Company Number: 610095

Waterstone's Booksellers Limited

Report and Accounts

52 weeks ended 24 April 2004

COMPANY INFORMATION

DIRECTORS

S D Carney
S Dormer
D S Gilbert (appointed 13 April 2004)
B F McLaughlin
L J Miles
D Pogrund
D L Roche
N J M Williams (appointed 3 February 2004)

M J Carr (resigned 10 November 2003)

SECRETARY

E Marriner (appointed 29 September 2003)

M G Lymath (appointed 1 July 2003, resigned 29 September 2003)
P G Howell (resigned 1 July 2003)

REGISTERED OFFICE

Capital Court
Capital Interchange Way
Brentford
Middlesex TW8 0EX

DIRECTORS' REPORT

The Directors submit their Report and the Accounts for the 52 weeks ended 24 April 2004.

Principal activities, review and future developments

During the period under review, the Company operated as a bookseller through a chain of general bookshops in the United Kingdom. The Company continues to trade successfully and it is intended that the Company will *continue its existing business for the foreseeable future.*

Results and dividend

The profit for the 52 weeks ended 24 April 2004 was £13,842,000 (2003: £17,655,000). A dividend of £20,000,000 (2003: £10,000,000) was paid after the financial period under review.

Directorate

The names of the Directors as at the date of this Report are shown on page 1.

None of the Directors had any interests in the shares of the Company. Directors' interests in the Company's ultimate parent undertaking, HMV Group plc, are as follows:

	Ordinary Shares		Share Incentive Plan		Options over Ordinary Shares			
	At 24 April 2004	At 26 April 2003[1]	**At 24 April 2004**	At 26 April 2003[1]	**At 24 April 2004**	Granted during the year	Exercised during the year	At 26 April 2003[1]
S Carney	-	-	-	-	**270,549**	90,909	-	179,640
S Dormer	-	-	**124**	121	**233,004**	76,923	21,351	177,432
D Gilbert[1]	-	-	-	-	**273,972**	273,972	-	-
L Miles	-	-	**3,240**	1,378	**235,750**	73,076	21,351	184,025
D Pogrund	-	-	**3,240**	1,378	**226,460**	69,930	21,351	177,881
D Roche	-	-	-	-	**329,758**	81,031	103,209	351,936
N Williams	-	-	-	-	**62,884**	39,571	-	23,313

[1] or date of appointment

Mr McLaughlin is a director of HMV Group plc and his interests are disclosed in the financial statements of that company.

Employment policies

The Company is a decentralised organisation with the aim of employing and developing the best people, putting them in the right positions with a significant level of delegated authority and responsibility, and supporting them with the infrastructure and technology required to perform at the highest levels and at the lowest costs with the quickest response time.

Responsibility for employment matters therefore rests primarily with each business operation under the general guidance of central policy and procedure guidelines. The Company is committed to the maintenance of a work environment free of discrimination on the grounds of gender, nationality, ethnic or racial origin, sexual orientation, non-job related disability, or marital status.

The Company gives full consideration to applications from disabled persons where the requirements of the job can be adequately fulfilled by a handicapped or disabled person. Where existing employees become disabled, it is the company's policy wherever practicable to provide continuing employment under normal terms and conditions and to provide training and career development and promotion to disabled employees wherever appropriate.

In order to promote employee involvement in the Company, regular meetings are held between local management and employees to allow a free flow of information and ideas.

DIRECTORS' REPORT (continued)

Supplier payment policy

The Company does not impose standard payment terms on its suppliers but agrees specific terms with each. It is the Company's policy to pay its suppliers in accordance with the terms that have been agreed. The number of days' purchases outstanding at 24 April 2004 is calculated as 67 days (2003: 55 days).

Charitable contributions

During the period, the Company made charitable contributions of £7,000 (2003: £10,000) in the UK.

Auditors

Pursuant to Section 379A of the Companies Act 1985, elective resolutions have been passed dispensing with the requirement to appoint auditors annually and to dispense with the requirement to hold annual general meetings. Therefore Ernst & Young LLP are deemed to continue as auditors of the Company.

