Horace Small Apparel PLC

ANNUAL REPORT AND ACCOUNTS 1997

CONTENTS

Horace Small Apparel PLC

Horace Small Apparel is a leading manufacturer and distributor of uniforms in the United States and Canada. Its products are supplied to consumers through its national network of independent distributors, company owned distributors and its unique national account distribution system.

Customers now include federal, state and local government agencies, major private sector commercial, telecommunications and transportation companies, public safety organisations and security forces.

Horace Small Apparel is committed to developing strong customer relationships based on a commitment to service, reliability and value.

CHAIRMAN'S STATEMENT

The past year has been one of important and constructive change for our company. As a result, I believe we are now well positioned with a strategy going forward which offers the opportunity for profitable long term growth of our business.

"THE PROCEEDS OF THE SALE WILL ALSO LEAVE US WITH A STRENGTHENED FINANCIAL CONDITION..."

In February 1998 we announced an agreement, subject to approval by our shareholders, to sell all our remaining company owned distributors for a cash consideration approximating the net book value of the assets being sold. This divestiture will permit us to focus on improving the cost structure and efficiency of our manufacturing operations and on growing our distribution business serving both our national accounts and wholesale customers. The proceeds of the sale will also leave us with a strengthened financial condition, providing a solid basis to finance future growth in our ongoing business.

RESULTS

Our results are for the nine month period ended 30th September 1997 reflecting the change to a new year end which we previously announced. Turnover for the nine months was £59.7 million ($97.3 million) compared with £91.3 million ($142.5 million) in the twelve months ended 31st December 1996. Sales for the nine months in 1997 were comparable with the nine months ended 30th September 1996, with sales and profits in the fourth calendar quarter being traditionally the strongest of the year due to seasonal factors. Operating profit for the nine months in 1997, before exceptional items, was £477,000 ($778,000) compared with £5.6 million ($8.8 million) for the twelve months in 1996. There was a loss for the nine months to 30th September 1997 of £6.0 million ($9.8 million) after exceptional items and interest expense, compared with a profit of £4.0 million ($6.3 million) for the twelve months to 31st December 1996. The loss per share for the nine months in 1997 was 17.7p compared to earnings per share for the twelve months in 1996 of 12.0p. Before exceptional items the loss per share for the nine months ended 30th September 1997 was 1.8p.

Consistent with previous practice the directors are not recommending the payment of a dividend.

RESULTS COMMENTARY

The exceptional charge of £5.4 million ($8.9 million) in 1997 related to the restructuring of our manufacturing operations, the rationalisation of inventory, the overhaul of our management information systems and the repositioning of our company owned distributors so as to permit the sale of these operations after the period end. It is important to note that the cash outflow associated with these exceptional items was £850,000 ($1.4 million) which is substantially less than the accounting charge. The sales and operating performance for the nine months were in line with the expectations we reported with our six months results and reflected the downturn in business we experienced during the second and third calendar quarters in 1997.

Sales for the nine months were comparable to the first nine months of

1996 with a slightly lower gross margin. Excluding the company owned distributors, sales for the 1997 nine months were slightly ahead of the same period in 1996 with a gross margin in line with 1996.

STRATEGIC DEVELOPMENTS

Although the financial results for the 1997 fiscal year were disappointing, I believe that important progress was made in several key areas of the company's operations.

The sale of our company owned distributors will strengthen our financial position and will enable us to focus exclusively on the programme of investment and improvement in our manufacturing operations and on growing our distribution business.

Focusing on the changing wholesale marketplace by strengthening our commitment to independent dealers will be a primary strategic objective of the company. Support for these customers will be accomplished through product development, merchandising, inventory investment, and a strong, professional field sales organisation.

Our national account business continued to grow in fiscal 1997 and we anticipate further growth in 1998 and 1999. After the sale of our company owned distributors, national accounts will represent over 60% of our sales.

During 1997 we closed our sewing plant in Guthrie, Kentucky and moved production to our new facility in Brownsville, Texas. Brownsville is now our largest sewing plant and we are presently investing in our own cutting facility in this plant to enhance our competitive position in the market place. The anticipated cost savings in Brownsville are proving slower to achieve than planned; however, we remain confident that our expectations for Brownsville will be realised.

Considerable progress was made during the year in strengthening our management information systems resources including the previously reported turnkey contract with EDS. We are pleased to note continuing progress and improvement in this area.

OUTLOOK

We anticipate a return to a profitability in fiscal 1998 (prior to the write off of goodwill related to the sale of the company owned distributors) with a further improvement in the following year.

I believe that we will look back on 1997 and 1998 as years of pivotal change and accomplishment. This will reflect a tremendous effort on the part of all our employees and I would like to thank them all for their outstanding contribution during a difficult transitional period. I would also like to thank shareholders for their continuing support.

J Colin Keith
CHAIRMAN

"OUR NATIONAL ACCOUNT BUSINESS CONTINUED TO GROW IN FISCAL 1997 AND WE ANTICIPATE FURTHER GROWTH IN 1998 AND 1999."

PRESIDENT'S REPORT

Throughout 1997 the company continued its vigorous efforts with the change process as we progressed on the manufacturing restructuring initiative, the design and selection of an integrated business system, and the reorganisation of sales, marketing, and inventory fulfillment functions in line with our "one company" philosophy.

"...WE CONTINUE TO SATISFY THE ENTIRE UNIFORM REQUIREMENTS OF SEVERAL OF NORTH AMERICA'S LARGEST CORPORATIONS..."

NATIONAL ACCOUNTS

The performance of our national accounts team has, once again, been encouraging, providing a first-rate service to our large customer groups and benefiting from a good growth rate in the majority of them. It is through this team's hard work and dedication that we continue to satisfy the entire uniform requirements of several of North America's largest corporations through established distribution programmes which ensure that each individual within those organisations is provided with the appropriate apparel items, in the correct sizes and at the right time. We have done this consistently for many years, earning a reputation for reliability and quality that has enabled us to retain the loyalty of our clients and their business.

FedEx's new uniform programme, which meets the needs of their staff in countries across the globe, recorded very strong results. And it was a similar story with other accounts such as American Airlines, Air Canada, BellSouth, US National Park Service, US Customs, and US Immigration and Naturalisation Service.

Our distribution centres, which run the uniform programmes, have performed well but we are still looking at ways to increase their throughput and improve their efficiency. The Memphis distribution centre, which handles the FedEx business, has been awarded ISO 9002 status and the Montreal, Canada distribution centre, which supports Air Canada, is on schedule to achieve this recognition in 1998.

COMPANY OWNED DISTRIBUTORS

We announced on 17th February 1998, that we had entered into an agreement to sell our 16 company owned distributors to Skaggs Companies, Inc., subject to shareholder approval. Our company, working closely with the Skaggs company representatives, forged an agreement that offers a win-win opportunity for our employees and customers, as well as for both of our companies. Furthermore, this agreement, which will be finalised no later than 30th June 1998, will strategically position our company to focus on the continuing development of our wholesale and national account businesses.

WHOLESALE

Wholesale has proved to be our most difficult market where we face an increasing level of competition with a consequent pressure on sales and margins. We did see growth in several of our largest customers including the sales performance of our products due to their showing in a major international police mail order catalogue.

Our excellent new range of outerwear met with stiff competition. Launched in 1997, it sells into a highly competitive market in which margins are continually being squeezed. Tuff Gear, our new tactical dress uniform for the police, had a disappointing introduction and is not yet selling in sufficient volume. However, we have taken steps to reduce production costs which will enable us to sell at a more competitive price in the future.

Other initiatives include the introduction of our Early Bird selling programme to boost sales, and the realignment of sales and marketing teams with the formation of five regional sales forces, each with a regional director.

MANUFACTURING

Manufacturing presented mixed results, with Bassfield taking longer than expected to achieve the required production rates. However, with organisational changes made early in 1998, we are confident that this facility will be back on track during the course of the year. Our new sewing facility in Brownsville, Texas began operations in April and by December had reached an output of 18,000 units per week with over 300 direct labour operators. In May our Guthrie plant in Kentucky was closed and production transferred to Brownsville. We expect the number employed at Brownsville to have reached 450 by July 1998, a stage we were not expecting to arrive at for another six months. This is an excellent plant with a skilled and experienced workforce that should perform at high efficiency levels. Computerised, state-of-the-art cutting equipment is due to arrive in May with full cutting production scheduled for July. This will complete our restructuring initiatives in Brownsville.

Our sourcing organisation continued its efforts to develop quality contractors located throughout North America, Central America, the Caribbean, and Asia. This organisation is of paramount importance in guaranteeing not only quality products and dependable delivery, but ensuring that all contractors utilized in the production of products we deliver to our customers comply with applicable labour standards and working conditions.

