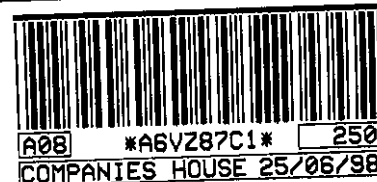


BAXI

367875

in focus

Baxi Partnership Limited
Annual Report 1997/98



This year the theme of our Annual Report is focus. Baxi is now focused on its core businesses of heating and air management. Our principal objective is to help home-owners create a comfortable, healthy environment.

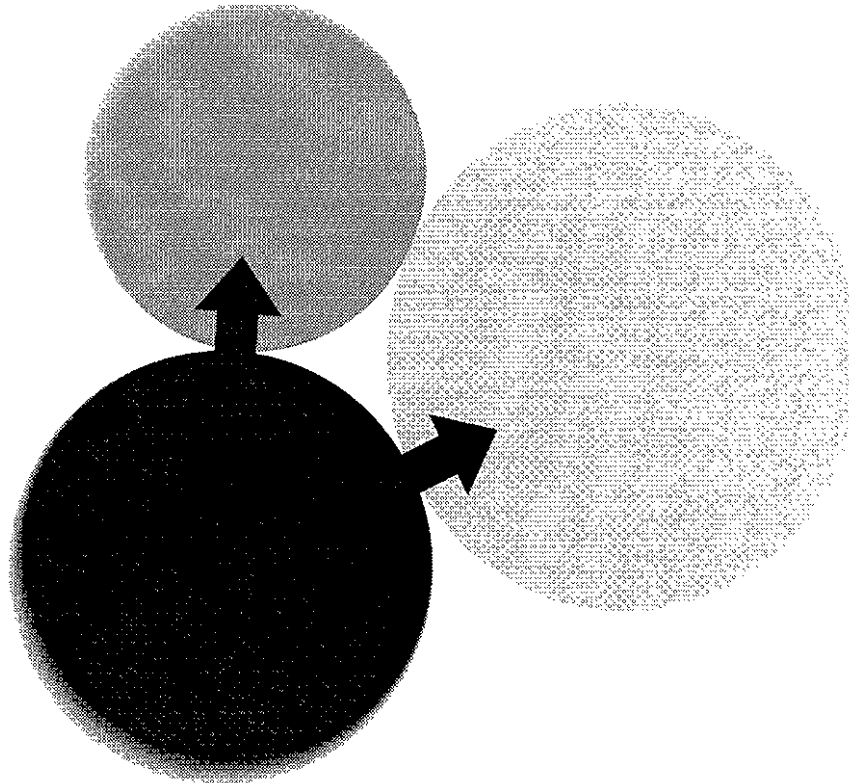
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The Group Structure

Baxi Partnership is made up of three divisions.

AIR MANAGEMENT

clean air systems, air handling products
and ventilation systems for domestic,
commercial and industrial markets



HEATING

gas, oil, and solid fuel
boilers, gas fires and stoves

ENGINEERING COMPONENTS

manufactures high quality components
for Baxi companies and an increasing
number of external customers

HEATING

Baxi Heating Limited UK market leader in gas fired central heating boilers. Also markets gas and solid fuel fires.

HS Kedler-Tarm A/S A leading manufacturer of domestic heating boilers in Denmark.

HS France SA Boiler distributor and service company.

HS Perifal AB A specialist heating distributor in Sweden.

Application Des Énergies Nouvelles SA A specialist heating distributor in France.

AIR MANAGEMENT

Baxi Air Management Limited Manufacturer of clean air systems, fire protection, air handling and heat recovery ventilation systems.

ENGINEERING COMPONENTS

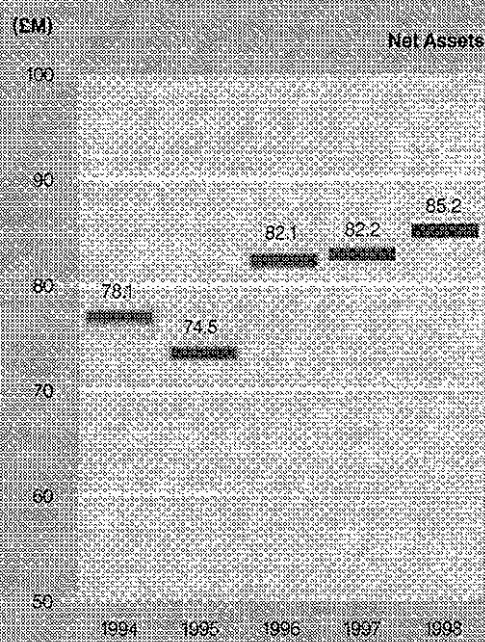
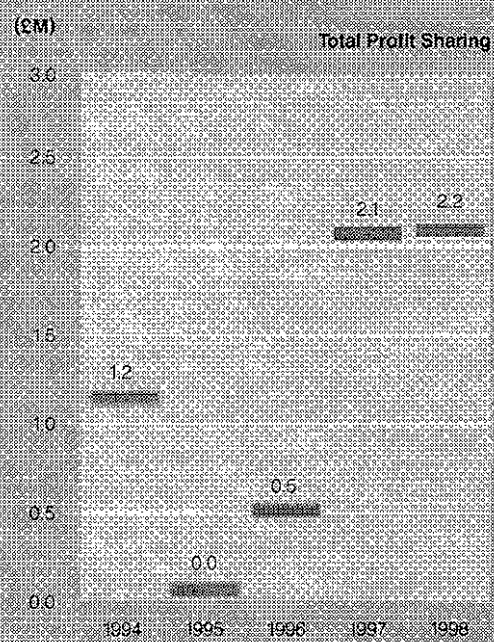
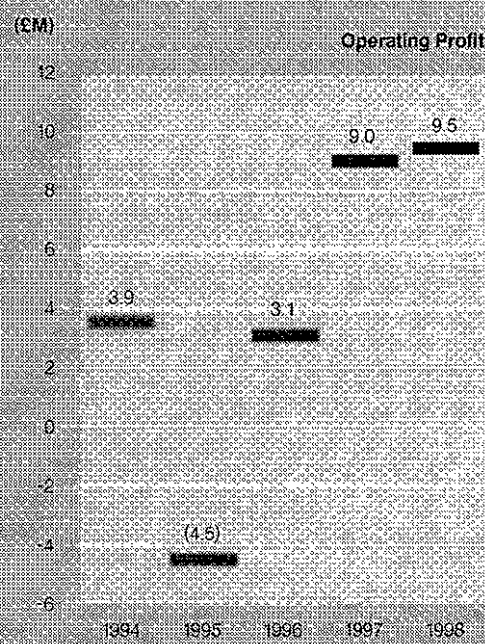
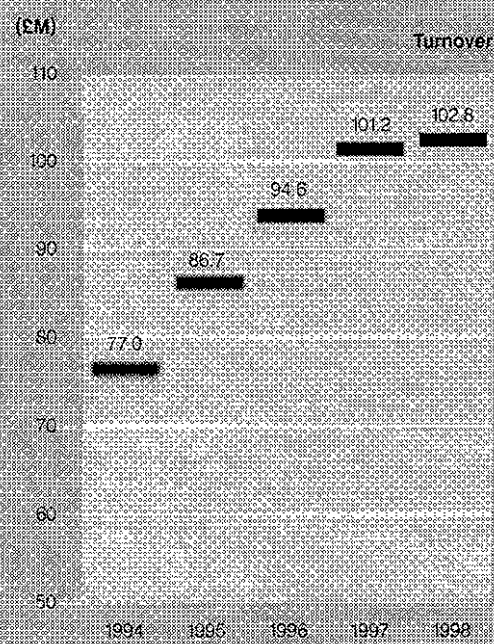
Alfer Limited Manufacturer of cast iron components.

Alloy Technologies Limited Manufacturer of cast aluminium components.

Landmark Components Limited Zinc die casting and decorative coatings.

Spartek Engineering Sheet metal, surface coatings and engineering components.

Financial Highlights



Baxi has made real progress again this year with operating profit increasing by 5.3% to £9.5M and sales increasing by 1.5% to £102.8M.

Our business strategy is to focus the Group on our core businesses. This means that we are concentrating on developing our Heating and Air Management divisions, supported by our Engineering Components division. We aim to grow both organically and where appropriate by acquisition. Good progress has been made this year towards these goals.

We want the structure of the Group to encourage each division to achieve its full potential. With this in mind, the directors and managers of each division have been given greater responsibility and freedom of decision making, and the Group Board has been streamlined.

The Councils, which provide the opportunity for all employees to participate and to influence decisions, have also developed well in most areas. As another step in strengthening this system, we are now going ahead with the appointment of an Employee Director, who will carry the employee perspective into the Group Board's decision making.



We wish to encourage long-term share ownership by employees directly and through the employee benefit trust. Progress was made in developing the constitution of the trust which holds most of Baxi's shares on behalf of all employees and the decision was taken to appoint an Employee Trustee. Philip Baxendale is actively involved as a trustee, and we were delighted that he was awarded the OBE in the New Year's honours list. I am sure everyone will join me in offering him our congratulations.

Everyone who works in Baxi can feel justly proud of the contribution they are making towards our vision of long-term prosperity for the Group, success which has continued into the start of the new financial year.



David Erdal Chairman

Chief Executive's Report



Last year I said, "1997/98 will be a difficult year as we anticipate tough competition in the heating market and the challenge of a strong currency". Those words were indeed prophetic; the heating market was tough and the UK's currency was stronger than anyone expected. Despite these challenges the Group had another good year. Turnover again exceeded £100M, operating profit advanced by 5% to £9.5M and the Group generated net cash from operating activities of £12.9M.

Strategic focus

The Group's strategy is to make products which create a comfortable environment in the home. Baxi has been heating homes for over sixty years, first with solid fuel and since the 1960's with gas. But heating is only one component of home comfort. Clean, fresh air is essential for health and comfort particularly if it can be provided in an energy efficient manner. That is why the Group is developing its Air Management division and has recently launched the Baxi Clean Air System.

The Group's three divisions are now focused on making their contribution to the Group's overall strategy.

Turnover of the Heating division was up by 3% at £79.9M despite the impact of the strong pound. Operating profit grew by 9% to £10.7M. The Group performed particularly well in the UK where market share increased. During the year the Group acquired Application Des Énergies Nouvelles SA (ADEN), a specialist heating distributor in north west France, in order to improve market access for its products. Further initiatives are planned to increase market share in Europe.

Radical changes took place in the Air Management division in order to focus further on the domestic market. Gradwood Limited, a small company involved in the design of industrial heating and ventilation systems was sold to a management led team and from the 28 March 1998 the division commenced trading as Baxi Air Management Limited with its headquarters at a new factory in Preston close to the M6 motorway. The former Packaged Air Conditioning Equipment Limited factory at Shipley was sold and the former Advanced Design & Manufacture Limited factory at Bradford closed down. In addition to the new factory at Preston, Baxi Air Management has a factory in Whitstable, Kent where it continues to manufacture fire dampers and fan coil units. Turnover for the division increased by 8% to £11.9M and broke even before restructuring and start up costs of £0.6M. The Baxi Clean Air System, to which I have already referred, is the first of a product range designed to provide clean air for homes in an energy efficient manner.

