

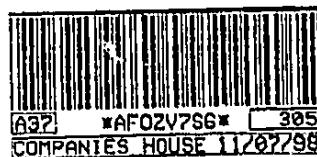
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P&O Scottish Ferries Limited

Director's report and financial statements

31 December 1997

Registered number 71375



Directors' report and financial statements

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Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 1997.

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

	1997 £000	1996 £000
Turnover	27,431	25,626
Profit on ordinary activities before taxation	1,248	217
Tax on profit on ordinary activities	(19)	(239)
Profit (loss) for the financial year	1,229	(22)

In June 1997, the Secretary of State for Scotland announced that P & O Scottish Ferries had been awarded a 5 year government contract to operate lifeline services to the Northern Isles. An annual block grant of £11.018M would be paid from April 1997 to March 2002. Capitalised costs of mandatory safety improvements will also be funded by the Scottish Office.

The results for the year are satisfactory. Passenger numbers during 1997 increased on all routes although car volumes on routes from Aberdeen showed a slight reduction on 1996. Freight volumes across several categories did not reach 1996 levels on routes from Aberdeen.

Dividend

The directors recommend that no dividend is paid, and that the profit for the year of £1,229,000 be transferred to reserves.

Directors' Report *(continued)*

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.

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 1997 Number	31 December 1996 Number	granted (lapsed) Number	exercised Number
TC Cairns	905	784	-	-
CS Colegate	374	298	-	-
CH Cunningham	723	959	2,469	609
H Stapleton	274	2,100	-	-

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.

Directors Report *(continued)*

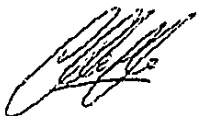
Charitable donations

During the year, the company made charitable donations amounting to £852.

Creditors

The company has procedures for dealing promptly with complaints and disputes. The company had 45 days purchases outstanding at 31 December 1997.

By order of the board



C Clark
Secretary

30 June 1998

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 judgments 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 auditors to the members of P&O Scottish Ferries Limited

We have audited the financial statements on pages 6 to 18.

Respective responsibilities of the director and auditors

As described on page 4 the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

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 1997 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 Auditors

30 June 1998

Profit and loss account
for the year ended 31 December 1997

	Note	1997 £000	1996 £000
Turnover	2	27,431	25,626
Staff costs	5	(9,419)	(8,737)
Depreciation	8	(2,775)	(2,565)
Other operating charges		(13,266)	(13,298)
Operating profit		1,971	1,026
Interest receivable		194	165
Interest payable	6	(917)	(974)
Profit on ordinary activities before taxation	3-5	1,248	217
Tax on profit on ordinary activities	7	(19)	(239)
Profit (loss) for the financial year		1,229	(22)
Retained profit brought forward		2,160	2,182
Retained profit carried forward		3,389	2,160

There is no material difference between the profit (loss) 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 (loss) for the financial year.

Balance sheet
at 31 December 1997

	Note	1997	1996
		£000	£000
Fixed assets			
Tangible assets	8	24,567	26,294
Investments	9	403	403
		<u>24,970</u>	<u>26,697</u>
Current assets			
Stocks	10	191	450
Debtors	11	3,709	3,108
Cash at bank and in hand		748	3,713
		<u>4,648</u>	<u>7,271</u>
Creditors: amounts falling due within one year	12	(11,181)	(14,803)
Net current liabilities		<u>(6,533)</u>	<u>(7,532)</u>
Total assets less current liabilities		<u>18,437</u>	<u>19,165</u>
Creditors: amounts falling due after more than one year	13	(7,766)	(8,438)
Provisions for liabilities and charges	14	(4,864)	(6,119)
Deferred income	15	(331)	(361)
Net assets		<u>5,476</u>	<u>4,247</u>
Capital and reserves			
Called up share capital	16	2,000	2,000
Revaluation reserve	17	87	87
Profit and loss account		3,389	2,160
Equity shareholders' funds	18	<u>5,476</u>	<u>4,247</u>

These financial statements were approved by the board of directors on 30 June 1998 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 properties

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
Plant and machinery	- 4 to 10 years

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

Goodwill relating to a business purchased by the company, is written off immediately against reserves.

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 and also to Merchant Navy Officers and Ratings Pension funds. Contributions to these are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the company.

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

	1997 £000	1996 £000
<i>Profit on ordinary activities before taxation is stated</i>		
<i>after charging</i>		
Operating lease rentals payable:		
Ships, plant and machinery	171	354
Other operating leases	4	278
Directors' emoluments (note 4):		
As executives	109	105
Auditors' remuneration and expenses:		
Audit	15	15
Other services	5	16
	<hr/>	<hr/>

Notes (continued)

4 Emoluments of directors

	1997 £000	1996 £000
Directors' emoluments	109	105

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

	Number of directors	
	1997	1996
Defined benefit schemes	2	2

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	
	1997	1996
Sea staff	229	230
Shore staff	204	213
	433	443

The aggregate payroll costs of these persons were:

	1997 £000	1996 £000
Wages and salaries	8,292	7,772
Social security costs	653	605
Other pension costs (note 20)	474	360
	9,419	8,737

6 Interest payable

	1997 £000	1996 £000
On bank loans	320	444
On loans from group undertakings	597	530
	917	974

Notes (continued)