CORPORATE DEVELOPMENT

One of our most important steps during the year was the formation of a Management Committee composed of all key officers and functional directors responsible for implementing the company's strategic policies. This group has played a significant role in identifying the measures that must be taken to further our current aims and, subsequently, by ensuring their fulfillment.

"...AN EXCELLENT PLANT WITH A SKILLED AND EXPERIENCED WORKFORCE THAT SHOULD PERFORM AT HIGH EFFICIENCY LEVELS."

PRESIDENT'S REPORT

In 1997 we continued our efforts in the comprehensive restructuring of our company, an ambitious project that had its origins in the summer of 1996 when we initiated our "one-company" philosophy. During the period we transformed a number of management responsibilities and strengthened the executive team with new appointments. But the most significant changes concerned the way in which large numbers of our workforce were brought together to act in closer harmony than ever before.

"...WE TRANSFORMED A NUMBER OF MANAGEMENT RESPONSIBILITIES AND STRENGTHENED THE EXECUTIVE TEAM..."

Merchandising and product development departments in wholesale, and national accounts are being fused into one group, helping to ensure a uniformity of vision and purpose throughout all their programmes. The customer service functions for both national accounts and wholesale are also being merged.

Similar changes have taken place in the operations of inventory and purchasing management where inventory planning, inventory forecasting and purchasing are now the responsibility of a single group. These represent further stages in our plans to establish a single purchasing department for the whole company.

We have been greatly assisted in this restructuring process through our link with EDS, a world leader in the effective deployment of information systems, who has brought us many benefits and the services of more qualified people than we were able to obtain independently. Through them we have been able to improve information gathering and dissemination, stabilise our workforce and accelerate the transformation of our company.

With their assistance we are now at the point of implementing an integrated business system complete with an enterprise resource planning package. Very much in accord with our "one-company" philosophy, this will bring about a complete integration of all the company's business processes - product development, sales, marketing, administration, finance, etc. The package we plan to use is SAP's R3 Apparel and Footwear Solution, one of two competing systems which were the subject of an exhaustive analysis carried out during the latter months of 1997. The final choice was made in February 1998 with commissioning to follow immediately. The software, which is year 2000 compliant, should be fully implemented in 1999.

This should bring our restructuring programme to a successful conclusion. During its course it will have affected every department and every individual in the company. All those involved are to be congratulated on their response to the need for change and the wholehearted manner in which they have approached the task of strengthening every aspect of our business.

FUTURE

In spite of the challenges experienced during the past year we are optimistic about our prospects in 1998, and with good reason. Our restructuring programme is proceeding and, when completed, should result in an efficient and profitable company with a growing level of business. Production capacity will increase with the Brownsville build-up; manufacturing initiatives are taking effect with a continued improvement in manufacturing efficiencies; and the reorganised sales group now has a greater capacity to attract business.

We expect to add to the number of our national accounts and we foresee internal growth in our existing national accounts. The sale of our company owned distributors to Skaggs will positively impact our opportunities with the independent dealers representing our wholesale product line throughout North America.

1998 has been designated the Year of the Customer which is our way of reminding everyone at Horace Small Apparel that every decision we make affects the customer and that our future depends entirely on their goodwill.

Robert W. Gates, Jr.

Robert W Gates, Jr
PRESIDENT AND CHIEF OPERATING OFFICER

"...AN EFFICIENT AND PROFITABLE COMPANY WITH A GROWING LEVEL OF BUSINESS."

FINANCIAL REVIEW

Since the group conducts substantially all of its operations in the United States and substantially all of its assets, liabilities, revenues and expenses are denominated in US dollars, all amounts included in this Financial Review are in US dollars, except for earnings per share, which are denominated in pence sterling. As a result of the change in the group's fiscal year-end in 1997, amounts included in this Financial Review relating to results of operations and cash flow are for the nine months ended 30th September, 1997 and for the twelve months ended 31st December, 1996. Comparisons of the results between the two periods are affected by both the difference in the number of months comprising the respective periods and the fact that the months excluded from fiscal 1997 are the fourth calendar quarter which is traditionally the strongest of the year. Also, all amounts are before the impact, where applicable, of exceptional charges of $8.9 million in 1997.

The effects of exchange rate movements on sterling results in relation to the profit and loss account and cash flow statement were an adverse 4.5% as the average exchange rate moved to $1.631 in 1997 from $1.561 in 1996. However, the period-end exchange rates in relation to the group balance sheet showed a favourable reduction of nearly 6% to $1.612 in 1997 from $1.712 in 1996 reflecting the weakening of the pound early in 1997 and the narrow range of movement during the rest of the period.

RESULTS OF OPERATIONS

Sales were $97.3 million for the nine months to 30th September, 1997 and $142.5 million in the full year ended 31st December, 1996. While consolidated sales for the period to 30th September, 1997 were virtually unchanged from the same period in 1996, a 14% increase in national account sales was offset by a 12% decline in wholesale and company owned distributor sales. After an encouraging start to 1997, the wholesale and company owned distributor businesses began to experience disappointing sales in the second quarter and this trend continued through the third (and final) quarter of fiscal 1997. This slowdown in sales resulted from a difficult competitive environment, problems with fabric quality and delivery from some of the company's suppliers, and a shortfall in production resulting from the move of its Guthrie, Kentucky plant operations to the new facility in Brownsville, Texas. National account sales growth in the nine months of fiscal 1997 compared to the same period of 1996 was primarily attributable to increases in sales to several of the company's airline and air freight accounts.

Gross profit, before exceptional cost of sales, in the nine months to 30th September, 1997 was $27.7 million, a margin of 28.5%, compared to gross profit of $44.6 million and a margin of 31.3% in the year to 31st December, 1996. Since 1997 results do not include the normally more profitable fourth calendar quarter, this comparison of gross profit margins is somewhat misleading. More appropriately, when compared to the approximate gross margin of less than 30% for the same nine-month period of 1996, the fiscal 1997 margin declined only slightly. This lower gross margin was primarily attributable to decreased margins in company owned distributors resulting from the competitive environment encountered during the period by those operations and increased costs in the company's manufacturing operation. These same competitive pressures prevented the company from raising prices to fully cover the cost increase.

Group operating expenses increased $0.9 million in the nine months of fiscal 1997 compared to the same period in 1996 primarily because of higher expenses incurred for management information systems. Expenditure levels in all other significant areas of operating expenses were comparable to 1996.

The group's pre-tax loss, before exceptional items, was $1.0 million for the nine month period ended 30th September, 1997 compared to pre-tax income of $6.3 million in the year to 31st December, 1996. Lower levels of profitability (or in the case of 1997, incurring a loss) for nine-month periods which exclude the fourth calendar quarter are somewhat indicative of the impact that quarter has on full year results. Interest expense for fiscal 1997 was down slightly from the comparable period in 1996.

The group recorded an exceptional charge totalling $8.9 million in 1997. This charge comprised $1.9 million for costs incurred in conjunction with the move of its manufacturing operation in Guthrie, Kentucky to a new location in Brownsville, Texas, $5.0 million for the rationalisation of the group's inventory in line with its business strategy, and $2.0 million to recognise the decreased value of certain management information systems the majority of which related to company owned distributors. With the exception of approximately $1.4 million of costs incurred in conjunction with the relocation of the manufacturing operation, none of the exceptional charge required the use of cash.

Tax losses available for offset against future profits subject to United States Federal taxation were approximately $18.4 million at 30th September, 1997 compared to $13.7 million at 31st December, 1996.

In fiscal 1997, the group incurred an after tax loss of $1.0 million and an adjusted loss per share of 1.8p compared to an after tax profit of $6.4 million and earnings per share of 12.0p in the full year 1996.

CASH FLOW AND FINANCING

Net cash provided by operating activities was $6.1 million in the nine-month period ended 30th September, 1997 compared to $10.5 million for the year to 31st December, 1996. Seasonal factors which normally reduce the working capital requirements at 30th September as compared to 31st December contributed to the cash flow from operations in fiscal 1997. Reduced working capital requirements for new national account programmes begun in 1995 were the primary reason for the significant cash flow in 1996.

Trade debtors decreased $8.1 million in the nine months to 30th September, 1997 primarily as a result of the seasonal nature of the group's sales which are traditionally higher in the fourth calendar quarter than the third quarter. Stock balances declined by $0.9 million in the nine months of 1997. Conversely, the balance of trade creditors declined $4.0 million which required the use of cash in the period.