The businesses which make up the Engineering Components division are important suppliers to Baxi Heating and Baxi Air Management. The Group acquired full control of the Alloy Technologies Limited's (ATL) aluminium casting business by purchasing the 50% of equity held by Brembo SpA. This move was made following the successful commissioning of the new factory in Leyland, Lancashire and enables the Group to control this unique process. Excluding ATL's results, turnover was up slightly to £22.8M and the division achieved an operating profit of £0.4M.

Financial results

Overall the Group turnover was up 3.5% on continuing businesses. Sales outside the UK represent 26% of turnover. The Group made an operating profit of £9.5M, an increase of £0.5M compared with last year. Profit before tax and profit sharing was £0.3M lower at £10.8M.

Net assets at the year end were £85.2M. The Group generated £12.9M of cash at the operating level and invested £6.4M in tangible fixed assets across all three divisions.

Employee ownership

The Group continues to support growth in employee ownership through investments by its employee ownership equity fund. Before the fund was established the Group's main support for employee ownership was through its ownership of Barrhead Sanitary Ware Limited, a company trading in Scotland. This investment absorbed significant management effort at a time when the Group wished to concentrate on its core businesses. Accordingly the company was disposed of during the year to a management led team. Further investments will only be considered where they meet sound investment criteria.

Community

The Group supports many community projects but is best known for its stewardship of Preston North End plc.

In June we had the honour of welcoming HRH The Prince of Wales to Deepdale to see the progress made since Baxi became involved in 1994.

Employees

It is the Group's policy to distribute a proportion of profit to employees. UK employees receive their profit share in cash or shares and overseas employees in cash. When Philip Baxendale established the partnership in 1983 he hoped that partners would retain shares and be able to cash them in when they retired, and perhaps be able to cash some of them in at other times. In practice the number of people retaining shares has been disappointing, due in part to the erratic share price performance. The Group Board and Group Council wish to ensure lasting share ownership consistent with Philip Baxendale's vision. For this reason, additional measures have been introduced during the year. These measures include a new discretionary share bonus scheme for managers (which has replaced the previous cash bonus arrangements) and the introduction of a share option scheme. Unlike similar schemes operated by many companies, everyone will have the opportunity to receive share options and the benefits the scheme is capable of delivering are closely linked to long-term profit performance. It is hoped that these measures will encourage more lasting share ownership.

At the end of March, Howard Hammersley, Group Marketing and Planning Manager, retired after 37 years with the Group. Howard joined in 1961 as the company's (then Richard Baxendale & Sons Limited) first graduate trainee. I am sure you will join me in wishing Howard a long and happy retirement.

The average number of people employed was 1,298 (1997: 1,319).

Corporate governance

With the full implementation of the divisional structure, some changes have been made to the way the Group is run. An Operations Board has now been established, consisting of the most senior executives of the Group. In consequence the Group Board has been reduced in size and now consists of the four non-executive directors, the Group Finance Director and me.

The Company Councils, Employee Directors and Group Council continue to grow in stature and make an important contribution to the Group. I would like to thank everyone involved in our representative structure, which I believe is one of the Group's unrivalled strengths.

Future outlook

This year the Group delivered good financial results despite operating in highly competitive markets and despite the pressures of a strong currency. This performance gives us the confidence to pursue opportunities to increase our presence in European heating markets and to further our Air Management business.



Bryan M Gray Chief Executive

Group Finance Director's Report



The results and financial position of the Group reflect progress on all fronts of the business. The Group is well placed to pursue opportunities for growth both organically and by acquisition.

Trading results

Group turnover was £102.8M (1997: £101.2M) an increase of 3.5% on continuing businesses, with increases in all divisions ranging from 3% to 8%. Sales to overseas customers accounted for 26% (1997: 27%) of turnover, with 16% (1997: 18%) of sales originating outside the UK.

Gross profit was £31.4M (1997: £30.2M). Gross margin was 30.5% (1997: 29.8%). The increase in gross margin was mainly due to exceptional redundancy costs of £0.9M last year.

Distribution expenses were £13.2M (1997: £12.7M). The increase was mainly due to higher marketing costs of new products and the prior year acquisition of Advanced Design & Manufacture Limited.

Administrative expenses were £8.6M (1997: £8.5M). We continued the development of our management information systems, in particular rolling out the Movex business system across the Group.

Group operating profit was £9.5M (1997: £9.0M), an increase of 5%.

The strength of sterling has adversely affected the export business of the Group's cast iron foundry. Sterling's strength has also affected the translation of the trading results and net assets of overseas subsidiaries.

Interest

Net interest was £2.9M (1997: £2.3M) representing an average return on investments of 6.5% (1997: 5.7%). The increase reflects the upward movement in UK base rates.

Profit on sale of fixed assets

The profit on sale of fixed assets of £0.5M relates to the sale of patent rights to Alloy Technologies Limited whilst it was an associated company.

Associated companies

The investment in PNE is accounted for as an associate and the Group's share of its loss was £0.3M (1997: £0.1M).

ATL has been accounted for as an associated company up to October 1997 and the share of its loss to that date was £0.4M (1997: £0.6M).

Acquisitions

On 23 October 1997 the Group acquired the 50% of ATL owned by Brembo for £1.6M. The goodwill arising on the acquisition of £1.4M has been written off directly to reserves. ATL is now a wholly owned subsidiary and its results have been consolidated from 23 October 1997. The operating loss of ATL included in the Group's results from 23 October 1997 was £0.7M. Combined with the Group's share of ATL's loss as an associate of £0.4M, the total loss of £1.1M in respect of ATL reflects the Group's investment in this technology as set out in the Engineering Components' division report.

In December 1997, Application Des Énergies Nouvelles SA, a specialist heating distributor in north west France, was acquired for £0.7M. The goodwill arising on acquisition of £0.4M has been written off directly to reserves.

Disposal of Barrhead and Gradwood

In October 1997 Barrhead was sold to a management led team. During its time in the Group Barrhead had absorbed significant amounts of management time and resources and had consistently made losses. Although the consideration received for the shares was nominal, the sale provides a mechanism to recover loans made by the Company to Barrhead,

albeit over a number of years dependent upon the success of Barrhead. No value has been attributed to the ultimate recovery of these loans in the financial statements. The loss on sale of £0.8M includes £0.4M of goodwill previously written off to reserves.

In January 1998 Gradwood was sold to the management team. Consideration on the sale was £0.4M and a Group loan of £0.3M was repaid at the date of sale, and a further £0.1M has been deferred. The loss on sale of £0.5M includes £0.6M of goodwill previously written off to reserves.

Profit sharing

Profit before profit sharing was £10.8M (1997: £11.1M). The reduction is due to the loss on sale of Barrhead and Gradwood. Profit sharing of £2.2M (1997: £2.1M) has been provided to reward the achievements of the year.

Taxation

The effective tax rate for the Group was 39.8% (1997: 37.7%). The increase in the tax rate is due to the loss on disposal of Barrhead and Gradwood, which is not eligible for tax relief.

Earnings per share

Basic earnings per share fell to 88.6p (1997: 98.3p). After adjusting for the impact of the loss on disposal of Barrhead and Gradwood and the profit on disposal of fixed assets, headline earnings per share rose 10.5% to 106.2p (1997: 96.1p). This was due to improved trading and a better return on cash investments caused by higher UK interest rates.

Cash flow

Operating cash flow was £12.9M (1997: £19.1M). Although reduced from the exceptional level of 1997, current year operating cash flow was satisfactory and included £9.5M of operating profit and £2.1M from the movement in working capital.

The overall increase in cash during the year before short term investments and financing was £3.0M (1997: £12.4M). Major items of expenditure were capital expenditure £6.4M (1997: £2.5M), acquisitions £2.7M (1997: £3.4M) and taxation £3.9M (1997: £2.4M).

Financial resources

The consolidated balance sheet remains strong with liquid investments and cash balances of £50.5M (1997: £48.0M) and net assets of £85.2M (1997: £82.2M).

Treasury

The objective is to maximise the return on investment of our liquid investments and cash balances whilst ensuring that the capital value is fully protected. Also hedging has taken place on certain foreign currency transactions.

Medium term funds totalling £31.7M at the end of the year were invested according to specific guidelines and objectives by our fund manager J Henry Schroders & Co. Limited who have replaced PDFM Limited. Other liquid funds are managed in-house within guidelines approved by the Board.

Year 2000

A committee has been established to review the impact of the year 2000 on the Group's computer based systems. The Group's key computer systems are believed to be year 2000 compliant and action plans have been put in place to deal with other non-compliant systems. Whilst it is not possible to guarantee that the year 2000 problems will be eliminated we believe that the Group will be appropriately prepared. The cost of implementing the action plans is not significant.

Summary

The results and financial position of the Group reflect progress on all fronts of the business. The Group is well placed to pursue opportunities for growth both organically and by acquisition.



John Acornley Group Finance Director

Heating



Peter Johnson Managing Director

The Heating division supplies both the UK and mainland European markets from its facilities in Bamber Bridge, Lancashire and Tarm in Denmark. The activities of the HS Group, which were acquired in 1993, are being integrated with those of Baxi Heating in the UK. Ultimately all products sold will carry the Baxi name.

The UK market

In the UK, Baxi Heating supplies a complete range of gas boilers through leading builders' merchants. The UK market for gas boilers increased by 2.8% in 1997, resulting in a total market of 915,000 boilers. Baxi Heating's market share improved for all products and its strong position in the back boiler market was strengthened by the launch of new Baxi Bermuda inset models. Baxi Heating has a small share of the combination boiler sector which accounts for 41% of the total market. The company's share is set to improve following the launch of the Baxi Bahama, a new product designed and developed in consultation with merchant customers and installers.

Although Baxi Heating has supplied the UK gas fire market for many years, its previously limited product range was much enhanced in 1997 with the launch of no less than ten new gas fires. Baxi Heating is unique in the industry in having its own show-rooms within independent gas retailers. The success of this strategy together with the new products accounted for a significant growth in this sector.

The initiative to achieve world class status continues ensuring constant improvement and efficiencies. As part of this initiative Baxi Heating was re-accredited as an "Investor in People".

The European market

In continental Europe the division trades as HS Group through subsidiaries in Denmark, France and Sweden. HS Group manufactures a wide range of floor-standing boilers powered by oil, gas, biomass and solar power. Sales increased in France, primarily through the acquisition of ADEN, a specialist heating distributor of boilers in north west France.

Financial performance

Turnover for the division was £79.9M (1997: £77.3M). An increase in turnover in the UK was offset by a fall in European sales when converted into sterling due to the strength of the pound. Operating profit for the division increased by 9% to £10.7M (1997: £9.8M) principally due to improved efficiency and overhead control.