7 Taxation

	1997 £000	1996 £000
Taxation based on the profit for the year:		
Corporation tax at 31.5%/33%	1274	78
Deferred tax	(875)	(5)
	<u>399</u>	<u>73</u>
Prior year adjustment		
Corporation tax	-	176
Deferred tax	(10)	(10)
Change in corporation tax rates	(370)	-
	<u>19</u>	<u>239</u>

8 Tangible fixed assets

	Ships £000	Land and buildings £000	Plant and machinery £000	Total £000
<i>Cost or valuation</i>				
At beginning of year	37,259	840	3,632	41,731
Additions	505	-	560	1,065
Disposals	-	-	(117)	(117)
At end of year	<u>37,764</u>	<u>840</u>	<u>4,075</u>	<u>42,679</u>
<i>Depreciation</i>				
At beginning of year	12,869	-	2,568	15,437
Charged in year	2,440	-	335	2,775
Disposals	-	-	(100)	(100)
At end of year	<u>15,309</u>	<u>-</u>	<u>2,803</u>	<u>18,112</u>
<i>Net book value</i>				
At 31 December 1997	<u>22,455</u>	<u>840</u>	<u>1,272</u>	<u>24,567</u>
At 31 December 1996	<u>24,390</u>	<u>840</u>	<u>1,064</u>	<u>26,294</u>

Included in fixed assets are leased assets with a net book value of £230,000 (1996: £166,000). The depreciation charge in respect of leased assets for the period is £48,000 (1996: £41,000).

Notes (continued)

8 Tangible fixed assets (continued)

The net book value of land and buildings comprises:

	At beginning and end of year £000
Short leasehold	600
Long leasehold	240
	<hr/> 840

The valuation of properties at 31 December 1997 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 £795,000 (1996: £795,000).

The cost of ships includes capitalised interest of £793,000 (1996: £793,000).

9 Unlisted investments (held as fixed assets)

	Shares in group undertakings £000	Other unlisted investments £000	Total £000
Cost			
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. This company does not trade.

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.

10 Stocks

	1997 £000	1996 £000
Raw materials, consumables and fuel	73	306
Goods for resale	118	144
	<hr/> 191	<hr/> 450

Notes (continued)

11 Debtors

	1997 £000	1996 £000
Amounts falling due within one year:		
Trade debtors	2,067	2,397
Amounts owed by group undertakings	64	123
Other debtors	21	135
Prepayments and accrued income	1,557	453
	<u>3,709</u>	<u>3,108</u>

12 Creditors: amounts falling due within one year

	1997 £000	1996 £000
Bank loans (note 13)	722	2,422
Trade creditors	1,923	1,354
Amounts owed to group undertakings	5,636	9,631
Other creditors including taxation and social security:		
Corporation tax	1275	78
Other taxes and social security	415	421
Taxation and social security	<u>1,690</u>	<u>499</u>
Other creditors	<u>290</u>	<u>153</u>
Accruals	1,980	652
Deferred income (note 15)	825	664
Obligations under finance leases (note 13)	42	39
	<u>53</u>	<u>41</u>
	<u>11,181</u>	<u>14,803</u>

Notes (continued)

13 Creditors: amounts falling due after more than one year

	1997 £000	1996 £000
Bank loans	2,165	4,587
Less: Current instalments (note 12)	(722)	(2,422)
	<u>1,443</u>	<u>2,165</u>
Parent company funding loan	6,148	6,148
Obligations under finance leases	175	125
	<u>7,766</u>	<u>8,438</u>

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 bears interest at market rates.

The maturity of obligations under finance leases is as follows:

	1997 £000	1996 £000
Between one and two years	53	41
Between two and five years	74	84
After five years	48	-
	<u>175</u>	<u>125</u>
Amounts due within one year (note 12)	53	41
	<u>228</u>	<u>166</u>

Notes (continued)

14 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	5,904	215	6,119
Transferred from profit and loss account	(1,190)	(65)	(1,255)
At end of year	4,714	150	4,864

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

	1997 £000	1996 £000
<i>Government grants</i>		
Opening balance	361	400
Received during year	15	-
Credited to operating profit	(3)	-
Less current instalment (note 12)	(42)	(39)
At end of year	331	361

16 Share capital

	1997 £000	1996 £000
Authorised, allotted, called up and fully paid 200,000 Ordinary shares of £10 each	2,000	2,000

17 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)

18 Reconciliation of movements in shareholders' funds

	1997 £000	1996 £000
Profit (loss) for the financial year	1,229	(22)
Other recognised gains and losses relating to the year	-	(35)
Shareholders' funds at the beginning of the year	4,247	4,304
Net addition to (reduction in) shareholders' funds	1,229	(57)
Shareholders' funds at the end of the year	5,476	4,247

19 Commitments

- (a) Capital commitments at 31 December 1997 were £410,000 (1996: £122,000).
- (b) At 31 December 1997 the company has annual commitments under non-cancellable operating leases of £176,000 (1996: £278,000) which expire as follows:

	Land and buildings		Other	
	1997 £000	1996 £000	1997 £000	1996 £000
Within one year	7	-	1	-
2 - 5 years	-	-	4	50
Over 5 years	164	278	-	-

20 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).

Contributions are made on behalf of sea staff to either a Merchant Navy Officers' or Ratings' Pension Fund. Again these schemes are independent of the company's finances.

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.

Notes *(continued)*

21 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.