During fiscal 1997, the group reduced its bank debt by $1.0 million following a $5.9 million reduction in 1996. On 1st October, 1997, the group entered into a new credit facility with its banks which provides for unsecured borrowings on a revolving basis up to $37.5 million, an increase of $10 million over the previous facility. In conjunction with the sale of the company owned distributors the group will be renegotiating certain aspects of this bank credit facility. Internally generated funds and availability under bank credit facilities will provide necessary capital for completion of the start-up of Brownsville, including the addition of an automated cutting operation, required expenditures on the integrated business information system, seasonal working capital requirements and the group's normal capital expenditure programme in 1998.

Richard B Vacek, Jr
FINANCE DIRECTOR

DIRECTORS' REPORT

The directors have pleasure in submitting their report together with the audited accounts for the nine months ended 30th September 1997.

Activities

The company's principal operating subsidiary undertaking, Horace Small Manufacturing Company ("Horace Small"), and its subsidiary undertakings together are integrated manufacturers and distributors of fitted uniforms and corporate clothing as well as being distributors of related accessories and equipment. Horace Small currently serves US Federal (non-military), State and Local Government agencies, a number of safety and security work forces and a range of large and small corporations.

A detailed review of the business and future prospects is contained in the Chairman's Statement, the President's Report and the Financial Review on pages 2 to 10.

Results

The results for the period are set out in the profit and loss account. The loss on ordinary activities after taxation and exceptional items amounted to £6,061,000 (1996 - profit £4,112,000).

Dividends

The directors are not recommending the payment of a dividend (1996 - nil).

Substantial interests

At the date of this report the company has been notified of the following substantial interests in the shares of the company:

	No. of shares	%
North Atlantic Smaller Companies Investment Trust PLC	5,012,466	14.6
Foreign & Colonial Enterprise Trust PLC	4,190,121	12.2
Seaway Ltd†	4,016,100	11.7
Schroder Unit Trusts Limited*	2,575,000	7.5
Douglas Small	1,977,573	5.8
Credit Suisse Smaller Companies Fund	1,535,000	4.5
Cumberland Partners	1,265,000	3.7

†The company has been informed that J O Hambro Capital Management Limited, discretionary fund manager of Seaway Ltd, has an interest in a total of 4,211,100 shares representing 12.3% of the issued share capital.

*Schroder Unit Trusts Limited is a wholly owned subsidiary of Schroder Investment Management Limited. The company has been informed that in total Schroder Investment Management Limited in its capacity as discretionary portfolio manager has an interest in 5,187,600 shares representing 15.1% of the issued share capital.

DIRECTORS' REPORT

Directors

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

J. Colin Keith (Chairman), Robert W. Gates, Jr., Richard B. Vacek, Jr., Paul G. Dumond, The Hon. William D.Eberle, Christopher H. B. Mills, R. James P. Morton, Irvin L. Small (resigned 10th October 1997).

In accordance with the Articles of Association, Robert W. Gates Jr. and R. James P. Morton retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

Supplier payment policy

It is Horace Small Apparel PLC's policy to negotiate payment terms with its suppliers and to ensure that they know the terms on which payment will take place when business is agreed. It is Horace Small Apparel PLC's policy to abide by these terms.

As the company is a holding company it has no trade creditors and accordingly no disclosure is made of the period end creditor days.

Post balance sheet event

Details of an event occurring after the balance sheet date can be found in note 21 to the accounts.

Close company status

So far as is known the company is not, and has not been, a close company as defined by the Income and Corporation Taxes Act 1988.

City Code on Takeovers and Mergers

The Panel on Takeovers and Mergers determined in March 1995 that the company is not governed by the City Code on Takeovers and Mergers.

Auditors

A resolution to reappoint Arthur Andersen as auditors will be proposed at the forthcoming Annual General Meeting.

Masters House
107 Hammersmith Road
London W14 0QH

11th March 1998

By order of the Board
Paul G. Dumond
Director

CORPORATE GOVERNANCE

Directors' Statement on Corporate Governance Matters

Following the publication in December 1992 of the Code of Best Practice by the Committee on the Financial Aspects of Corporate Governance, the Board has reviewed the company's compliance during the period ended 30th September, 1997. The Code covers four broad areas, namely the composition and procedures of the Board of Directors, the appointment and role of non-executive directors, the service contracts and pay of executive directors and the directors' responsibilities with respect to financial reporting and controls. The Code contains nineteen specific provisions in respect of these four areas.

The company has complied throughout the period with the Code except that non-executive directors are not appointed for specific terms because the directors believe it to be in the best interest of shareholders that there be greater flexibility in relation to non-executive director appointments. The board periodically reviews their performance and effectiveness.

Internal financial control

The Board of Directors has overall responsibility for ensuring that the group maintains a system of internal financial control to provide them with reasonable assurance regarding the reliability of financial information used within the business and for publication and that assets are safeguarded. There are inherent limitations in any system of internal financial control and accordingly even the most effective system can provide only reasonable, and not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets.

The key features of the internal financial control system that operated throughout the period covered by the accounts are described under the following headings:

Management information systems	Incorporating planning, budgeting and forecasting systems and a monthly review of actual results compared with budget and previous periods.
Group controls	Common accounting systems and controls are in place throughout the group and are monitored on a regular on-going basis.
Organisation	There are well structured financial and administrative functions at both head office and operational level staffed by appropriately qualified personnel. The key functions include: *Group accounting* *Corporate planning and group treasury* *Legal and company secretarial* *Group taxation* All functions report to the Board of Directors on a regular basis to provide assurance that their respective areas of responsibility are adequately controlled.
Monitoring procedures	All aspects of internal financial control are considered and monitored regularly by the Board of Directors and the Audit Committee.

Going concern

After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Directors' responsibilities

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and group and of the profit or loss of the group for that period. In preparing those accounts, 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 accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the group will continue in business.

CORPORATE GOVERNANCE

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

Auditors' responsibilities

Company law requires auditors to form an independent opinion on the accounts presented by the directors based on their audit and to report their opinion to the shareholders. The Companies Act 1985 also requires auditors to report to the shareholders if the following requirements are not met:

- that the companies in the group have maintained proper accounting records;
- that the accounts are in agreement with the accounting records;
- that directors' emoluments and other transactions with directors are properly disclosed in the accounts; and
- that the auditors have obtained all the information and explanations which, to the best of their knowledge and belief, are necessary for the purpose of their audit.

The auditors' opinion does not encompass the directors' report on pages 11 and 12. However, the Companies Act 1985 requires auditors to report to the shareholders if the matters contained in the directors' report are inconsistent with the accounts.

Remuneration committee report

The members of the remuneration committee during the period were The Hon. William D. Eberle (Chairman), Christopher H. B. Mills and Irvin L. Small. Following the resignation of Irvin L. Small on 10th October 1997, Paul G. Dumond was appointed a member of the remuneration committee on 4th December 1997.

The group's general policy on the granting of share options is to motivate and reward key management that are in a position to influence the future of the group. The share options are issued at the discretion of the Remuneration Committee, subject to a maximum of 10% of the issued share capital. There are no group performance requirements attached to the grant of the options. Options under the U.S. scheme which comprise the substantial majority of those outstanding at the period end are exercisable between the third and tenth anniversaries of the date of grant. During the period, options held by two directors lapsed and they were subsequently granted options over the equivalent number of shares. The committee and board believe it is appropriate to align the interests of directors and shareholders through the award of options.

The group has complied throughout the period with Section A "Remuneration Committees" of the best practice provisions on directors' remuneration annexed to the Listing Rules of the London Stock Exchange. In framing the group's remuneration policy, the committee has given full consideration to the provisions of Section B "Remuneration Policy, Service Contracts and Compensation" also annexed to those rules.

The group's policy on executive directors' remuneration is to provide remuneration packages to attract, retain and motivate executive directors of the quality required taking into account the levels paid by comparable companies and the relative performance of those companies. These packages principally comprise a basic salary, which is reviewed annually, a performance related bonus and executive share options. The performance related element of remuneration for the executive directors is directly related to the profitability of the group and to their performance compared with individual achievement goals.

Robert W. Gates Jr. and R. James P. Morton are being proposed for re-election at the forthcoming Annual General Meeting. R. James P. Morton does not have a service contract with any group company. Robert W. Gates has a service contract with a subsidiary undertaking with pre-determined compensation on termination not exceeding one year's salary.

Full details of the remuneration of the individual directors and information on share options and the executives' performance related bonus scheme are set out in note 4 to the accounts.

REPORT BY THE AUDITORS TO HORACE SMALL APPAREL PLC ON CORPORATE GOVERNANCE MATTERS

Report by the Auditors on Corporate Governance Matters

In addition to our audit of the accounts, we have reviewed the directors' statement on page 13 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the company's system of internal financial control or its corporate governance procedures nor on the ability of the company and group to continue in operational existence.