The future

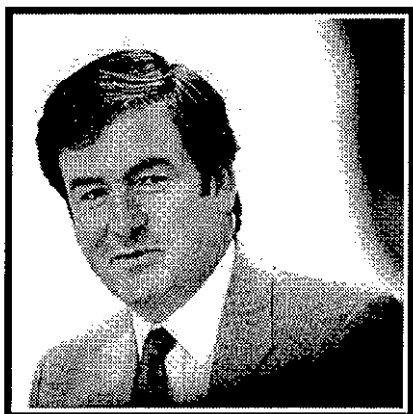
Baxi Heating is a founder member of the Central Heating Information Council, which both promotes high standard of training for installers and provides advice for consumers. The division also supports industry initiatives to improve energy efficiency and is always striving to improve boiler efficiency, which has positive environmental benefits. The division is investing heavily in product development with several important new product launches including a condensing boiler planned for the coming year.



Opposite and below: Baxi Heating's recently launched Bahama combination boiler. Designed and developed after consultation with merchant customers and installers.



Air Management



Chris Droogan Managing Director

The significant restructuring referred to in last year's report was completed during the year in order to reposition the division for the future. A new factory was acquired in Preston close to the M6 motorway. The new management team is now based at Preston where the Baxi Clean Air System will be manufactured. The "Actionair" industrial range of damper and fan coil units will continue to be manufactured at Whitstable in Kent.

The Air Management division sells products for domestic use and also products for industrial and commercial use. In the domestic sector the division has identified an opportunity to market products which improve the quality of the air we breathe through energy efficient ventilation. The acquisition of Advanced Design & Manufacture Limited in 1997 brought patented technology, which has enabled the Baxi Clean Air System to be developed. Modern homes which are well insulated suffer from stale air, condensation and airborne pollution. The Baxi Clean Air System can be applied to a single room or a whole house. The system has recently been awarded the British Allergy Foundation's prestigious seal of approval.

The Baxi Clean Air System was test marketed in 1997 and will shortly be launched nationally. In addition to the domestic environment, the system can be applied equally to commercial premises such as shops and offices.

The division's industrial and commercial product range includes dampers and fan coil units sold under the "Actionair" brand name. Exports are significant for these products and the number of overseas agencies was extended during the year.

Financial performance

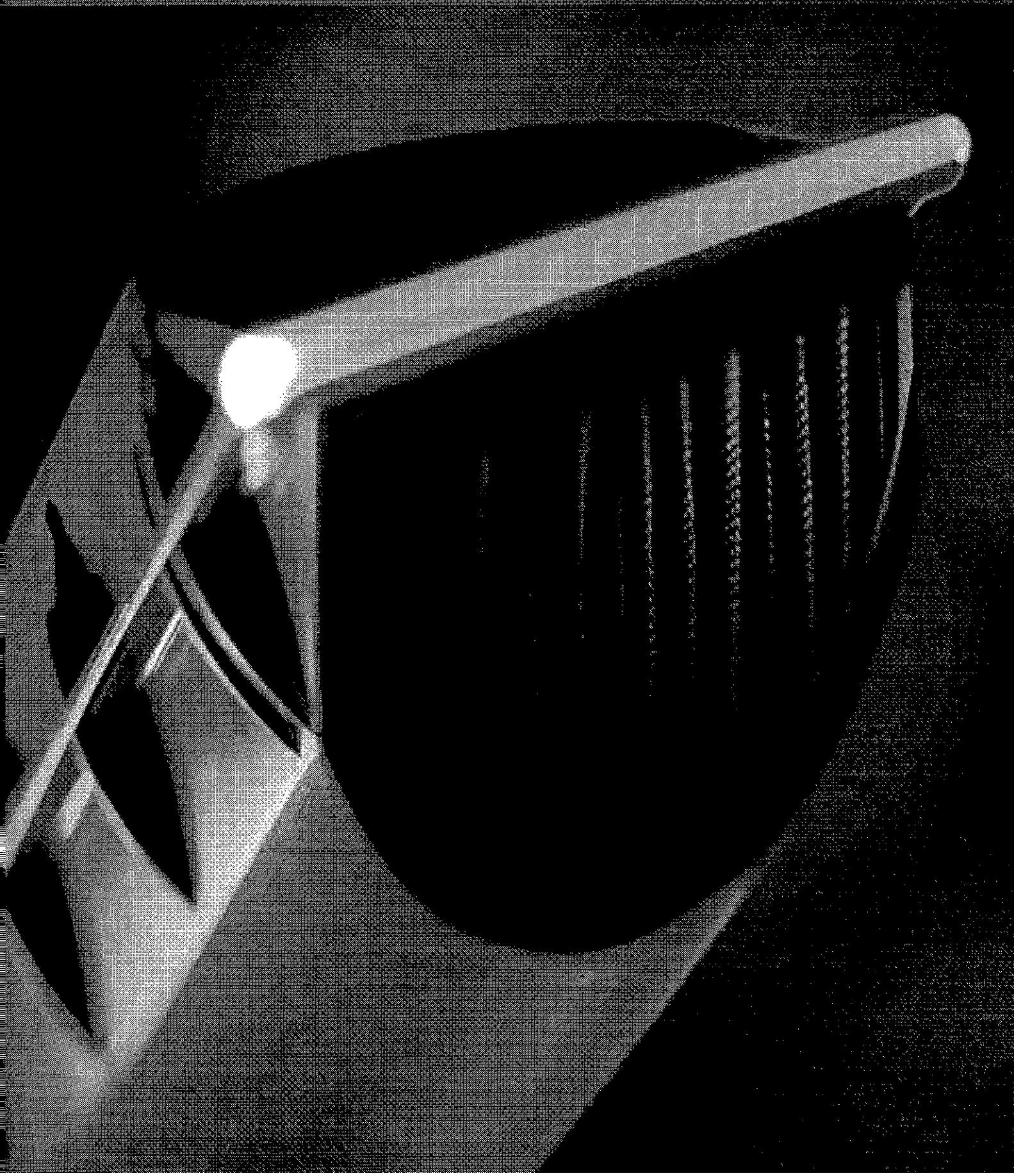
Excluding Gradwood, which was sold during the year, turnover for the division increased to £10.8M (1997: £9.4M). This increase was due to growth in sales of Baxi Clean Air Systems.

The division incurred an operating loss of £0.6M (1997: £Nil). The operating loss was after charging restructuring costs of £0.6M.

The future

Following the restructuring during the last two years the Air Management division is now well positioned to increase its presence in both the domestic and industrial markets. The Baxi Clean Air System builds on the reputation and recognition of the Group as a supplier of heating products, while creating a new market opportunity. The division's "Actionair" industrial products are market leaders in their sectors and continual re-engineering enables them to compete in world markets despite the strength of sterling.

The Clean Air System sample and control air flows
are 85% clean air, 15% diesel engine exhaust
with short pulses of methane.



Engineering Components



David Cook Managing Director

The Engineering Components division exists primarily to provide the Heating and Air Management divisions with key engineered products. Sales to Group companies are balanced by external sales in order to improve asset utilisation and to keep in touch with developing technologies. Product is transferred to Group companies at market prices.

Alfer

The Group's cast iron foundry, Alfer, increased turnover to £12.5M (1997: £12.3M), of which 58% represents sales outside the Group. Castings to the value of £6.2M were exported despite sterling's 11% appreciation against relevant continental European currencies. Profit margins were reduced in order to protect volumes. The result was that an operating loss of £0.2M was incurred (1997: £0.2M profit).

During May 1998 a rationalisation programme was announced following a reduction in the level of export business.

A strategic review was undertaken of the foundry business and plans are now in place to enable new business to be won and to substitute low margin export business with higher margin work.

Spartek

Spartek Engineering had another successful year with the Group's sheet metal, surface coatings and engineering components business turnover increasing to £8.0M (1997: £7.5M). Whilst external business is still small at around 4%, good progress continues to be made in securing business outside the Group. There was continued emphasis on materials management and production planning systems and this has resulted in major improvements

in service levels to all customers. Operating profit increased by 32% to £0.9M (1997: £0.7M).

Alloy Technologies

The Group has a major investment in the development of aluminium casting technology through Alloy Technologies Limited. This technology is seen as fundamental to the development of the Heating division. Patent protection has been achieved in Europe and the USA. ATL is now a wholly owned subsidiary. The new Leyland factory opened in June 1997 and the first aluminium heat exchangers for the Heating division were produced in December 1997. In addition to applications in heating products there is a major opportunity to supply aluminium castings for the automotive sector and orders have been secured from this growing market.

The investment made in this technology resulted in a total operating loss of £1.1M (1997: £0.6M) of which £0.4M (1997: £0.6M) was incurred whilst the company was an associate.

In view of the investment made in ATL it is now vital to commercially exploit the technology by volume production of high quality castings both for the heating and automotive sectors.

Landmark

Landmark Components Limited, the Group's zinc diecasting and decorative coatings supplier, maintained turnover at £2.4M (1997: £2.4M). The recent investment in modern diecasting plant has significantly assisted the business in tendering for new external business and there exists major potential for growth, particularly in the automotive sector. The result was that the company achieved break even, a similar result to 1997.

Financial performance

Overall turnover for the Engineering Components division was £22.9M (1997: £22.3M) and an operating loss of £0.3M (1997: profit £0.6M) was achieved which includes the £0.7M operating loss of ATL as set out above.

The future

Whilst progress was made on a number of fronts, market conditions continue to remain demanding for all of the Engineering Components businesses.

Monitoring the power profile as liquid aluminium is pumped into a greensand mould at Alloy Technologies Limited



Partnership, Employee Ownership & Community

Group Council, Company Councils and Employee Director

Last year's report explained the structure and roles of our present system of Group and Company Councils which is the latest stage in an evolutionary process which traces its origins back to the Baxi Works Council of the 1960s. Whilst the practice of industrial democracy within the Group has improved beyond recognition since then, and particularly so since the adoption of the present structure, the effect has been to make the job of Company Councillor or Employee Director more demanding. We are grateful to them for the sense of responsibility that they have brought to their roles and for the way in which they have continued to recognise that business decisions made with future success and the interests of all employees in mind are not always popular among all groups of employees.

During the year it was decided to enhance the representative arrangements by appointing an Employee Director to the Group Board.

Training and development

Commercially focused training and development continues to be a strategic theme for the Group as it keeps pace with new technology and methods of operation and grows its skill base for the future. Senior business managers have taken part in business education programmes run by local universities. Performance review and appraisal procedures continue to be developed. The Group continues to be committed to the Modern Apprenticeship Scheme and the training and development of young people. Plans are in place to recruit further apprentices and management trainees in the current year. Investors In People accreditation was achieved for the second time in both Baxi Heating and Spartek.

Employee ownership

The company has a minority shareholding in Capital Strategies Limited, a corporate finance house which provides advice on all aspects of employee ownership.

The employee ownership investment fund, which is managed by Close Investment Management Limited, has invested £0.5M in Tinsley Foods Limited during the year, taking the total investments of the fund to £1.0M.

