetland from the UK mainland during the year.

3 Profit on ordinary activities before taxation

	1999 £000	1998 £000
<i>Profit on ordinary activities before taxation is stated</i>		
<i>after charging</i>		
Operating lease rentals payable:		
Land and buildings	192	176
Other operating leases	3	8
Directors' emoluments (note 4):		
As executives	151	151
Auditors' remuneration and expenses:		
Audit	18	16
Other services	2	6
	<hr/>	<hr/>

4 Emoluments of directors

	1999 £000	1998 £000
Directors' emoluments	151	151
	<hr/>	<hr/>

Retirement benefits are accruing to the following numbers of directors under:

	Number of directors	
	1999	1998
Defined benefit schemes	2	2
	<hr/>	<hr/>

Notes (continued)

5 Employees

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	1999	1998
Sea staff	-	229
Shore staff	195	202
	<hr/>	<hr/>
	195	431
Sea staff contracted from P&O Scottish Ferries (Bermuda) Limited	228	-
	<hr/>	<hr/>
	423	431
	<hr/>	<hr/>

The aggregate payroll costs of these persons were:

	1999	1998
	£000	£000
Wages and salaries	3,655	8,670
Social security costs	264	675
Other pension costs (note 21)	234	415
	<hr/>	<hr/>
	4,153	9,760
Staff recharges	6,057	-
	<hr/>	<hr/>
	10,210	9,760
	<hr/>	<hr/>

6 Interest receivable and similar income

	1999	1998
	£000	£000
Receivable from group undertakings	39	-
Bank interest receivable	124	151
	<hr/>	<hr/>
	163	151
	<hr/>	<hr/>

7 Interest payable

	1999	1998
	£000	£000
On bank loans	119	184
On loans from group undertakings	-	236
Finance charges payable in respect of finance leases and hire purchase contracts	15	17
	<hr/>	<hr/>
	134	437
	<hr/>	<hr/>

Notes (continued)

8 Taxation

	1999 £000	1998 £000
Taxation based on the profit for the year:		
Corporation tax at 30% (1998: 31%)	1,574	1,792
Deferred tax	(762)	(483)
	<hr/> 812	<hr/> 1,309
Prior year adjustment		
Corporation tax	33	-
Deferred tax	(666)	-
	<hr/> 179	<hr/> 1,309
	<hr/> <hr/>	<hr/> <hr/>

9 Tangible fixed assets

	Ships £000	Land and buildings £000	Plant and machinery £000	Total £000
Cost or valuation				
At beginning of year	39,039	844	4,438	44,321
Additions	25	-	245	270
Disposals	-	-	(132)	(132)
	<hr/> 39,064	<hr/> 844	<hr/> 4,551	<hr/> 44,459
Depreciation				
At beginning of year	20,523	-	3,091	23,614
Charged in year	5,194	-	391	5,585
Disposals	-	-	(125)	(125)
	<hr/> 25,717	<hr/> -	<hr/> 3,357	<hr/> 29,074
Net book value				
At 31 December 1999	<hr/> 13,347	<hr/> 844	<hr/> 1,194	<hr/> 15,385
At 31 December 1998	<hr/> 18,516	<hr/> 844	<hr/> 1,347	<hr/> 20,707

Included in fixed assets are leased assets with a net book value of £133,000 (1998: £182,000). The depreciation charge in respect of leased assets for the period is £49,000 (1998: £49,000).

The net book value of land and buildings comprises:	Short leasehold £000	Long leasehold £000	Total £000
At beginning and end of year	<hr/> 600	<hr/> 244	<hr/> 844

Notes (continued)

9 Tangible fixed assets (continued)

The valuation of properties at 31 December 1998 were all made on the basis of open market value by The Peninsular and Orientation Steam Navigation Company Group chief surveyor RA Knight FRICS and Healey & Baker. The historical cost of properties net of accumulated amortisation is £799,000 (1998: £799,000).

The cost of ships includes capitalised interest of £793,000 (1998: £793,000).

10 Unlisted investments (held as fixed assets)

	Shares in group undertakings £000	Other unlisted investments £000	Total £000
<i>Cost</i>			
At beginning and end of year	400	3	403

The company holds 100% of the ordinary share capital of North of Scotland Orkney and Shetland Shipping Company Limited which is incorporated in Great Britain and registered in Scotland. From 1 January 1999 this company has been renamed P&O Scottish Ferries Ship Management Limited, and has commenced trading as a manager of vessels.

Group financial statements are not submitted as the company is a wholly owned subsidiary of The Peninsular and Oriental Steam Navigation Company which is incorporated in Great Britain. In the opinion of the directors the investments in subsidiary undertakings are worth at least the amounts at which they are stated in the balance sheet.