Opinion

With respect to the directors' statement on internal financial control and going concern on page 13, in our opinion the directors have provided the disclosures required by the Listing Rules as referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the accounts.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statement on page 13 appropriately reflects the company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Arthur Andersen

Arthur Andersen
Chartered Accountants
London

11th March 1998

AUDITORS' REPORT

To the shareholders of Horace Small Apparel PLC

We have audited the accounts on pages 16 to 34 which have been prepared under the historical cost convention and the accounting policies set out on pages 20 and 21.

Respective responsibilities of directors and auditors

As set out on pages 13 and 14 the company's directors are responsible for the preparation of the accounts. It is our responsibility to form an independent opinion, based on our audit, on those accounts 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 accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the company and 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 accounts 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 accounts.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the company and group as at 30th September 1997 and of the group's loss and cash flows for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

Arthur Andersen
Chartered Accountants and Registered Auditors
London

11th March 1998

GROUP PROFIT AND LOSS ACCOUNT

FOR THE NINE MONTHS ENDED 30TH SEPTEMBER, 1997

	Notes	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Turnover	1	59,666	91,307
Cost of sales - Normal		(42,683)	(62,707)
- Exceptional	2	(3,724)	–
Gross profit		13,259	28,600
Distribution costs		(8,124)	(11,917)
Administrative expenses - Normal		(8,430)	(11,195)
- Exceptional	2	(1,712)	–
Other operating income		48	126
Operating (loss)/profit	2	(4,959)	5,614
Interest payable and similar charges	5	(1,065)	(1,590)
(Loss)/profit on ordinary activities before taxation		(6,024)	4,024
Taxation on loss/profit on ordinary activities	6	(37)	88
(Loss)/retained profit for the period		(6,061)	4,112
Earnings per share:			
Basic (loss)/earnings per share	7	(17.7p)	12.0p
Adjustment for exceptional items		15.9p	–
Adjusted (loss)/earnings per share	7	(1.8p)	12.0p
Average exchange rate applied	£1=	$1.631	$1.561

Movements on reserves are set out in note 15.

The accompanying notes are an integral part of these accounts.

GROUP BALANCE SHEET

AT 30TH SEPTEMBER, 1997

	Notes	At 30th September, 1997 £000	At 31st December, 1996 £000
Fixed assets			
Tangible assets	8	10,591	10,864
Current assets			
Stocks	10	24,412	26,449
Debtors	11	11,857	15,943
Cash at bank and in hand		909	363
		37,178	42,755
Creditors: amounts falling due within one year	12	(9,355)	(15,651)
Net current assets		27,823	27,104
Total assets less current liabilities		38,414	37,968
Creditors: amounts falling due after more than one year	13	(15,834)	(10,939)
Net assets		22,580	27,029
Capital and reserves			
Called up share capital	14	1,714	1,714
Share premium account	15	20,881	20,881
Exchange translation reserve	15	(3,926)	(5,538)
Profit and loss account	15	3,911	9,972
Shareholders' funds	16	22,580	27,029
Period end exchange rate applied	£1=	$1.612	$1.712

As approved by the Board of Directors on 11th March 1998 and signed on its behalf by:

J. Colin Keith
Richard B. Vacek, Jr. } Directors

The accompanying notes are an integral part of these accounts.

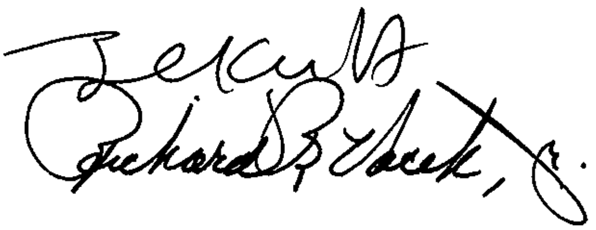
COMPANY BALANCE SHEET

AT 30TH SEPTEMBER, 1997

	Notes	At 30th September, 1997 £000	At 31st December, 1996 £000
Fixed assets			
Investments	9	**45,056**	45,260
Current assets			
Debtors	11	**48**	48
Creditors: amounts falling due within one year	12	**(141)**	(576)
Net current liabilities		**(93)**	(528)
Net assets		**44,963**	44,732
Capital and reserves			
Called up share capital	14	**1,714**	1,714
Share premium account	15	**20,881**	20,881
Special reserve	15	**17,296**	17,296
Profit and loss account	15	**5,072**	4,841
Shareholders' funds		**44,963**	44,732

As approved by the Board of Directors on 11th March 1998 and signed on its behalf by:

J. Colin Keith
Richard B. Vacek, Jr. } Directors



GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

FOR THE NINE MONTHS ENDED 30TH SEPTEMBER, 1997

	Notes	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
(Loss)/profit on ordinary activities after taxation		**(6,061)**	4,112
Currency translation differences on foreign currency net investments	15	**1,612**	(2,776)
Total (losses)/gains recognised since the previous balance sheet date		**(4,449)**	1,336

The accompanying notes are an integral part of these accounts.

GROUP CASH FLOW STATEMENT

FOR THE NINE MONTHS ENDED 30TH SEPTEMBER, 1997

	Notes	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Net cash inflow from operating activities	20a	**3,761**	6,723
Returns on investments and servicing of finance	20b	**(957)**	(1,703)
Taxation	20b	**(32)**	(58)
Capital expenditure and financial investment	20b	**(1,638)**	(1,856)
Cash inflow before financing		**1,134**	3,106
Financing - (decrease) in debt	20b, c	**(632)**	(3,789)
Increase/(decrease) in cash in the period	20c	502	(683)

The accompanying notes are an integral part of these accounts.

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

The accounts have been prepared under the historical cost convention and in accordance with applicable Accounting Standards. The following paragraphs describe the principal policies, all of which have been applied consistently throughout the current and preceding periods.

The accounting policies of some overseas subsidiary undertakings do not conform with UK Accounting Standards and, where appropriate, adjustments are made on consolidation in order to present the group accounts on a consistent basis.

Basis of consolidation

The group accounts include the accounts of the company and all of its subsidiary undertakings at any time during the financial period. In 1997 all group undertakings made up their accounts to 30th September. In 1996 all group undertakings made up their accounts to 31st December. The results of subsidiary undertakings and businesses acquired during the period are included from the date of acquisition. The results of subsidiary undertakings and businesses disposed of during the period are included to the date of their disposal. Goodwill arising on consolidation is written off to reserves on acquisition.

By virtue of Section 230(4) of the Companies Act 1985, the company is exempt from presenting a profit and loss account.

Turnover

Turnover comprises invoiced sales of fitted uniforms, corporate clothing, related accessories and equipment, excluding sales taxes. Advances on contract sales are recorded as deferred income and released to turnover only when the goods are dispatched.

The directors are of the opinion that the group operates in one unified segment, the manufacture of uniforms and the distribution of uniforms and accessories. All turnover arose in North America. Turnover by destination is not materially different from that by origin.

Tangible fixed assets

Property and equipment are stated at cost.

Depreciation and amortisation are provided in order to write off assets on a straight line basis over their estimated useful lives as follows:

Buildings and leasehold improvements	3 to 25 years
Plant, machinery and vehicles	3 to 10 years
Furniture, fixtures and fittings	10 years

Freehold land and assets in the course of construction are not depreciated.

Leases

Assets held under finance leases are initially reported at the fair value of the asset, with an equivalent liability categorised as appropriate under creditors due within or after one year. The asset is depreciated over the shorter of the lease term and its useful economic life. Finance charges are allocated to accounting periods over the period of the lease to produce a constant rate of return on the outstanding balance. Rentals are apportioned between finance charges and reduction of the liability, and allocated to cost of sales and other operating expenses as appropriate.

Annual rentals payable in respect of operating leases are charged to the profit and loss account on a straight line basis over the lease term.

Investments

Fixed asset investments are shown at cost less amounts written off. No provision is made for temporary fluctuations in value. Income is included in the accounts for the period in which it is receivable.

Stocks

Stocks are valued at the lower of first-in first-out cost and net realisable value. The valuation of work-in-progress and finished goods includes the cost of direct materials and labour, plus a reasonable proportion of manufacturing overheads based on normal levels of activity.

1. ACCOUNTING POLICIES (continued)

Set up and start up costs attributable to long term contracts
Incremental costs that are directly attributable to the set up of new facilities and systems required to service long term National Account contracts are capitalised and shown under debtors. The costs are normally amortised over the term of the contract as follows:

i) one half is amortised on a straight line basis over the first twelve months following the commencement of full shipping operations;

ii) the balance is amortised on a straight line basis over a period not exceeding the term of the contract commencing with the first anniversary of full shipping operations; and

iii) the balance is reviewed on an annual basis and any permanent diminution in value is charged to the profit and loss account.