Community

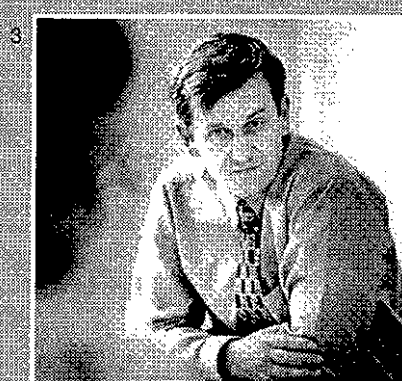
The Group continues to hold 41% of Preston North End plc; a tangible expression of its commitment to the community local to its main manufacturing facilities. Whilst the season just ended was a disappointment, given the promising start, Baxi's profile, both locally and nationally, was raised through the extensive exposure of the name through the Group's sponsorship of the club.

The policy of the Group Board is to encourage each Group company to have an involvement with the local community. In addition, many of the Group's employees play important and active roles in the community and the Group's contribution included donations of £35,000 to charities during the year.

Partnership founder Philip Baxendale OBE depicted in 'A History
of Richard Baxendale & Sons'



Board of Directors



1 Bryan Gray, age 44, Chief Executive. Bryan is the Chairman of the Central Heating Information Council and a member of the Council of the Society of British Gas Industries. He is also Chairman of the Central Lancashire Development Agency and Preston North End plc.

2 John Acornley, age 44, Group Finance Director. John joined Baxi in May 1997. He was previously Group Finance Director and Deputy Managing Director of Rainford Group plc.

3 David Erdal, age 50, Non-executive Chairman. David is a trustee of the Baxi Trust and the Russell Trust, a Director of Tullis Russell Group Limited and the China Heartland Fund and Chairman of Tayburn Limited and Job Ownership Limited.

4 Cairns Campbell, age 53, Non-executive Director. Cairns is the Director of Nobel Exhibition Trust.

5 Nick Kuenssberg, age 55, Non-executive Director. Nick is chairman of Stoddard Sekers International plc and GAP Group Limited. He is also a Non-executive Director of Standard Life Assurance Company and other companies. Nick chairs the Remuneration & Appointments Committee.

6 Andrew Thomas, age 55, Non-executive Director. Andrew is Chairman of Greenalls Group plc and Non-executive Chairman of Somerfield plc and Linelight Group plc. He is also a Non-executive Director of JJB Sports plc and a number of non-quoted companies. Andrew chairs the Audit Committee.

7 Peter Rothwell, age 53, Company Secretary. Peter joined Baxi in September 1997. He was formerly Company Secretary/solicitor to Norweb plc.

Group Advisers

Solicitors **Addleshaw Booth & Co.**
100 Barbirolli Square
Manchester
M2 3AB

**Pension Fund
Investment Managers** **Schroder Investment
Management (UK) Limited**
33 Gutter Lane
London
EC2V 8AS

**Auditors, Corporate
Finance & Tax Advisers** **KPMG**
Edward VII Quay
Navigation Way
Ashton on Ribble, Preston
PR2 2YF

**Employee Ownership
Fund Managers** **Close Investment
Management Limited**
12 Appold Street
London
EC2A 2AA

Consultant Actuaries **Watson Wyatt Partners**
Cardinal House
20 St Mary's Parsonage
Manchester
M3 2LY

Bankers **Royal Bank of Scotland plc**
175-177 Station Road
Bamber Bridge
Preston
PR5 6LA

**Corporate Investment
Managers** **J. Henry Schroder
& Co. Limited**
Senator House
85 Queen Victoria Street
London
EC4V 4EJ

Barclays Bank plc
Management Suite
PO Box 229
Navigation Way
Preston
PR2 2XY

Compliance statement

The Group complies with all the provisions of the Cadbury Committee's Code of Best Practice.

The Board of directors

The Board of directors currently comprises two executive and four non-executive directors, two of whom are independent, and meets at least every two months during the year. A full schedule of matters is reserved for the Board's attention, but it is primarily responsible for overall Group strategy, approval of major capital expenditure projects and consideration of significant financial matters. The Company Secretary is available to advise all Board directors and attends Board meetings.

Audit Committee

The Committee consists of non-executive directors. The Committee meets at least twice a year, with the Group Finance Director and external auditors in attendance. The Committee is responsible for agreeing external audit plans and for reviewing and reporting to the Board on the interim and annual financial statements.

Remuneration and Appointments Committee

The role of the Committee is to determine the emoluments of the executive directors and senior managers and to make recommendations on their appointment. The Committee consists entirely of non-executive directors. A full report of the Committee is included on pages 19 to 21.

Internal financial control

The Board has overall responsibility for the Group's systems of internal financial control and has reviewed their effectiveness. The systems of internal financial control are designed to provide reasonable, but not absolute, assurance, against material misstatement or loss.

They include:

- the setting of annual budgets;
- monthly reporting of financial performance by operating companies;
- monthly meetings of a Board sub-committee and senior Group executives to review business performance and key operational issues;

- formal capital authorisation procedures;
- clearly defined revenue expenditure authorisation procedures.

Additionally the Group maintains an Accounting Guidance and Internal Control Manual, which all subsidiary companies are required to follow.

Going concern

The directors consider that the Company and the Group have adequate resources for the foreseeable future and therefore continue to adopt the going concern basis in preparing the financial statements.

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 the Group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

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

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

Composition and role of the Remuneration and Appointments Committee

The members of the Remuneration and Appointments Committee (the Committee) are NCD Kuenssberg (Chairman), D E Erdal, T C Campbell and A G Thomas. The Committee is responsible for recommending to the Board the emoluments of the executive directors and senior managers and for recommending the appointment of directors. The fees payable to non-executive directors are determined by the Board.

Remuneration policy

The Committee's policy is to remunerate executive directors and senior managers at competitive rates for delivering Group performance which will ensure the vision of long term prosperity is achieved.

(a) Executive Directors

The remuneration package for executive directors comprises:

- (i) a basic salary which is reviewed annually, having regard to information about remuneration levels in companies of comparable size and with similar manufacturing businesses.
- (ii) an annual performance-related discretionary share bonus. Half of this bonus depends on the degree to which individual objectives are met and the other half is dependent upon the degree to which profit targets are met. Like other UK employees, executive directors receive both the equal and the Company-specific allocations of shares made under the Group's profit sharing arrangements.
- (iii) use of a car and fuel (or an allowance in lieu) and private health insurance for the director and his family.
- (iv) membership of the Baxi Partnership Pension Scheme (the Pension Scheme) or a contribution to a private pension.
- (v) participation in a Long Term Bonus Plan (LTBP). Each year, the Committee makes a provisional award of shares with a value of up to 30% of the director's basic salary. Three years later the Committee considers Group and individual performance during the period against the Strategic Plan. In the light of its assessment, it

makes a final award of shares. The number of shares finally awarded is not more than the number provisionally awarded less shares equal in value to the income tax payable by virtue of the final award. The shares finally awarded must be left in an unapproved Employees' Share Scheme for three further years before the director is free to offer them for sale. BM Gray is the only present director to have so far received benefits under this plan.

- (vi) participation in an Inland Revenue Approved Company Share Option Plan (CSOP) adopted in March 1998 and open to all employees who satisfy criteria set in accordance with the plan. Awards of options under the CSOP have been made subject to a condition which makes the number of options exercisable dependent upon cumulative operating profit over the three years ending March 2001.

- (vii) participation in the Company's Savings Related Share Option Scheme 1992 (the SAYE Scheme) on the same basis as all other employees may participate.

(b) Non-Executive Directors

The fees payable to non-executive directors are determined by the Board within the total limit set by the Company's Articles of Association. Non-executive directors derive no other benefits from their office; they are not eligible to participate in the Company's pension scheme and they do not participate in any of the Company's Share Schemes.

(c) Service Contracts

- (i) in July 1997 the Committee revised its policy on directors' service contracts by deciding that future contracts should not be terminable by the company on more than 12 month's notice. Previously the application of contract periods in excess of one year had been considered appropriate to recruit and retain key executives. Presently the executive directors are serving under contracts providing for two years notice.
- (ii) the non-executive directors serve for terms of 3 years, but otherwise do not have service contracts with the company.

Report of the Remuneration and Appointments Committee (continued)

Directors' emoluments

The emoluments of the executive directors for the year were as follows:

	Salary	Benefits	Cash bonus	Share bonus and profit share†	Pension contributions	Total 1998	Total 1997
	£	£	£	£	£	£	£
BM Gray*	120,917	12,989	19,180	84,455	21,715	259,256	158,629
JK Acornley**	69,314	10,988	-	-	6,090	86,392	-
DE Cook***	59,290	7,196	-	17,666	5,475	89,627	6,447
CJ Droogan***	59,290	4,515	-	21,886	5,475	91,166	15,489
PR Johnson***	79,054	5,434	5,759	30,821	7,705	128,773	104,168
L King	-	-	-	-	-	-	131,969
	<u>387,865</u>	<u>41,122</u>	<u>24,939</u>	<u>154,828</u>	<u>46,460</u>	<u>655,214</u>	<u>416,702</u>

* BM Gray's bonus includes £13,324 in cash and £19,987 in shares awarded under the LTBP.

** Appointed as a director on 20 May 1997

*** A director until 16 March 1998

† Amounts represent the value of shares allocated in August 1997 at £4.05 per share.

Directors' emoluments are stated from or to the date of appointment or resignation where appropriate.

The emoluments of the Chairman and non-executive directors for the year were as follows:

	DE Erdal (Chairman)	TC Campbell	AG Thomas	NCD Kuenssberg	Total 1998	Total 1997
	£	£	£	£	£	£
Fees	<u>25,000</u>	<u>14,000</u>	<u>17,667</u>	<u>17,667</u>	<u>74,334</u>	<u>62,500</u>

The fees shown in respect of AG Thomas were paid as consultancy fees to a company controlled by him. The fees paid to NCD Kuenssberg attributable to the period until June 1997 were paid as consultancy fees to a company controlled by him.

Directors' pension information

The Group operates a contributory defined benefit Pension Scheme, membership of which is open to all employees in the UK between the ages of 18 and 62 years. The Pension Scheme is fully funded and the subject of an independent trust. Subject to Inland Revenue limits, it provides a maximum pension of two thirds of final basic salary on retirement at normal retirement age. The pension payable to an individual depends upon the number of years membership of the scheme and the rate at which pension rights accrue (expressed as a proportion of pensionable salary). Neither bonuses nor benefits in kind are pensionable.

B M Gray is a member of the Pension Scheme. The company pays 10% of J K Acornley's basic salary (less the cost of life assurance cover) to his personal pension plan. Executive directors have the benefit of life assurance cover amounting to four times basic salary.