By order of the Board

E Marriner
Secretary

16 August 2004

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company 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; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF WATERSTONE'S BOOKSELLERS LIMITED

We have audited the Company's financial statements for the 52 weeks ended 24 April 2004, which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet, and the related notes 1 to 24. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the financial statements, which are required to be prepared in accordance with applicable United Kingdom law and accounting standards as set out in the Statement of Directors' Responsibilities in relation to the financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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

We read the Directors' Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 24 April 2004 and of its profit for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London

16.8.04

Profit and loss account

For the 52 weeks ended:

	Notes	24 April 2004 £000	26 April 2003 £000
Turnover	2	**270,464**	257,076
Cost of sales		**(236,165)**	(227,470)
Gross profit		**34,299**	29,606
Administrative expenses		**(16,667)**	(14,320)
Other operating income and expenses	4	**136**	(338)
Operating profit	2, 3	**17,768**	14,948
Profit on disposal of Irish branch	9	**-**	4,644
Profit on ordinary activities before interest		**17,768**	19,592
Interest receivable	7	**3,101**	2,421
Profit on ordinary activities before taxation		**20,869**	22,013
Tax on profit on ordinary activities	8	**(7,027)**	(4,358)
Profit on ordinary activities after taxation		**13,842**	17,655
Dividend	10	**(20,000)**	(10,000)
Transfer (from) to reserves	19	**(6,158)**	7,655

The profit for the financial period arises solely from continuing operations.

There is no difference between the profit on ordinary activities before taxation and the retained (loss) profit for the period stated above, and their historical cost equivalent.

Statement of total recognised gains and losses

For the 52 weeks ended:

	24 April 2004 £000	26 April 2003 £000
Transfer (from) to reserves for the financial period	**(6,158)**	7,655
Exchange translation differences	**-**	90
Total recognised gains and losses relating to the period	**(6,158)**	7,745

WATERSTONE'S BOOKSELLERS LIMITED
Company number 610095

Balance sheet
As at 24 April 2004:

	Notes	24 April 2004 £000	26 April 2003 £000
Fixed assets			
Tangible assets	11	**42,355**	40,650
Investments	12	**20,000**	20,000
		62,355	60,650
Current assets			
Stock	13	**34,790**	32,358
Debtors	14	**89,323**	57,542
Cash at bank and in hand		**17,467**	38,435
		141,580	128,335
Creditors: amounts falling due within one year	15	**(128,843)**	(108,943)
Net current assets		**12,737**	19,392
Total assets less current liabilities		**75,092**	80,042
Provisions for liabilities and charges	17	**(1,279)**	(242)
		73,813	79,800
Capital and reserves			
Called up share capital	18	**71,014**	71,014
Profit and loss reserve	19	**2,799**	8,786
Total shareholders' funds (equity)	20	**73,813**	79,800

These financial statements on pages 6 to 16 were approved by the Board of Directors on 16 August 2004 and were signed on its behalf by:

B F McLaughlin
Director

Notes to the financial statements

1. Accounting policies

Basis of preparation
The financial statements of the Company are made up to the Saturday on or immediately preceding 30 April each year. Consequently, the financial statements for the current period cover the 52 weeks ended 24 April 2004, whilst the comparative period covered the 52 weeks ended 26 April 2003.

They are prepared under the historical cost convention and in accordance with applicable accounting standards and specifically in accordance with the following accounting policies. The Company is exempt from preparing group financial statements as it is itself a subsidiary undertaking under S228 of the Companies Act 1985. These financial statements present information about the Company as an individual undertaking and not about its Group.

Change of accounting policy
The accounting policies set out below are consistent with the previous period, except for the adoption of UITF 17 (revised), 'Employee Share Schemes'. The cost of awards made under the deferred annual bonus scheme is charged to the profit and loss account based on an assessment of the probability of the performance conditions being met. The charge is allocated on a straight-line basis over the performance period of the scheme. As a result of the revision to UITF 17, the corresponding credit entry is taken to the profit and loss reserve. The impact of this change of accounting policy on the prior period was not material.