11 Stocks

	1999 £000	1998 £000
Raw materials, consumables and fuel	85	55
Goods for resale	126	125
	<u>211</u>	<u>180</u>

12 Debtors

	1999 £000	1998 £000
Amounts falling due within one year:		
Trade debtors	2,133	2,295
Amounts owed by group undertakings	44	2,010
Other debtors	115	104
Prepayments and accrued income	581	372
	<u>2,873</u>	<u>4,781</u>

Notes (continued)

13 Creditors: amounts falling due within one year

	1999	1998
	£000	£000
Bank loans (note 14)	722	722
Trade creditors	2,076	1,694
Amounts owed to group undertakings	21	406
Other creditors including taxation and social security:		
Corporation tax	1,574	1,792
Other taxes and social security	275	674
	<hr/>	<hr/>
Taxation and social security	1,849	2,466
Other creditors	153	205
	<hr/>	<hr/>
	2,002	2,671
Accruals	1,021	2,471
Deferred income (note 16)	396	396
Obligations under finance leases (note 14)	53	53
	<hr/>	<hr/>
	6,291	8,413
	<hr/>	<hr/>

14 Creditors: amounts falling due after more than one year

	1999	1998
	£000	£000
Bank loans	722	1,444
Less: Current instalments (note 13)	(722)	(722)
	<hr/>	<hr/>
	-	722
Parent company funding loan	6,148	6,148
Obligations under finance leases	70	123
	<hr/>	<hr/>
	6,218	6,993
	<hr/>	<hr/>

The company presently has one bank loan to finance the acquisition of ships. The loan is repayable in half yearly instalments and bears interest at a rate of 8.6% per annum. The loan is secured by a mortgage over the ship to which it relates.

The parent company funding loan has no set repayment date and is interest free.

The maturity of obligations under finance leases is as follows:

	1999	1998
	£000	£000
Between one and two years	12	53
Between two and five years	33	34
After five years	25	36
	<hr/>	<hr/>
	70	123
Amounts due within one year (note 13)	53	53
	<hr/>	<hr/>
	123	176
	<hr/>	<hr/>

Notes (continued)

15 Provisions for liabilities and charges

The amounts provided for deferred taxation, equivalent to the full potential liability and calculated on the liability method, are set out below:

	Difference between accumulated depreciation and capital allowances £000	Other £000	Total £000
At beginning of year	4,215	166	4,381
Transferred to profit and loss account	(1,280)	(148)	(1,428)
At end of year	2,935	18	2,953

16 Deferred income: amount falling due after more than one year

	1999 £000	1998 £000
<i>Government grants</i>		
At beginning of year	1,286	373
Received during year	-	1,271
Credited to operating profit	(396)	(358)
	890	1,286
Less: Current instalment (note 13)	(396)	(396)
At end of year	494	890

17 Share capital

	1999 £000	1998 £000
Authorised, allotted, called up and fully paid 200,000 Ordinary shares of £10 each	2,000	2,000

18 Reserves

	£000
Revaluation reserve:	
At beginning and end of year	87

The cumulative amount of goodwill resulting from acquisitions of businesses in earlier financial years which has been written off against the profit and loss account is £95,000.

Notes *(continued)*

19 Reconciliation of movements in shareholders' funds

	1999 £000	1998 £000
Profit for the financial year	2,441	1,082
Dividends	(566)	-
Net addition to shareholders' funds	1,875	1,082
Opening shareholders' funds	6,558	5,476
Closing shareholders' funds	8,433	6,558

20 Commitments

- (a) Capital commitments at 31 December 1999 were nil (1998: £nil).
- (b) At 31 December 1999 the company has annual commitments under non-cancellable operating leases of £195,000 (1998: £196,000) which expire as follows:

	Land and buildings		Other	
	1999 £000	1998 £000	1999 £000	1998 £000
Within one year	11	28	2	
2 - 5 years	-	-	1	4
Over 5 years	181	164	-	

21 Pension schemes

The company participates in a group contributory defined benefit pension scheme covering the majority of its onshore salaried employees and sea staff of officer rank. The scheme funds are administered by trustees and are independent of the company's finances. Contributions are paid to the scheme in accordance with the recommendation of independent actuaries. The company's contributions are charged against profits in the year in which contributions are made (note 5).

Further details of the most recent actuarial valuations and main actuarial assumptions of the schemes are disclosed in the accounts of The Peninsular and Oriental Steam Navigation Company.

22 Ultimate holding company

The company's ultimate holding company is The Peninsular and Oriental Steam Navigation Company, which is incorporated in Great Britain and registered in England and Wales.

The largest group in which the results of the company are consolidated is that headed by The Peninsular and Oriental Steam Navigation Company. The consolidated financial statements of The Peninsular and Oriental Steam Navigation Company are available to the public and may be obtained from the Registrar of Companies, Companies House, Crown Way, Cardiff CF4 3HZ.

No other group financial statements include the results of the company.