The increase during the year in the accrued pension to which each executive director (including those who ceased to be directors during the year) would be entitled on leaving service, (over and above any general increase to compensate for inflation to which early leavers would be entitled) and the transfer value of the relevant increase in accrued pension are as follows:

	Age of director as at 28 March 1998	Years of pensionable service	Additional annual pension earned during year to 28 March 1998*		Accrued annual entitlement year end		Estimated transfer value of additional pension earned*
			£000	£000	1998	1997	
BM Gray	44	5	2	27	24		25
DE Cook	52	2	1	2	1		19
CJ Droogan	39	6	1	6	5		12
PR Johnson	53	3	3	17	13		47

* Excludes inflation

The basic salary payable to B M Gray is in excess of the limit set by the Inland Revenue on contributions to an Inland Revenue approved pension scheme. The Company therefore pays contributions into a Funded Unapproved Retirement Benefit Scheme (FURB). When the FURB was established, the Company's contributions were set, on actuarial advice, at a level expected to enable the FURB and the Pension Scheme, taken together, to provide benefits comparable with those which would have been provided by the Pension Scheme if there were no applicable limits. However, in contrast with the Pension Scheme, the Company does not carry the investment risks arising from the investment of the contributions made to the FURB. The gross amount of contributions payable by the Company each year is 72% of that part of basic

salary which is in excess of the Inland Revenue limit. The amount paid into the FURB is that gross amount less income tax.

Directors' interests in shares and share options

The directors are capable of having both beneficial and non-beneficial interests in shares. A "beneficial interest" is one which the director can exchange for cash which he may use for his own benefit. Of the directors who held office at the end of the year, only B M Gray, had a beneficial interest in shares in the Company. At the beginning of the year he had such an interest in 58 shares and at the end of the year he had such an interest in 20,911 shares.

Non-beneficial interests are those which exist because a director is a trustee of a share scheme. D E Erdal and T C Campbell are trustees of an employee share ownership trust (ETI) and accordingly had a non-beneficial interest, at the start and the end of the year, in 4,595,329 ordinary shares and 450,000 preference shares of the Company.

Share option schemes

The following table shows the options to acquire shares in the Company granted to directors who held office at the end of the year:

	Date of Grant	Scheme	Number of shares	Option price per share	Exercisable
BM Gray	17/12/96	SAYE	4,721	£3.47	1/2/2002 to 31/7/2002
BM Gray	22/4/98	CSOP	7,407(1)	£4.05	Note (2)
JK Acornley	22/4/98	CSOP	7,407(1)	£4.05	Note (2)

Notes

- (1) The number of options exercisable depends upon the cumulative operating profits of the Group in the three years ending March 2001. For operating profit of £29,500,000, 3,703 options will be exercisable, for operating profit of £36,500,000, 7,407 options will be exercisable (and proportionately less options for operating profit between £29,500,000 and £36,500,000).
- (2) Options are exercisable between the date of announcement of the Group's results in 2001 and 21 April 2008.

None of the other directors who held office at the end of the financial year had any discloseable interest in the shares of any Group undertaking. Except as disclosed above, no directors have the right to subscribe for shares or debentures in any Group undertaking.

The directors present their annual report and the audited financial statements for the year ended 28 March 1998

Principal activities

The principal activities of the Group are:

- **Heating** – manufacture and distribution of domestic heating products in the UK and Europe.
- **Air Management** – manufacture and distribution of air management products in the UK and Europe.
- **Engineering Components** – manufacture of high quality cast iron, aluminium, sheet metal and die cast components.

The Group has also established a venture capital fund for investment in employee owned companies utilising the Group's financial strength and unique experience of managing an employee owned business.

In addition, the Group has focused its community involvement through the investment in Preston North End plc.

Review of the business

The review of the Group's operating performance during the year and an indication of likely future developments are set out in the Chief Executive's report on pages 4 and 5.

Details of acquisitions and disposals are set out in the Group Finance Director's report on pages 6 and 7 and in note 11.

Substantial shareholdings

As at 28 March 1998, employee share ownership trust (ET1) held 79.1% (1997: 79.1%) of the Company's ordinary share capital. This shareholding represents shares held in trust, for the benefit of employees. All preference share capital is held by ET1.

Dividends and transfers to reserves

The directors do not recommend the payment of a dividend. The profit for the year retained in the Group was £5,145,000.

Profit sharing

The Company operates an Inland Revenue approved profit sharing scheme for the Group. The profit and loss account includes a total profit sharing allocation of £2,214,000 (1997: £2,117,000). The Baxi Partnership Limited Savings Related Share Option Schemes enacted in 1992 and 1996, allow employees periodically to apply for three, five or seven year share option contracts to purchase shares in the Company.

Directors and directors' interests

The directors who held office during the year are detailed on page 16. Details of directors' interests in shares of the Company are disclosed in the report of the Remuneration and Appointments Committee on pages 19 to 21.

Employees

The Group places considerable emphasis on the contribution of the people within its business, supporting the view that its continued prosperity is dependent on the involvement and participation of every employee.

The Group believes in a structured approach to the training and development of employees. Links with further education institutions and a commitment to self development through open learning education programmes are maintained.

Disabled people are employed and trained whenever their aptitudes and abilities allow and suitable vacancies are available. Where an employee becomes disabled an attempt is made to continue his or her employment and to arrange appropriate retraining or transfer if necessary. The Group's disabled employees are treated equally in every respect and are constantly encouraged to develop their skills in accordance with their abilities.

Health and safety

The Group's policy is to ensure that there is a working environment which will minimise the risk to the health and safety of employees. It is considered that health and safety is an integral part of good business management and accordingly high standards are required.

Payment to suppliers

The Group supports the CBI initiative to address the problem of delayed payments to suppliers, consequently the Group always endeavours to meet agreed supplier payment terms. This is consistent with our Vendor Improvement Programme which continues to support a total quality approach with suppliers. In the current year the Group's average creditor days was 61 days (1997: 62 days).

Political and charitable contributions

The Group made no political contributions during the year. Donations to UK charities amounted to £35,000 (1997: £23,000).

Auditors

In accordance with Section 385 of the Companies Act 1985, a resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the Annual General Meeting.

By order of the board.

P J Rothwell
SECRETARY

Brownedge Road
Bamber Bridge
Preston PR5 6SN

22 May 1998



Review Report of the Auditors to
Baxi Partnership Limited
on corporate governance matters

In addition to our audit of the financial statements, we have reviewed the directors' statements on page 18 on the Company's compliance with the paragraphs of the Cadbury Code of Best Practice relating to the Group's system of internal financial control and their adoption of the going concern basis in preparing the financial statements.

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform any additional work necessary to express a separate opinion on the effectiveness of either the Group's system of internal financial control or the Company's corporate governance procedures, or on the ability of the Group to continue in operational existence.

Opinion

With respect to the directors' statements on internal financial control and going concern, both set out on page 18, in our opinion the directors have provided the disclosures required by the Cadbury Code, as if the application of the Code was a requirement for the Group, and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.


KPMG
CHARTERED ACCOUNTANTS

22 May 1998

Report of the Auditors
to the members of Baxi Partnership Limited

We have audited the financial statements on pages 24 to 44.

**Respective responsibilities of directors
and auditors**

As described on page 18 the Company's directors are responsible for the preparation of the 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 Group'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 affairs of the Company and the Group as at 28 March 1998 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.


KPMG
CHARTERED ACCOUNTANTS
REGISTERED AUDITORS

22 May 1998

Consolidated Profit and Loss Account

for the year ended 28 March 1998

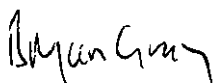
	Note	1998	1997
		£000	£000
Turnover	2	102,767	101,217
Cost of sales	3	<u>(71,385)</u>	<u>(71,062)</u>
Gross profit		31,382	30,155
Distribution expenses	3	(13,247)	(12,675)
Administrative expenses	3	<u>(8,628)</u>	<u>(8,450)</u>
Operating profit	2	9,507	9,030
Share of associated companies' losses		<u>(723)</u>	<u>(686)</u>
Total operating profit		8,784	8,344
Profit on disposal of fixed assets		450	394
Loss on disposal of subsidiary undertakings	11	(1,335)	-
Net interest receivable and similar income	7	<u>2,858</u>	<u>2,347</u>
Profit before profit sharing		10,757	11,085
Profit sharing		<u>(2,214)</u>	<u>(2,117)</u>
Profit on ordinary activities before taxation	4	8,543	8,968
Tax on profit on ordinary activities	8	<u>(3,398)</u>	<u>(3,378)</u>
Profit on ordinary activities after taxation		5,145	5,590
Minority interests	19	<u>-</u>	<u>121</u>
Retained profit for the financial year	18	<u>5,145</u>	<u>5,711</u>
Basic earnings per share	9	88.6p	98.3p
Headline earnings per share	9	106.2p	96.1p

Balance Sheets

as at 28 March 1998

		Group		Company	
	Note	1998	1997 As restated	1998	1997 As restated
		£000	£000	£000	£000
Fixed assets					
Tangible assets	10	29,818	22,403	1,342	84
Investments	11	4,583	5,248	40,034	43,466
		<u>34,401</u>	<u>27,651</u>	<u>41,376</u>	<u>43,550</u>
Current assets					
Stocks	12	9,516	11,729	-	-
Debtors	13	22,363	20,311	900	2,274
Investments	14	3,038	-	3,038	-
Cash		48,579	48,018	31,927	32,177
		<u>83,496</u>	<u>80,058</u>	<u>35,865</u>	<u>34,451</u>
Creditors: amounts falling due within one year	15	<u>(28,639)</u>	<u>(24,678)</u>	<u>(2,446)</u>	<u>(2,311)</u>
Net current assets		<u>54,857</u>	<u>55,380</u>	<u>33,419</u>	<u>32,140</u>
Total assets less current liabilities		<u>89,258</u>	<u>83,031</u>	<u>74,795</u>	<u>75,690</u>
Creditors: amounts falling due after one year	15	<u>(4,016)</u>	<u>(437)</u>	<u>-</u>	<u>(40)</u>
Provisions for liabilities and charges	16	<u>-</u>	<u>(395)</u>	<u>(72)</u>	<u>(37)</u>
Net assets		<u>85,242</u>	<u>82,199</u>	<u>74,723</u>	<u>75,613</u>
Capital and reserves					
Called up share capital – equity	17	581	581	581	581
Called up share capital – non equity	17	450	450	450	450
Reserves - equity	18	84,211	81,369	73,692	74,582
Shareholders' funds		<u>85,242</u>	<u>82,400</u>	<u>74,723</u>	<u>75,613</u>
Minority interests	19	<u>-</u>	<u>(201)</u>	<u>-</u>	<u>-</u>
		<u>85,242</u>	<u>82,199</u>	<u>74,723</u>	<u>75,613</u>

These financial statements were approved by the Board of directors on 22 May 1998 and were signed on its behalf by:



B M Gray

DIRECTOR



J K Acornley

DIRECTOR

Consolidated Cash Flow Statement

for the year ended 28 March 1998

	Note	1998	1997 As restated
		£000	£000
Cash inflow from operating activities	23	12,867	19,067
Returns on investments and servicing of finance	24	2,902	2,080
Taxation	24	(3,918)	(2,379)
Capital expenditure and financial investment	24	(6,123)	(2,964)
Acquisitions and disposals	24	(2,746)	(3,365)
Cash inflow before use of liquid resources and financing		2,982	12,439
Management of liquid resources		(3,038)	-
Financing	24	(429)	(240)
(Decrease)/increase in cash during the year		(485)	12,199
Reconciliation of net cash flow to movements in net funds			
(Decrease)/increase in cash in the year		(485)	12,199
Cash outflow from decrease in debt and leasing		429	604
Cash outflow from increase in liquid funds		3,038	-
Increase in net funds resulting from cash flows		2,982	12,803
Loans and finance leases acquired with subsidiary		(4,811)	(309)
Currency translation difference		(87)	(276)
Movement in net funds during the year		(1,916)	12,218
Net funds at beginning of year	25	47,867	35,649
Net funds at end of year	25	45,951	47,867

Consolidated Statement of Total Recognised Gains and Losses

for the year ended 28 March 1998

	1998	1997
	£000	£000
Retained profit for the financial year	5,145	5,711
Surplus on revaluation of fixed assets	131	347
Net exchange loss on currency translation	(574)	(1,162)
Total recognised gains relating to the financial year	4,702	4,896

Note of Consolidated Historical Cost Profits and Losses

for the year ended 28 March 1998

	1998	1997
	£000	£000
Retained profit on ordinary activities before taxation	8,543	8,968
Realisation of fixed asset revaluation gains	1,575	303
Difference between an historical cost depreciation charge and the actual depreciation charge calculated on the revalued amount	122	376
Historical cost profit on ordinary activities before taxation	10,240	9,647
Historical cost profit for the year retained after taxation	6,842	6,390

Reconciliation of Movements in Shareholders' Funds

for the year ended 28 March 1998

	Group		Company	
	1998	1997	1998	1997
	£000	£000	£000	£000
Retained profit/(loss) for the year	5,145	5,711	(742)	(135)
Net exchange loss on currency translation	(574)	(1,162)	(279)	(732)
Surplus on revaluation of fixed assets	131	347	131	325
Goodwill on disposals previously written off	1,041	-	-	-
Goodwill arising on acquisitions	(2,901)	(2,983)	-	-
Movement in shareholders' funds	2,842	1,913	(890)	(542)
Shareholders' funds at beginning of year	82,400	80,487	75,613	76,155
Shareholders' funds at end of year	85,242	82,400	74,723	75,613
Equity shareholders' funds	84,792	81,950	74,273	75,163
Non equity shareholders' funds	450	450	450	450
Shareholders' funds at end of year	85,242	82,400	74,723	75,613

Notes to the Accounts

1. Accounting policies

The principal Group accounting policies are set out below and have been applied consistently through the current and preceding year.

Basis of accounting

The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and in accordance with applicable United Kingdom accounting standards. Certain prior year comparatives have been restated to achieve consistency with the layout adopted in the current year.

Basis of consolidation

The Group profit and loss account, balance sheet and cash flow statement incorporate the financial statements of the Company and all of its subsidiary undertakings by the acquisition method of accounting. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal. Goodwill arising on consolidation (representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired) is written off against reserves on acquisition. On the disposal of acquired businesses, the attributable amount of goodwill previously written off to reserves is included in determining the profit or loss on disposal.

Associated undertakings are those investments other than subsidiary undertakings where the Group exercises significant influence, typically through representation on the Board of directors. The consolidated financial statements include the Group's share of the post acquisition reserves of all such companies.

In the Company's financial statements, investments in subsidiary and associated undertakings are stated at cost less provisions for diminution in value. Dividends

received and receivable are credited to the Company's profit and loss account to the extent that they represent a realised profit for the Company.

In accordance with Section 230(4) of the Companies Act 1985, the Company is exempt from the requirement to present its own profit and loss account.

Tangible fixed assets and depreciation

Land and buildings are reviewed each year by the directors and revalued, where appropriate, to their estimate of depreciated replacement cost or existing use value. Plant and machinery is stated at cost.

Depreciation is provided to write off the cost or valuation of the assets over their estimated useful economic lives as follows:

Freehold land	- not depreciated
Freehold buildings	- 50 years
Plant and machinery	- 3 to 15 years

Current asset investments

Current asset investments are stated at the lower of cost and market value net of accrued interest.

Stocks

Stocks are stated at the lower of cost and net realisable value. For work in progress and finished goods manufactured by the Group, cost is taken as production cost, which includes an appropriate proportion of attributable overheads. Provision is made for obsolete and slow moving stock where appropriate.

Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction or contract rate if appropriate. 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. Exchange differences on translating long term group loans are taken directly to reserves where the loans are substitutes for equity investment.

The results and cash flows of non-United Kingdom operations are translated at the average rates of exchange during the period and their balance sheets at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets and results of non-United Kingdom operations are dealt with through reserves.

Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and the rentals are charged to the profit and loss account on a straight line basis over the life of the lease.

Research and development expenditure

Expenditure on research and development is written off against profits in the year in which it is incurred.

Pensions and other post retirement benefits

The Group operates a contributory defined benefit pension scheme in the United Kingdom with regular pension costs assessed as a substantially level percentage of pensionable payroll and charged to the profit and loss account so as to spread the cost of pensions over the employees' working lives. Actuarial surpluses and deficits

result in variations from the regular pensions costs, and these are spread forward over the average expected remaining service lives of employees. In certain circumstances, subsidiaries may operate defined contribution pension schemes. In these cases the assets of the scheme are held separately from those of the Group in an independently administered fund. The amount charged against profits represents the contributions payable to the scheme in respect of the accounting period.

Employee share ownership trusts

Company shares acquired and the associated borrowings of employee share ownership trusts which are controlled by the Company are recognised in the Company and Group balance sheets. The shares are revalued to their market value and differences taken to the revaluation reserve. Shares distributed to employees under the profit sharing arrangements are charged to the profit and loss account in the year in which the profit distribution arises. The value of own shares included in fixed assets is correspondingly reduced to reflect the allocation to employees.

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 if there is reasonable evidence that such deferred taxation will be payable or recoverable in the foreseeable future.

Turnover

Turnover comprises the invoiced value of sales for goods supplied and services provided by the Group net of sales tax and discounts.

2. Segmental information

	1998			1997		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	£000	£000	£000	£000	£000	£000
Turnover						
By market						
Heating	79,891	-	79,891	77,343	-	77,343
Air Management	10,760	1,176	11,936	9,357	1,715	11,072
Engineering Components	22,889	-	22,889	22,255	-	22,255
Other activities	-	1,403	1,403	801	2,730	3,531
Inter divisional turnover	(13,352)	-	(13,352)	(12,984)	-	(12,984)
	<u>100,188</u>	<u>2,579</u>	<u>102,767</u>	<u>96,772</u>	<u>4,445</u>	<u>101,217</u>
By origin						
United Kingdom	83,501	2,579	86,080	78,378	4,445	82,823
Mainland Europe	16,687	-	16,687	18,394	-	18,394
	<u>100,188</u>	<u>2,579</u>	<u>102,767</u>	<u>96,772</u>	<u>4,445</u>	<u>101,217</u>
By destination						
United Kingdom	73,897	2,579	76,476	69,705	4,424	74,129
Mainland Europe	24,896	-	24,896	25,746	-	25,746
Rest of World	1,395	-	1,395	1,321	21	1,342
	<u>100,188</u>	<u>2,579</u>	<u>102,767</u>	<u>96,772</u>	<u>4,445</u>	<u>101,217</u>
Operating profit						
By market						
Heating	10,706	-	10,706	9,822	-	9,822
Air Management	(680)	89	(591)	(40)	168	128
Engineering Components	(267)	-	(267)	622	-	622
Other activities	-	(341)	(341)	(52)	(413)	(465)
Exceptional items (see note 4)	-	-	-	(1,077)	-	(1,077)
	<u>9,759</u>	<u>(252)</u>	<u>9,507</u>	<u>9,275</u>	<u>(245)</u>	<u>9,030</u>
By origin						
United Kingdom	8,560	(252)	8,308	7,848	(245)	7,603
Mainland Europe	1,199	-	1,199	1,427	-	1,427
	<u>9,759</u>	<u>(252)</u>	<u>9,507</u>	<u>9,275</u>	<u>(245)</u>	<u>9,030</u>

2. Segmental information (continued)

	1998			1997		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	£000	£000	£000	£000	£000	£000
Operating net assets						
By market						
Heating	17,333	-	17,333	16,773	-	16,773
Air Management	4,958	-	4,958	5,263	111	5,374
Engineering Components	13,965	-	13,965	9,457	-	9,457
Other activities	-	-	-	-	42	42
	<u>36,256</u>	<u>-</u>	<u>36,256</u>	<u>31,493</u>	<u>153</u>	<u>31,646</u>
By origin						
United Kingdom	30,178	-	30,178	25,654	153	25,807
Mainland Europe	6,078	-	6,078	5,839	-	5,839
	<u>36,256</u>	<u>-</u>	<u>36,256</u>	<u>31,493</u>	<u>153</u>	<u>31,646</u>

The discontinued activities relate to Barrhead Sanitary Ware Limited and Gradwood Limited, which were disposed of during the year, as set out in note 11.

Operating net assets excludes: investments £4,583,000, net funds £45,951,000, net corporation and deferred tax payable £2,221,000 and other net current assets of £673,000.

3. Profit and loss

	1998			1997		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	£000	£000	£000	£000	£000	£000
Turnover	100,188	2,579	102,767	96,772	4,445	101,217
Cost of sales	(69,460)	(1,925)	(71,385)	(67,031)	(3,147)	(70,178)
Exceptional items	-	-	-	(884)	-	(884)
	<u>30,728</u>	<u>654</u>	<u>31,382</u>	<u>28,857</u>	<u>1,298</u>	<u>30,155</u>
Distribution costs	(13,112)	(135)	(13,247)	(12,363)	(312)	(12,675)
Administrative expenses	(7,857)	(771)	(8,628)	(7,026)	(1,231)	(8,257)
Exceptional items	-	-	-	(193)	-	(193)
Operating profit	<u>9,759</u>	<u>(252)</u>	<u>9,507</u>	<u>9,275</u>	<u>(245)</u>	<u>9,030</u>

The total figures for continuing operations in 1998 include the following amounts relating to acquisitions: turnover £244,000, cost of sales £200,000, distribution expenses £82,000, administrative expenses £715,000 and operating loss £753,000. The operating loss principally arises from the Group's investment in Alloy Technologies Limited, as discussed on page 12 in the Engineering Components division's review.

4. Profit on ordinary activities before taxation

	1998	1997
	£000	£000
Profit on ordinary activities before taxation is stated after charging:		
Auditors' remuneration		
audit	87	90
other services	259	113
Depreciation of tangible fixed assets		
owned assets	2,934	3,147
assets held under hire purchase contracts	22	75
Provision for diminution in value of fixed assets	-	750
Operating lease rentals - plant and machinery	50	45
Research and development expenditure	1,049	1,174
Exchange losses	57	132
Exceptional items	-	1,077

The exceptional items in the prior year represented redundancy and reorganisation costs. Auditors' remuneration with respect to audit and non-audit services to the Company was £14,000 (1997: £14,000) and £211,000 (1997: £102,000) respectively.