Deferred taxation
Provision is made, at rates expected to be in force at the time of reversal, for taxation deferred in respect of all material timing differences to the extent that, in the opinion of the directors, there is a reasonable probability that the liability will arise in the foreseeable future (the liability method).

Foreign currencies
Foreign currency transactions are converted at the rate of exchange ruling at the date of the transaction or translated at the year end rate in the case of transactions not then finalised. Assets and liabilities denominated in foreign currencies at the period end are expressed in sterling at the rate of exchange ruling at that date. The results of United States subsidiary undertakings have been translated into sterling at the average rate of exchange for the period.

Currency adjustments are included in trading profits except that the difference arising on the retranslation of the group's share of the net assets of overseas subsidiary undertakings at the beginning of the period, or on acquisition if later, is treated as a movement on reserves.

Pensions
Entry to Horace Small's pension scheme was closed during 1993 and there is no longer a regular pension cost charged to the profit and loss account. Independent actuarial valuations on a going concern basis are carried out annually and the resultant actuarial surplus or deficit is spread in the profit and loss account over the average remaining service lives of employees, currently estimated at 13 years.

NOTES TO THE ACCOUNTS

2. OPERATING (LOSS)/PROFIT

	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
This is stated after charging:		
Auditors' remuneration	86	92
Other fees paid in the UK to the auditors	–	7
Depreciation of tangible fixed assets:		
Owned	888	937
Held under finance leases	109	135
Loss on disposal of tangible fixed assets	10	17
Hire of plant and machinery and motor vehicles under operating leases	199	307
Payments under operating leases – premises	891	1,203
Exceptional charges - cost of sales:		
Rationalisation of inventory lines	3,066	–
Start-up costs associated with new manufacturing facility at Brownsville	658	–
	3,724	–
Exceptional charges - administrative expenses:		
Closure of manufacturing facility at Guthrie	492	–
Accelerated depreciation in respect of management information system	1,220	–
	1,712	–
Total exceptional charges	5,436	

3. EMPLOYEES

	Nine months ended 30th September, 1997	Year ended 31st December, 1996
The monthly average number of employees was made up as follows:	Number	Number
Production	829	765
Warehousing and distribution	404	460
Sales	121	120
Administration	57	50
	1,411	1,395

All employees, including executive directors, are employed in North America.

Staff costs, including directors' remuneration during the period comprised:	£000	£000
Salaries and wages	13,247	19,036
Social security costs	1,265	1,645
Other pension credits (note 19a)	(29)	(13)
Profit sharing costs	316	435
	14,799	21,103

4. DIRECTORS' REMUNERATION AND INTERESTS

Directors' remuneration

Name of Director	Fees £000	Basic salary and other emoluments £000	Taxable benefits £000	Prior year performance related bonus £000	Profit sharing retirement plan £000	Nine months ended 30th September, 1997 total £000	Year ended 31st December, 1996 total £000
Executive							
J. C. Keith	4	26	–	–	–	30	40
R. W. Gates, Jr.	4	81	7	28	4	124	153
R. B. Vacek, Jr.	4	70	7	22	4	107	134
Non-executive							
P. G. Dumond	4	4	–	–	–	8	6
W. D. Eberle	4	4	–	–	–	8	10
C. H. B. Mills	4	19	–	–	–	23	30
R. J. P. Morton	4	4	–	–	–	8	10
I. L. Small *(resigned 10th October, 1997)*	4	4	–	–	–	8	10
Aggregate emoluments	32	212	14	50	8	316	393

The emoluments of the chairman, J. C. Keith, totalled £30,000 (1996 – £40,000). The emoluments of the highest paid director for services rendered in the UK in the period totalled £23,000 (1996 – £30,000).

Executives' performance related bonuses

The executive directors, excluding J. C. Keith, are entitled to participate in a management bonus pool which is available to all of the group's senior management. The level of each director's bonus is determined in the year following the year to which the bonus relates.

4. DIRECTORS' REMUNERATION AND INTERESTS (continued)

Directors' interests

The aggregate emoluments disclosed above do not include any amounts for the value of options to subscribe for ordinary shares in the company granted to or held by the directors. Details of the options are as follows:

	30th September, 1997	31st December, 1996	Date of grant	Exercise price
Directors:				
J. C. Keith	409,200	409,200	13th July, 1993	68.43p
	90,800	90,800	12th December, 1996	84.00p
R. W. Gates, Jr.	102,300	102,300	30th May, 1990	122.19p
	20,460	20,460	24th September, 1992	68.43p
	25,000	25,000	7th June, 1995	106.00p
	100,000	100,000	26th September, 1995	98.00p
	33,000	33,000	13th May 1996	88.00p
R. B. Vacek, Jr.	102,300	102,300	30th May, 1990	122.19p
	20,460	20,460	24th September, 1992	68.43p
	20,000	20,000	7th June, 1995	106.00p
	33,000	33,000	13th May 1996	88.00p
P. G. Dumond (UK scheme)	–	15,345**	30th May, 1990	122.19p
	15,345*	–	15th September, 1997	77.00p
W. D. Eberle	102,300	102,300	30th May, 1990	122.19p
C. H. B. Mills (UK scheme)	–	409,200**	30th May, 1990	122.19p
	409,200*	–	15th September, 1997	77.00p
R. J. P. Morton	102,300	102,300	30th May, 1990	122.19p
I. L. Small (resigned 10th October 1997)	102,300	102,300	3rd November, 1992	70.38p

* Options granted during the period.

** Options lapsed during the period.

Options granted under the company's US Stock Option Plan may be exercised between the third and tenth anniversaries of the date of grant.

Options granted under the company's UK Executive Share Option Scheme may be exercised between the third and seventh anniversaries of the date of grant.

Since the period end the options held by I.L. Small terminated following his resignation as a director. Other than this there have been no changes in the numbers of options held by directors or their exercise prices.

4. DIRECTORS' REMUNERATION AND INTERESTS (continued)

The directors' beneficial interests in the share capital of the company, are set out below:

	Number of Ordinary Shares of 5p each	
	At 30th September, 1997	At 31st December, 1996
J. C. Keith	**505,000**	505,000
R. W. Gates, Jr.	**144,967**	144,967
R. B. Vacek, Jr.	**30,178**	30,178
P. G. Dumond	**–**	–
W. D. Eberle	**–**	–
C. H. B. Mills	**168,000**	168,000
R. J. P. Morton	**158,000**	158,000
I. L. Small (resigned 10th October, 1997)	**106,911**	106,911

Since the period end, there have been no changes in the holdings shown above.

5. INTEREST PAYABLE AND SIMILAR CHARGES

	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Interest on bank loans and overdrafts	**1,050**	1,566
Interest on finance leases	**13**	15
Other interest	**2**	9
	1,065	1,590

6. TAXATION ON LOSS/PROFIT ON ORDINARY ACTIVITIES

	Nine months ended 30th September 1997 £000	Year ended 31st December, 1996 £000
UK Corporation tax	**37**	–
US Federal tax credit	**–**	(88)
Total tax charge/(credit)	**37**	(88)

At 30th September, 1997 the group had tax losses of approximately $18.4 million (1996 - $13.7 million) available for offset against future profits subject to United States Federal taxation. The losses begin to expire in 2006.

No deferred taxation has been provided and no potential liability arises in the group or company due to the availability of tax losses to offset reversals of other short term timing differences and the excess of the book value of tangible assets over their tax value.

7. (LOSS)/EARNINGS PER SHARE

The calculation of the basic (loss)/earnings per share is based on the loss after tax of £6,061,000 (1996 - profit £4,112,000) and on the average number of ordinary shares in issue during the period of 34,281,526 (1996 - 34,281,526). The adjusted loss per share in 1997 is based on the adjusted loss after tax of £625,000 after excluding exceptional charges totalling £5,436,000 net of taxation.