5. Remuneration of directors

See the Report of the Remuneration and Appointments Committee on pages 19 to 21 for details of directors' remuneration.

6. Staff numbers and costs

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

	Number of employees	
	1998	1997
Production	814	931
Sales and administration	484	388
	<u>1,298</u>	<u>1,319</u>

The aggregate payroll costs of these persons were as follows:

	1998	1997
	£000	£000
Wages and salaries	24,033	24,433
Social security costs	1,821	1,833
Other pension costs	1,349	1,122
	<u>27,203</u>	<u>27,388</u>

7. Net interest receivable and similar income

	1998	1997
	£000	£000
Interest receivable and similar income:		
Bank interest	3,181	2,255
Income from listed investments	60	158
	<u>3,241</u>	<u>2,413</u>
Interest payable and similar income:		
On bank loans and overdrafts wholly repayable within five years not by instalments	(58)	(55)
Finance charges payable in respect of hire purchase contracts	(185)	(11)
Share of associate's interest payable	(140)	-
	<u>2,858</u>	<u>2,347</u>

8. Tax on profit on ordinary activities

	1998	1997
	£000	£000
United Kingdom corporation tax at 31% (1997: 33%)	3,392	3,545
United Kingdom deferred taxation	(185)	(494)
Overseas tax	415	466
Overseas deferred taxation	(49)	(78)
Share of associate's current taxation	(175)	-
Adjustment relating to earlier years	-	(61)
	<u>3,398</u>	<u>3,378</u>

The tax charge is higher than the applicable corporate tax rate primarily due to unrelieved associated company losses and the loss on disposal of subsidiary undertakings.

9. Earnings per share

Earnings per share is calculated on the profit attributable to ordinary shareholders of £5,145,000 (1997: £5,711,000) and on the number of ordinary shares in issue during the year of 5,809,931 (1997: 5,809,931). The dilutive effect of outstanding share options is not material.

Headline earnings per ordinary share excludes certain capital items and is based on the recommendations of the Institute of Investment Management and Research (IIMR). The directors believe that this measure gives a more meaningful indication of the Group's underlying performance.

	1998 pence	1997 pence
Basic earnings per share (defined by FRS3)	88.6	98.3
Profit on disposal of fixed assets	(5.4)	(2.2)
Loss on disposal of subsidiary undertakings	23.0	-
Headline earnings per share (defined by IIMR)	<u>106.2</u>	<u>96.1</u>

10. Tangible fixed assets

	Freehold land and buildings	Group Plant and machinery	Total	Company Plant and machinery
	£000	£000	£000	£000
Cost or valuation				
At beginning of year	15,186	42,751	57,937	161
Acquisitions	48	6,489	6,537	-
Additions	1,528	5,301	6,829	875
Transfer from Group companies	-	-	-	2,206
Disposals	(1,717)	(3,642)	(5,359)	(84)
Currency translation differences	(310)	(607)	(917)	-
At end of year	<u>14,735</u>	<u>50,292</u>	<u>65,027</u>	<u>3,158</u>
Depreciation and diminution in value				
At beginning of year	1,338	34,196	35,534	77
Acquisitions	2	101	103	-
Transfer from Group companies	-	-	-	1,535
Charge for year	326	2,630	2,956	259
Disposals	(149)	(2,719)	(2,868)	(55)
Currency translation differences	(66)	(450)	(516)	-
At end of year	<u>1,451</u>	<u>33,758</u>	<u>35,209</u>	<u>1,816</u>
Net book value				
at 28 March 1998	<u>13,284</u>	<u>16,534</u>	<u>29,818</u>	<u>1,342</u>
At 29 March 1997	<u>13,848</u>	<u>8,555</u>	<u>22,403</u>	<u>84</u>

Properties in the UK were valued by external valuers, Lambert Smith Hampton, Consultant Surveyors as at 30 March 1996 on the basis of existing use value in accordance with the Appraisal & Valuation Manual of The Royal Institution of Chartered Surveyors. The properties of the Group's European subsidiaries were also valued on this date by external valuers on the basis of existing use.

The depreciated historic cost of land and buildings is £7,967,000 (1997: £8,338,000). The net book value of land, which is not depreciated, is £3,443,000 (1997: £3,444,000).

Included in the total net book value of plant and machinery is £5,341,000 (1997: £79,000) in respect of assets held under hire purchase contract. Depreciation for the year on these assets was £22,000 (1997: £75,000). The Company held no assets under hire purchase contracts.

11. Fixed asset investments

	Shares in group undertakings	Interests in associated undertakings	Other investments	Own shares	Total
Group	£000	£000	£000	£000	£000
Cost or valuation					
At beginning of year	11	4,684	856	2,537	8,088
Acquisitions	-	-	21	-	21
Additions	-	-	575	1,172	1,747
Revaluation	-	-	-	131	131
Disposal	-	-	(1)	(1,392)	(1,393)
Reclassification as subsidiary undertaking	(11)	(1,497)	-	-	(1,508)
Currency translation difference	-	-	(1)	-	(1)
At end of year	-	3,187	1,450	2,448	7,085
Share of post acquisition reserves and provisions					
At beginning of year	-	734	-	2,106	2,840
Provisions created	-	450	-	2,437	2,887
Share of current year losses	-	503	-	-	503
Utilised	-	-	-	(2,106)	(2,106)
Reclassification as subsidiary undertaking	-	(1,622)	-	-	(1,622)
At end of year	-	65	-	2,437	2,502
Net book value					
At 28 March 1998	-	3,122	1,450	11	4,583
At 29 March 1997	11	3,950	856	431	5,248

At 28 March 1998 interests in associated undertakings represents 41% of the ordinary share capital of Preston North End plc, a company listed on the Alternative Investment Market. The principal activity of Preston North End plc, a company registered in England and Wales, is the operation of a football club.

Fixed asset investments include the market value of Company shares held by employee share ownership trusts sponsored by the Company. At the year end 604,483 (1997: 659,033) shares were so held. Provision has been made for the share element of bonuses and profit share distribution in respect of the year ended 28 March 1998.

11. Fixed asset investments (continued)

	Shares in Group undertakings	Loans to Group undertakings	Shares in associated undertakings	Other investments	Own shares	Total
Company	£000	£000	£000	£000	£000	£000
Cost or valuation						
At beginning of year	7,335	29,681	5,433	847	2,537	45,833
Additions	4,904	-	-	575	1,172	6,651
Revaluation	-	-	-	-	131	131
Transfer	8,934	(6,687)	(2,247)	-	-	-
Disposals and repayments	(1,211)	(7,056)	-	-	(1,392)	(9,659)
Currency translation differences	-	(404)	-	-	-	(404)
At end of year	<u>19,962</u>	<u>15,534</u>	<u>3,186</u>	<u>1,422</u>	<u>2,448</u>	<u>42,552</u>
Provisions						
At beginning of year	2,224	-	-	-	143	2,367
Transfer from current liabilities	-	2,842	-	-	-	2,842
Utilised	(1,174)	(1,656)	-	-	(143)	(2,973)
Created	-	-	-	-	282	282
At end of year	<u>1,050</u>	<u>1,186</u>	<u>-</u>	<u>-</u>	<u>282</u>	<u>2,518</u>
Net book value						
At 28 March 1998	<u>18,912</u>	<u>14,348</u>	<u>3,186</u>	<u>1,422</u>	<u>2,166</u>	<u>40,034</u>
At 29 March 1997	<u>5,111</u>	<u>29,681</u>	<u>5,433</u>	<u>847</u>	<u>2,394</u>	<u>43,466</u>

Disposals

On 10 October 1997 the Group sold its entire ordinary shareholding in Barrhead Sanitary Ware Limited to its management for a nominal sum (see page 6). On 16 January 1998 the Group sold its entire ordinary shareholding in Gradwood Limited to its management for £400,000 of redeemable preference shares, plus an agreement to participate in profits resulting from any subsequent sale of the business.

The loss on disposal of subsidiary undertakings was £1,335,000 which includes £1,041,000 of goodwill previously written off to reserves.

Acquisitions

On 11 July 1997 the Group exercised its option to acquire the entire issued ordinary share capital of Bright Ideas Limited for £750,000 cash, plus a further £200,000 payable on 11 July 1999. Goodwill arising on the acquisition was £952,000.

On 23 October 1997 the Group acquired 50% of Alloy Technologies Limited, bringing the Group's holding to 100%, for a cash consideration of £1,650,000. Provisional goodwill arising on the acquisition was £1,376,000.

On 11 December 1997 the Group acquired the entire ordinary share capital of Application Des Énergies Nouvelles SA for cash of £424,000. A further £203,000 of consideration will be paid on 30 June 1998, and an additional £101,000 is payable on 30 June 1999 should the company achieve certain performance targets. Goodwill arising on the acquisition was £416,000.

11. Fixed asset investments (continued)

The fair value of assets acquired on current year acquisitions is as follows:

	Book value	Accounting policy alignments	Fair value adjustments	Fair value
	£000	£000	£000	£000
Intangible fixed assets	2,400	(2,400)	-	-
Tangible fixed assets	6,425	(232)	-	6,193
Hire purchase contracts	(4,814)	-	-	(4,814)
Other net liabilities	(1,869)	-	844	(1,025)
	<u>2,142</u>	<u>(2,632)</u>	<u>844</u>	<u>354</u>
Goodwill written off to reserves				2,901
Existing interest in associate				<u>126</u>
Consideration				<u>3,381</u>

The accounting policy alignments relate to the write off of intangible fixed assets (£2,400,000) and capitalised tooling costs in accordance with Group accounting policy. The fair value adjustment recognises the value to the Group of tax losses and allowances.

12. Stocks

	Group	
	1998	1997
	£000	£000
Raw materials and consumables	3,658	4,390
Work in progress	1,245	1,590
Finished goods and goods for resale	<u>4,613</u>	<u>5,749</u>
	<u>9,516</u>	<u>11,729</u>

13. Debtors

	Group		Company	
	1998	1997	1998	1997
	£000	£000	£000	£000
Amounts falling due within one year				
Trade debtors	19,224	17,999	-	22
Amounts owed by subsidiary undertakings	-	-	349	165
Amounts owed by associated undertakings	-	322	-	-
Taxation recoverable	65	-	74	-
Other debtors	63	47	-	10
Prepayments and accrued income	<u>2,266</u>	<u>1,943</u>	<u>310</u>	<u>250</u>
	21,618	20,311	733	447
Amounts falling due after more than one year				
Amounts owed by subsidiary undertakings	-	-	-	1,827
Deferred tax assets (see note 16)	578	-	-	-
Other debtors	<u>167</u>	<u>-</u>	<u>167</u>	<u>-</u>
Total debtors	<u>22,363</u>	<u>20,311</u>	<u>900</u>	<u>2,274</u>

14. Current asset investments

Current asset investments are listed investments with a market value of £3,038,000 (1997: £Nil). The prior year comparatives have been restated to exclude cash deposits which have been included within cash.