8. TANGIBLE ASSETS

The Group

	Freehold property £000	Long leasehold property £000	Plant, machinery & vehicles £000	Furniture, fixtures & fittings £000	Assets in course of construction £000	Total £000
Cost						
At 1st January, 1997	1,338	5,715	6,175	1,714	–	14,942
Additions	–	46	948	126	522	1,642
Disposals	(48)	(17)	(3)	–	–	(68)
Exchange movement	83	355	394	107	7	946
At 30th September, 1997	1,373	6,099	7,514	1,947	529	17,462
Depreciation						
At 1st January, 1997	68	792	2,543	675	–	4,078
Charge for the period	309	218	1,853	137	–	2,517
Disposals	–	(3)	(4)	–	–	(7)
Exchange movement	9	51	180	43	–	283
At 30th September, 1997	386	1,058	4,572	855	–	6,871
Net book value						
At 30th September, 1997	987	5,041	2,942	1,092	529	10,591
At 31st December, 1996	1,270	4,923	3,632	1,039	–	10,864
Leased assets included in the above: **Net book value**						
At 30th September, 1997	–	4,012	185	–	–	4,197
At 31st December, 1996	–	4,541	205	–	–	4,746

Freehold property includes freehold land with a book value of £987,000 (1996 - £947,000) which is not being depreciated. Long leasehold property includes land, with a book value of £1,757,000 (1996 - £1,655,000), which is not being depreciated as the group has an option to acquire the freehold of the property for a nominal sum at any time prior to the year 2008.

9. FIXED ASSET INVESTMENTS

	The Company	
	At 30th September, 1997 £000	At 31st December, 1996 £000
Investment in subsidiary undertakings at cost	41,000	41,000
Long term loans to subsidiary undertakings	4,056	4,260
	45,056	45,260
Movements in the period comprise:		
(Decrease)/increase in loans to subsidiary undertakings	(423)	217
Exchange movement on long term loans	219	(432)
	(204)	(215)

The company's principal subsidiary undertakings are set out below:

Company	Proportion and class of shares held	Country of incorporation and operation	Principal activity during the period
Horace Small Holdings Corporation of Delaware, Inc.[1]	100% common stock	USA	Holding company
Horace Small Holdings Corporation[2]	100% common stock	USA	Holding company
Horace Small Manufacturing Company[3]	100% common stock	USA	Manufacture and distribution of fitted uniforms and corporate clothing
Greenbrier Garment Company[4]	100% common stock	USA	Manufacture of fitted uniforms and corporate clothing
R&R Uniforms, Inc.[4]	100% common stock	USA	Distribution of uniforms
R&R Uniforms of Florida, Inc.[5]	100% common stock	USA	Distribution of uniforms
Horace Small Apparel Limited	100% group owned partnership	USA	Manufacture of fitted uniforms and corporate clothing

[1] Held by Horace Small Apparel PLC
[2] Held by Horace Small Holdings Corporation of Delaware, Inc.
[3] Held by Horace Small Holdings Corporation
[4] Held by Horace Small Manufacturing Company
[5] Held by R&R Uniforms, Inc.

A full list of subsidiary undertakings will be included in the company's annual return.

10. STOCKS

	The Group	
	At 30th September, 1997 £000	At 31st December, 1996 £000
Raw materials	**3,740**	3,996
Work-in-progress	**1,421**	1,068
Finished goods	**19,251**	21,385
	24,412	26,449

Finished goods comprise stocks of uniforms, clothing and accessories held for resale. The replacement cost of stock is not considered to be materially different from the balance sheet value.

11. DEBTORS

	The Group		The Company	
	At 30th September, 1997 £000	At 31st December, 1996 £000	At 30th September, 1997 £000	At 31st December, 1996 £000
Amounts falling due within one year:				
Trade debtors	**10,651**	14,525	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**–**	13
Other debtors	**123**	214	**2**	–
Value added tax recoverable	**18**	16	**18**	16
Prepayments and accrued income	**489**	256	**28**	19
	11,281	15,011	**48**	48
Amounts falling due after more than one year:				
Other debtors	**12**	13	**–**	–
Prepayments and accrued income	**405**	604	**–**	–
Deferred start up costs	**159**	315	**–**	–
	576	932	**–**	–
	11,857	15,943	**48**	48

12. CREDITORS: amounts falling due within one year

	The Group		The Company	
	At 30th September, 1997 £000	At 31st December, 1996 £000	At 30th September, 1997 £000	At 31st December, 1996 £000
Bank loans and overdrafts	15	4,567	15	3
Obligations under finance leases	79	72	–	–
Payments received on account	–	146	–	–
Trade creditors	6,402	7,912	–	–
Amounts owed to subsidiary undertakings	–	–	25	460
Other creditors	34	45	–	–
UK corporation tax	18	3	18	3
Overseas tax	182	229	–	–
Accruals	2,625	2,677	83	110
	9,355	15,651	141	576

The group has entered into a revised bank facility the details of which are described in note 13 below.

13. CREDITORS: amounts falling due after more than one year

	The Group	
	At 30th September, 1997 £000	At 31st December, 1996 £000
Obligations under finance leases:		
Payable over one to two years	81	77
Payable over two to five years	70	100
Payable over five years	70	67
Bank loans:		
Payable over one to two years	2,433	6,840
Payable over two to five years	13,027	3,186
Payable over five years	–	531
Other creditors:		
Payable over two to five years	124	117
Payable over five years	29	21
	15,834	10,939

The group has entered into a revised bank facility with SunTrust Bank and Creditanstalt. The new agreement provides for an unsecured revolving credit facility of $37,500,000 reducing to $21,000,000 on 30th September, 1999. The facility matures on the 1st October 2000 and bears interest, at the group's option, at either (a) the banks' base rate to banks' base rate plus 0.50% or (b) the US dollar LIBOR plus 1.75% to 3.00%.

13. CREDITORS: amounts falling due after more than one year (continued)

As of 30th September, 1997, the group had interest rate swap agreements with a bank to reduce the impact of interest rate changes on its debt. Interest on the group's primary credit facilities are based on a floating base rate plus 1.75% to 3.00%. The interest rate swap agreements involve an exchange of the floating base rate for a fixed rate of 5.87% and 5.185% on notional amounts of $10,00,000 and $5,000,000, respectively. As a result of the interest rate swap agreements, the group pays interest on the notional amounts at the fixed rates plus 1.75% to 3.00%. The $5,000,000 agreement expires in March 1998. The $10,000,000 matures in April 2000, however the bank has the option to terminate the agreement on 27th April, 1998. Subsequent to 30th September, 1997, the group entered into an additional $5,000,000 interest rate swap agreement, which expires in January 2001. This agreement involves an exchange of a floating rate interest payment for a fixed rate of 5.76%.

14. CALLED UP SHARE CAPITAL

(a) Share Capital

This comprises ordinary shares of 5 pence each as follows:

	Authorised		Allotted, called up and fully paid	
	No. of shares	£000	No. of shares	£000
At 1st January, 1997 and 30th September, 1997	50,000,000	2,500	34,281,526	1,714

(b) Options

The following options, including those detailed in note 4, granted under the UK Executive Share Option Scheme and the US Stock Option Plan, were outstanding at the period ends:

Date of Grant	Price per fully paid share	At 30th September, 1997 Number of ordinary shares	At 31st December, 1996 Number of ordinary shares
30th May, 1990	122.19p	557,538	557,538
30th May, 1990 (UK scheme)	122.19p	–	567,765
26th June, 1992	84.07p	93,095	96,165
24th September, 1992	68.43p	40,920	40,920
3rd November, 1992	70.38p	–	102,300
30th November, 1992	79.18p	51,150	51,150
13th July, 1993	68.43p	409,200	409,200
8th November, 1993	62.56p	51,150	51,150
15th August, 1994	82.11p	53,709	71,612
7th June, 1995	106.00p	124,000	127,500
26th September, 1995	98.00p	100,000	100,000
18th December, 1995	91.00p	30,000	30,000
13th May, 1996	88.00p	320,000	415,000
18th December, 1996	84.00p	145,800	145,800
23rd June, 1997	84.00p	25,000	–
15th September 1997	77.00p	140,000	–
15th September, 1997 (UK scheme)	77.00p	424,545	–
		2,566,107	2,766,100

14. CALLED UP SHARE CAPITAL (continued)

Options granted under the company's US Stock Option Plan may be exercised between the third and tenth anniversaries of the date of grant.

Options granted under the company's UK Executive Share Option Scheme may be exercised between the third and seventh anniversaries of the date of grant.

No options were exercised during the period. Options held to acquire up to 789,538 shares lapsed during the period.

The market price of the ordinary shares at 30th September, 1997 was 72.5p and the range during the period was 70.0p to 101.5p.

15. RESERVES

	Share Premium £000	Exchange Translation Reserve £000	Profit and Loss Account £000	Total £000
Group				
At 1st January, 1997	20,881	(5,538)	9,972	25,315
Loss for the period	–	–	(6,061)	(6,061)
Currency translation differences	–	1,612	–	1,612
At 30th September, 1997	20,881	(3,926)	3,911	20,866

	Share Premium £000	Special Reserve £000	Profit and Loss Account £000	Total £000
Company				
At 1st January, 1997	20,881	17,296	4,841	43,018
Profit for the period	–	–	231	231
At 30th September, 1997	20,881	17,296	5,072	43,249

At 30th September, 1997 the profit and loss account of the company included £4,493,000 (1996 - £4,257,000) of unrealised exchange gains on the translation of amounts denominated in US dollars advanced to subsidiary undertakings. Accordingly, the distributable reserves of the company at 30th September, 1997 totalled £579,000 (1996 - £584,000).