15. Creditors

	Group		Company	
	1998	1997	1998	1997
	£000	£000	£000	£000
Amounts falling due within one year				
Bank overdraft	1,142	-	-	-
Obligations under hire purchase contracts	739	20	-	-
Other loans	66	-	30	-
Trade creditors	12,370	11,688	-	-
Amounts owed to subsidiary undertakings	-	-	1,757	1,300
Amounts owed to associated undertakings	-	54	-	-
United Kingdom corporation tax	2,633	2,993	-	666
Overseas tax	231	249	-	-
Other taxes and social security	1,416	1,551	-	-
Other creditors	1,045	1,174	-	-
Accruals and deferred income	8,997	6,949	659	345
	<u>28,639</u>	<u>24,678</u>	<u>2,446</u>	<u>2,311</u>
Amounts falling due after one year				
Obligations under hire purchase contracts	3,683	10	-	-
Other loans	36	121	-	40
Accruals and deferred income	297	306	-	-
	<u>4,016</u>	<u>437</u>	<u>-</u>	<u>40</u>
Total creditors	<u>32,655</u>	<u>25,115</u>	<u>2,446</u>	<u>2,351</u>

Obligations under hire purchase contracts

	Group	
	1998	1997
	£000	£000
Amounts payable:		
within one year	1,135	23
within two to five years	3,923	10
after five years	566	-
	<u>5,624</u>	<u>33</u>
Finance charges allocated to future periods	(1,202)	(3)
	<u>4,422</u>	<u>30</u>

16. Provision for liabilities and charges

	Group		Company	
	1998	1997	1998	1997
	£000	£000	£000	£000
Deferred taxation				
At beginning of year	395	818	37	754
Arising on acquisition	(844)	-	-	-
(Release)/charge for the year	(234)	(572)	35	(717)
Reclassified as an associated undertaking	-	200	-	-
Disposals	(6)	-	-	-
Transferred to corporation tax	133	-	-	-
Currency translation differences	(22)	(51)	-	-
At end of year	<u>(578)</u>	<u>395</u>	<u>72</u>	<u>37</u>

The amounts provided for deferred taxation and the amounts unprovided, calculated on the liability method are set out below:

	1998 Amount provided	1998 Amount unprovided	1997 Amount provided	1997 Amount unprovided
Group	£000	£000	£000	£000
Difference between accumulated depreciation and capital allowances	446	544	657	637
Revaluation of properties	-	870	-	1,081
Other timing differences	(1,024)	-	(262)	206
	<u>(578)</u>	<u>1,414</u>	<u>395</u>	<u>1,924</u>
Company				
Difference between accumulated depreciation and capital allowances	9	-	(10)	-
Other timing differences	63	-	47	-
	<u>72</u>	<u>-</u>	<u>37</u>	<u>-</u>

The potential liability to capital gains tax on revalued assets is not provided as, in the opinion of the directors, the likelihood of any material liability arising is remote.

17. Called up share capital

	1998 £000	1997 £000
Authorised		
Ordinary shares of 10 pence each – equity	750	750
Preference shares of £1 each – non equity	450	450
	<u>1,200</u>	<u>1,200</u>
Allotted, called up and fully paid		
Ordinary shares of 10 pence each – equity	581	581
Preference shares of £1 each – non equity	450	450
	<u>1,031</u>	<u>1,031</u>

18. Reserves

	Share premium account	Revaluation reserve	Profit and loss account	Total
Group	£000	£000	£000	£000
At beginning of year	3,566	7,907	69,896	81,369
Retained profit for year	-	-	5,145	5,145
Surplus on revaluation of own shares	-	131	-	131
Realisation of revaluation reserve	-	(1,697)	1,697	-
Goodwill on disposals included in retained profit	-	-	1,041	1,041
Goodwill arising on acquisitions	-	-	(2,901)	(2,901)
Currency translation differences	-	-	(574)	(574)
At end of year	<u>3,566</u>	<u>6,341</u>	<u>74,304</u>	<u>84,211</u>

The cumulative amount of goodwill resulting from acquisitions in the current and earlier financial years which has been written off to the profit and loss account reserve is £10,330,000 (1997: £8,470,000). The profit and loss account reserve includes the cumulative share of net losses retained by associated undertakings of £387,000 (1997: £810,000).

	Share premium account	Revaluation reserve	Profit and loss account	Total
Company	£000	£000	£000	£000
At beginning of year	3,566	325	70,691	74,582
Retained loss for the year	-	-	(742)	(742)
Surplus on revaluation of own shares	-	131	-	131
Currency translation differences	-	-	(279)	(279)
At end of year	<u>3,566</u>	<u>456</u>	<u>69,670</u>	<u>73,692</u>

19. Minority interests

	1998	1997
	£000	£000
At beginning of year	(201)	1,572
Reclassification as associate	-	(1,652)
Share of losses for year	-	(121)
Disposed of during year	<u>201</u>	<u>-</u>
At end of year	<u>-</u>	<u>(201)</u>

20. Commitments

	Group		Company	
	1998	1997	1998	1997
	£000	£000	£000	£000
Tangible fixed assets				
Contracted	98	475	-	-
Authorised but not contracted	1,206	5	-	-

The company has an outstanding commitment of £2,000,000 to a fund managed by Close Investment Management Limited for the investment in employee owned companies.

Neither the Group or Company have any significant operating lease commitments.

21. Contingent liabilities

The Company has guaranteed the borrowings of certain Group companies. The outstanding liabilities under these commitments are £5,526,000 (1997: £3,139,000).

The Company also guarantees the borrowings of an employee share ownership trust. The outstanding liability under this commitment is £2,000,000 (1997: £1,500,000).

22. Pension scheme

The Company operates a contributory defined benefit pension scheme in the UK. The scheme funds are administered by Trustees and are independent of the Company's finances. The latest actuarial valuation of the scheme was carried out by independent actuaries as at 1 February 1995 using the projected unit funding method. The principal financial assumptions adopted in that valuation were that the annual rate of return on new investments would be 9%, the average annual increases in pensionable salaries would be 7%, the average annual increase in pension payments would be 5% and the average annual increases in equity dividends would be 4.5%.

At the date of the latest actuarial valuation, the market value of the assets of the scheme was £51,650,000 and the actuarial value of the assets was sufficient to cover 112% of the benefits that had accrued to members, after allowing for expected future increases in earnings and pensions. For the purpose of assessing pension costs this excess of assets is being spread evenly over the weighted average expected future working lifetime of scheme members. The charge in the profit and loss account is £1,181,000 (1997: £987,000) for the year and the existing prepayment remains unchanged at £1,164,000 at 28 March 1998. The charge in respect of other schemes is £168,000 (1997: £135,000).

23. Reconciliation of operating profit to net cash inflow from operating activities

	1998	1997
	£000	£000
Operating profit	9,507	9,030
Profit sharing paid	(1,055)	(263)
Depreciation	2,956	3,248
Loss on disposal of fixed assets	65	-
Government grants released to profit	(24)	(67)
Decrease in stocks	1,731	1,694
(Increase)/decrease in debtors	(2,167)	3,911
Increase in creditors	2,520	848
Exceptional items	(666)	666
Net cash inflow from operating activities	12,867	19,067

24. Analysis of cash flows for headings netted in the cash flow statement

	1998	1997
	£000	£000
Returns on investments and servicing of finance		
Interest received	3,176	2,163
Interest paid	(79)	(72)
Interest element of finance lease rentals	(195)	(11)
	<u>2,902</u>	<u>2,080</u>
Taxation		
UK Corporation tax	(3,284)	(2,217)
Overseas tax	(634)	(162)
	<u>(3,918)</u>	<u>(2,379)</u>
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(6,417)	(2,525)
Purchase of intangible fixed assets	-	(9)
Disposal of tangible fixed assets	1,890	149
Disposal of intangible fixed assets	-	1,500
Purchase of own shares (note 11)	(1,020)	(1,523)
Purchase of other fixed asset investments	(576)	(556)
	<u>(6,123)</u>	<u>(2,964)</u>
Acquisitions and disposals		
Purchase of subsidiary undertakings	(2,877)	(2,824)
Net cash/(overdraft) acquired with subsidiary undertakings	228	(438)
Disposal of shares in subsidiary undertakings	(99)	1,874
Overdraft disposed of	2	656
Purchase of shares in associate undertaking	-	(2,633)
	<u>(2,746)</u>	<u>(3,365)</u>
Financing		
New loans received	-	143
Loan repayments	(10)	(693)
Capital element of finance lease payments	(419)	(54)
Grants received	-	364
	<u>(429)</u>	<u>(240)</u>

Cash flows of acquisitions and discontinued operations were as follows:

	Acquisitions	Disposals	
	1998	1998	1997
	£000	£000	£000
Operating activities	(797)	145	197
Returns on investment and servicing of finance	(237)	10	13
Taxation	(20)	48	(11)
Capital expenditure and financial investment	<u>(337)</u>	<u>(67)</u>	<u>(185)</u>

25. Movement in net funds

	At 29 March 1997 As restated	Cash flow	Acquisitions and disposals	Exchange movements	At 28 March 1998
	£000	£000	£000	£000	£000
Cash in hand net of overdraft	48,018	(485)	-	(96)	47,437
Other loans	(121)	10	-	9	(102)
Finance leases	(30)	419	(4,811)	-	(4,422)
Current asset investments	-	3,038	-	-	3,038
	<u>47,867</u>	<u>2,982</u>	<u>(4,811)</u>	<u>(87)</u>	<u>45,951</u>

26. Related party disclosures

B M Gray is Chairman of Preston North End plc.

Baxi Partnership Limited acts as guarantor of a bank loan to one of the employee share ownership trusts. The loan facility available to this trust is £2,000,000 (1997: £1,500,000) and their present borrowings are at that level. During the year Baxi Partnership Limited made a gift of £66,000 (1997: £26,000) to this trust, which was utilised by the trust towards meeting its interest costs.

During the year the final instalment of £900,000 for UK and overseas patent rights was received from Alloy Technologies Limited.

27. Subsidiary undertakings

The following is a list of principal subsidiary undertakings in the Group:

	Country of incorporation	Holding	Year end
Heating			
Baxi Heating Limited	England	100%	28 March
HS Group A/S	Denmark	100%	*7 April
HS Kedler-Tarm A/S	Denmark	100%	*7 April
HS France SA	France	100%	28 March
HS Perifal AB	Sweden	100%	28 March
Thermitec Sarl	France	95%	28 March
Application Des Énergies Nouvelles SA	France	100%	28 March
Air Management			
Baxi Air Management Limited	England	100%	28 March
Engineering Components			
Alfer Limited	England	100%	28 March
Alloy Technologies Limited	England	100%	28 March
Landmark Components Limited	England	100%	28 March

* Due to the local statutory reporting requirements of these companies they have a different accounting period.

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HS France SA

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HS Perital AB

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Application Des Energies

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Air Management

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Engineering Components

Alfer Limited

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Spartek Engineering

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Registered in England no. 367875