Of the group loss for the period, a profit of £231,000 (1996 - loss £353,000) has been dealt with in the accounts of the company.

At 30th September, 1997 the cumulative amount of goodwill resulting from acquisitions which had been written off to reserves, net of goodwill attributable to subsidiary undertakings or businesses disposed of, amounted to £22,436,000 (1996 - £22,436,000).

16. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	The Group	
	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
(Loss)/profit on ordinary activities after taxation	**(6,061)**	4,112
Currency translation differences on foreign currency net investments	**1,612**	(2,776)
Net movement of shareholders' funds	**(4,449)**	1,336
Shareholders' funds at the beginning of the period	**27,029**	25,693
Shareholders' funds at the end of the period	**22,580**	27,029

NOTES TO THE ACCOUNTS

17. OPERATING LEASE COMMITMENTS

Commitments under leases to pay rentals during the year following the period of these accounts, analysed by year of expiry of each lease, are given in the tables below:

	At 30th September, 1997 £000	At 31st December, 1996 £000
Operating leases – land and buildings:		
Within one year	115	135
From one to five years	819	581
Over five years	297	271
	1,231	987
Operating leases – other assets:		
Within one year	126	57
From one to five years	104	134
Over five years	10	8
	240	199

18. CAPITAL COMMITMENTS

Capital commitments at 30th September, 1997 which had been contracted for but not provided for in these accounts totalled £785,000 (1996 - £256,000).

19. PENSION AND RETIREMENT ARRANGEMENTS

(a) Horace Small operates a funded defined benefit pension scheme for certain US employees.

Entry to this scheme was closed on 30th June, 1993; however, previous contributions remain in the trust funds to pay vested retirement benefits. The group plans to make no contributions to the pension scheme in the future, unless independent professionally qualified actuaries, in their annual review of the scheme, determine a payment is necessary to fund vested benefits.

The pension cost and related prepayment are assessed in accordance with the advice of the actuaries under the principles of US Accounting Standards. The projected unit credit actuarial cost method is used to determine the normal cost of the pension plan and estimate pension benefit obligations. In the most recent actuarial valuation the main assumptions were that (a) salaries would increase by 3.0% p.a., (b) pensions in payment remain constant, and (c) the return on scheme investments would be 8.0% p.a.

The market value of the assets of the scheme at 30th September, 1997 was £3,583,000 (1996 - £3,142,000) and the actuarial value of the assets was sufficient to cover 113% of the benefits that had accrued to members after allowing for expected future increases in earnings.

The pension credit for the period, reflecting the benefit of amortisation of the actuarial surplus, was £29,000 (1996 - £13,000). No contributions were paid to the scheme during the period (1996 - nil). Prepaid contributions of £347,000 (1996 - £299,000) at the period end are shown in the balance sheet under 'Prepayments'. The directors consider that no material adjustment would arise if these amounts were revised to reflect UK Accounting Standards, the expense of which exercise is therefore not justified.

(b) The Horace Small Profit Sharing Retirement Plan includes a profit sharing component, made at the group's discretion, for all eligible employees. Horace Small also contributes amounts equal to one-half of the employees' contribution up to a maximum of 3% of covered wages. The total charge for the period was £213,000 (1996 - £348,000).

20. NOTES TO THE GROUP CASH FLOW STATEMENT

a) Reconciliation of operating profit to operating cash flows

	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Operating (loss)/profit	(4,959)	5,614
Depreciation charges	997	1,072
Exceptional items	5,436	–
Loss on sale of fixed assets	10	17
Decrease/(increase) in stocks	568	(2,004)
Decrease in debtors	4,989	3,236
(Decrease) in creditors and provisions	(2,478)	(1,348)
Other translation adjustments	48	136
Net cash inflow from operating activities before cash outflow from exceptional items	4,611	6,723
Cash outflow from exceptional items	(850)	–
Net cash inflow from operating activities	3,761	6,723

b) Analysis of cash flows

Returns on investments and servicing of finances	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Interest received	9	24
Interest paid	(951)	(1,705)
Interest element of finance lease payments	(15)	(22)
Net cash outflow	(957)	(1,703)
Taxation		
UK corporation tax paid	(22)	(1)
Overseas tax paid	(10)	(57)
Net cash outflow	(32)	(58)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(1,642)	(1,862)
Proceeds from sale of tangible fixed assets	4	6
Net cash outflow	(1,638)	(1,856)
Financing		
Increase/(decrease) in other loans	241	(7,609)
(Decrease)/increase in unsecured loan	(836)	3,844
Capital element of finance lease rental payments	(37)	(24)
Net cash (outflow)	(632)	(3,789)

20. NOTES TO THE GROUP CASH FLOW STATEMENT (continued)

c) Analysis and reconciliation of net debt

	At 1st January, 1997 £000	Cash flow £000	Other non-cash changes £000	Exchange movement £000	At 30th September, 1997 £000
Cash at bank and in hand	363	502	–	44	909
Debt due after 1 year	(10,557)	595	(4,793)	(705)	(15,460)
Debt due within 1 year	(4,567)	–	4,793	(241)	(15)
Finance leases	(317)	37	–	(20)	(300)
Net debt	(15,078)	1,134	–	(922)	(14,866)

	Nine months ended 30th September, 1997 £000	Year ended 31st December, 1996 £000
Increase/(decrease) in cash in the period	**502**	(683)
Cash outflow from decrease in debt and lease financing	**632**	3,789
Change in net debt resulting from cash flows	**1,134**	3,106
New finance leases	**–**	(220)
Translation difference	**(922)**	1,544
Movement in net debt in the period	**212**	4,430
Net debt at beginning of period	**(15,078)**	(19,508)
Net debt at end of period	**(14,866)**	(15,078)

21. POST BALANCE SHEET EVENTS

On 16th February, 1997 the group entered into a sale and purchase agreement for the sale of its company owned distributors to Skaggs Companies, Inc. ("Skaggs"), one of the group's wholesale customers. These distributors market a range of uniforms manufactured by the group and other items procured from outside the group, such as uniform accessories and public safety related equipment. Sales associated with these distributors totalled approximately £16 million in the nine months ended 30th September, 1997 and £25 million in the year ended 31st December,1996. Because of the size of the sale, the agreement is conditional on the approval of the shareholders of the company.

Under the terms of the agreement, Skaggs is to purchase the inventory and fixed assets of the company owned distributors at completion for each location, which will take place no later than 30th June, 1998. The purchase price will be determined at completion based on a formula which approximates to the net book of the inventory and fixed assets at the relevant locations at that time. Also in conjunction with the transaction the group will be renegotiating certain aspects of its bank credit facility.

CORPORATE INFORMATION

US OFFICES	350 28th Avenue North P.O. Box 1269 Nashville, Tennessee 37202-1269, USA Tel: (615) 320 1000 Fax: (615) 327 1912
LONDON OFFICE AND REGISTERED ADDRESS	Masters House 107 Hammersmith Road London W14 0QH Tel: 0171 603 1515 Fax: 0171 603 8448
COMPANY NUMBER:	153088
SECRETARY	Paul G. Dumond
BANKERS	SunTrust Bank, Nashville, N.A. 201 Fourth Avenue North, Nashville, Tennessee 37244, USA Creditanstalt Two Ravinia Drive, Suite 1680, Atlanta, Georgia 30346, USA
AUDITORS	Arthur Andersen 1 Surrey Street, London WC2R 2PS
LEGAL ADVISORS	Boult, Cummings, Connors & Berry 414 Union Street, Suite 1600 Nashville, Tennessee 37219, USA Ashurst Morris Crisp 5 Appold Street, London EC2A 2HA
REGISTRARS	IRG plc Balfour House, 390-398 High Road, Ilford, Essex IG1 1NQ
STOCKBROKERS	Collins Stewart & Company 21 New Street, London EC2M 4HR
ADR DEPOSITARY	Bank of New York ADR Division 101 Barclay Street, 22nd Floor New York, New York, 10286, USA

DIRECTORS

J. Colin Keith (Chairman and Chief Executive)

Colin Keith, aged 53, was appointed Chairman in June 1993 and Chief Executive in March 1996. He also serves as Chairman of Denison International plc, an international group engaged in the manufacture and distribution of hydraulic pumps and valves.

Robert W. Gates, Jr. (President and Chief Operating Officer)(USA)

Robert Gates, aged 51, was one of the founders of R&R Uniforms and has served as its President since its inception in 1972. He became President and Chief Operating Officer of Horace Small in March 1996.

Richard B. Vacek, Jr. (Finance Director)(USA)

Richard Vacek, aged 49, became a Certified Public Accountant in 1973. Prior to joining Horace Small in July 1989, he spent over 15 years in various financial management positions in the health care industry.

Paul G. Dumond (Company Secretary)†

Paul Dumond, aged 42, has served as Company Secretary since 1990 and was appointed a Director in May 1996. He is also a director of Mid-States PLC and was Finance Director of Aberdeen Petroleum PLC from 1987 to 1993.

The Hon. William D. Eberle (USA)*†

The Hon. William Eberle, aged 74, was appointed a non-executive Director in June 1990. He served as a Special Trade Representative during the Nixon and Ford administrations. A director of various U.S. corporations, he was a founder of Boise Cascade and served as Chairman and Chief Executive Officer of American Standard. He is currently Deputy Chairman of Mid-States PLC and Vice Chairman of the US Council of the International Chamber of Commerce.

Christopher H.B. Mills*†

Christopher Mills, aged 45, was appointed a non-executive Director in January 1988. He is Managing Director of North Atlantic Smaller Companies Investment Trust PLC and American Opportunity Trust PLC. He is also Chairman of Paramount plc and a director of a number of other publicly listed companies.

R. James P. Morton*

James Morton, aged 44, was appointed a non-executive Director in May 1990. He is director of investments with European American Securities, Inc. He is also a director of Knox d'Arcy plc and of a number of private companies. He is the editor of the Financial Times Global Guide to Investing and author of Investing with the Grand Masters.

* Member of the Audit Committee

† Member of the Remuneration Committee

ANNUAL GENERAL MEETING

The Company's Annual General Meeting will be held at the offices of J O Hambro & Co Ltd, 10 Park Place, London SW1 1LP on Wednesday 6th May, 1998 at 2pm. The Notice of Meeting follows, and sets out the business to be transacted. An explanation of each of the resolutions follows below.

ORDINARY BUSINESS

Resolution 1: Adoption of Accounts

This is an ordinary resolution for the adoption of the Directors' Report and Accounts for the financial year ended 30th September 1997.

Resolutions 2 and 3: Re-election of Directors

The Company's Articles of Association require that every year, a third of the directors retire from office and, where appropriate, seek re-election. This year, Robert W. Gates, Jr. and R. James P. Morton retire in this way and resolutions 2 and 3 are for their re-election.

Resolution 4: Reappointment of Auditors

The Company's Auditors are required to be reappointed at every Annual General Meeting. Resolution 4 is for the reappointment of Arthur Andersen and, in accordance with normal practice, to authorise the Directors to fix their remuneration.

SPECIAL BUSINESS

Resolution 5: Allotment of Relevant Securities

This is an ordinary resolution to renew the authority granted to the directors at last year's Annual General Meeting to allot relevant securities in terms of Section 80 of the Companies Act 1985, up to an aggregate nominal amount of £571,358, representing approximately one third of the share capital currently in issue.

Resolution 6: Disapplication of Pre-emption Rights

Resolution 6 is a special resolution which would renew the power granted to the directors at last year's Annual General Meeting to disapply the statutory pre-emption rights under section 95 of the Companies Act 1985 thus overcoming certain technical difficulties that may arise in connection with a rights issue or grant of options. It also permits issues of the company's share capital for cash, other than pro-rata to shareholders, up to an aggregate nominal value of £85,703. This represents approximately 5% of the ordinary share capital currently in issue.

Resolution 7: Authority to Buy Back the Company's Own-Shares

This is a special resolution to authorise the company to buy back its own shares. No purchases will be made unless the effect is expected to increase earnings per share and the directors consider the purchases to be in the interests of shareholders generally. The proposed authority will be limited by the terms of the resolution to purchases of up to 5,142,228 ordinary shares (representing approximately 15% of the share capital of the company currently in issue) made through The London Stock Exchange at prices not exceeding 105% of the average of the middle market quotations derived from The London Stock Exchange Daily Official Listing for the ten business days before each purchase.

NOTICE OF MEETING

Notice is hereby given that the Annual General Meeting of Horace Small Apparel PLC will be held at the offices of J O Hambro & Co Ltd, 10 Park Place, London SW1 1LP on Wednesday 6th May, 1998 at 2pm.

Agenda

1. To receive and adopt the Directors' Report and Accounts for the financial year ended 30th September 1997.

2. To re-elect Robert W. Gates, Jr. as a director.

3. To re-elect R. James P. Morton as a director.

4. To reappoint the auditors and authorise the directors to fix their remuneration.

5. Special Business: To consider and, if thought fit, approve the following Ordinary Resolution:

That the directors be and they are hereby generally and unconditionally empowered, in place of all existing authorities under Section 80 of the Companies Act 1985, to exercise all powers of the company to allot relevant securities (within the meaning of Section 80 of the Companies Act 1985) up to an aggregate nominal amount of £571,358 provided that this authority shall expire on 5th May, 2003, save that the company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the board may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

6. Special Business: To consider and, if thought fit, approve the following Special Resolution:

That subject to the passing of the previous resolution the directors be and they are hereby generally and unconditionally authorised to exercise all powers of the company to allot equity securities (within the meaning of Section 94(2) of the Companies Act 1985), as if Section 89(1) of the Companies Act 1985 did not apply to such allotment, provided that this authority shall:

(i) expire on 5th May, 2003 save that the directors may allot equity securities under this authority after the expiry thereof pursuant to any offer or agreement made by the company on or before such expiry date pursuant to this authority as if such authority had not expired; and

(ii) be limited to the allotment of equity securities:

(a) in connection with a rights issue or any other pre-emptive offer concerning equity securities in the company where it is, in the opinion of the directors, necessary or expedient to allot equity securities otherwise than in accordance with Section 89 of the Companies Act 1985 by reason of the rights attached to any shares or securities of the company or in relation to fractional entitlements or legal or practical problems under the laws of or the requirements of any recognised regulatory body or stock exchange in any territory; and

(b) pursuant to the terms of any stock option plan or share option scheme or other plan for employees and/or executive or non-executive directors approved by the company in General Meeting, up to an aggregate nominal value of £171,407; and

(c) otherwise than pursuant to sub-paragraphs (a) and (b), up to an aggregate nominal value not exceeding £85,703.

NOTICE OF MEETING (continued)

7. Special Business: To consider and, if thought fit, approve the following Special Resolution:

That the company is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of ordinary shares of 5p each in the capital of the company ("Ordinary Shares") with effect from the conclusion of this meeting provided that:

(a) the maximum aggregate number of Ordinary Shares authorised to be purchased is 5,142,228;

(b) the minimum price which may be paid for each such Ordinary Share is 5p;

(c) the maximum price (inclusive of expenses) which may be paid for each such Ordinary Share is an amount equal to 105 per cent of the average of the middle market quotations as derived from The London Stock Exchange Daily Official List for the ten business days immediately preceding the day on which such Ordinary Share is purchased; and

(d) the company may make a contract to purchase its Ordinary Shares under this authority prior to the expiry thereof, which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of its Ordinary Shares pursuant to any such contract.

The authority will expire at the conclusion of the next Annual General Meeting of the company, or, if earlier, 5th August, 1999.

By order of the Board
Paul G. Dumond
Director

11th March, 1998

Notes:

1. A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote instead of him. A form of proxy is enclosed with this notice.

2. To be valid, the form of proxy and any power of attorney, or notarially certified copy thereof, under which it is executed, must be lodged with IRG plc, Balfour House, 390/398 High Road, Ilford, Essex, IG1 1NQ not later than 48 hours before the time fixed for the holding of the meeting or adjourned meeting. The completion and return of the proxy form does not preclude a member from attending the meeting and voting in person.

3. The Company, pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995 specifies that only those shareholders registered in the register of members of the Company as at 2pm on 4th May, 1998 shall be entitled to attend or vote at this Meeting in respect of the number of shares registered in their name at that time. Changes in entries on the relevant register of members after 2pm on 4th May, 1998 shall be disregarded in determining the rights of any person to attend or vote at this Meeting.

4. If this meeting is adjourned to a time not more than 48 hours after the specified time applicable to the original meeting, the time referred to in the foregoing note 3 will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purposes of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period, then to be so entitled members must be entered on the Company's register of members at a time which is 48 hours before the time fixed for the adjourned meeting or, if the Company gives notice of the adjourned meeting, at the time specified in that notice.

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