Cash Flow statement
Under FRS 1 (revised), Waterstone's Booksellers Limited is exempt from the requirement to prepare a cash flow statement as the Company is a wholly owned subsidiary undertaking of HMV Group plc, whose financial statements include a consolidated cash flow statement in accordance with FRS 1 (revised).

Foreign currencies
Transactions denominated in foreign currencies are recorded at the rates of exchange ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into sterling either at period end rates or, where there are related foreign exchange contracts, at contract rates. The resulting foreign exchange differences are dealt with in the determination of profit for the period.

Related party transactions
The Company has taken advantage of the exemption in FRS 8 not to disclose related party transactions between wholly owned fellow subsidiary undertakings.

Turnover
Turnover represents the value of goods and services supplied, less discounts given. Turnover excludes value added tax ("VAT") and similar sales-related taxes.

Advertising costs
Advertising costs are expensed as incurred.

Tangible fixed assets
The capitalised cost of tangible fixed assets includes only those costs that are directly attributable to bringing an asset to its working condition for its intended use.

Depreciation of tangible fixed assets is calculated on cost at rates estimated to write off the cost, less the estimated residual value of the relevant assets, by equal annual amounts over their estimated useful lives.

The annual rates used are:

Short-term leasehold property	Period of the lease
Plant, fixtures, fittings and vehicles	10 - 33 $^1/_3$ % or the period of the lease

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Leased assets
In respect of property operating leases, benefits received and receivable as an incentive to sign a lease are spread on a straight line basis over the shorter of the lease term and the period to the date of the first rent review. All other operating lease payments are charged directly to the profit and loss account in the financial period to which the payments relate.

Stock
Stock, which represents finished goods and goods for resale, is stated at the lower of cost and net realisable value on a first-in, first-out basis.

Goodwill
Goodwill in respect of acquisitions made prior to 25 April 1998 has been written off directly against reserves. As allowed by FRS 10's transitional arrangements, the Company has not applied the new accounting policy to goodwill already written off against reserves in previous years. The goodwill has been eliminated as a matter of accounting policy and would be charged to the profit and loss account on the subsequent disposal of the business to which it relates. No goodwill has arisen since 25 April 1998.

Pensions
HMV Group plc operates both defined benefit and defined contribution schemes.

For the defined benefit schemes, pension costs are charged to the profit and loss account so as to spread the cost of the pensions over the working lives of the employees. Valuation surpluses or deficits are amortised over the expected remaining working lives within the Group of the relevant employees (estimated to be eight years in respect of the United Kingdom). The amortisation of valuation surpluses is restricted to an amount equal to the regular pension cost.

For the defined contribution schemes, contributions are charged in the profit and loss account as they become payable in accordance with the scheme rules.

Deferred taxation
The charge for taxation is based on the profits for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date. Deferred tax assets are recognised only to the extent that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred bonus scheme
The cost of awards made under the deferred annual bonus component of a long-term incentive plan is charged to the profit and loss accounts based on an assessment of the probability of the performance conditions being met. The charge is allocated on a straight-line basis over the performance period of the scheme. The corresponding credit entry is taken to the profit and loss reserve in accordance with UITF 17.

Notes to the financial statements (continued)

2. Segmental analyses

Geographical analysis of turnover and operating profit:

	Turnover		Operating profit	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£000
United Kingdom	**270,464**	252,680	**17,768**	14,478
Rest of Europe	**-**	4,396	**-**	470
	270,464	257,076	**17,768**	14,948

In the opinion of the Directors, the Company only operates in one business segment - retailing.

Turnover analysed by destination is not materially different from turnover analysed by origin.

3. Operating profit

	2004	2003
	£000	£000
Operating profit is stated after charging:		
Auditors' remuneration:		
Fees as auditors	**46**	40
Fees for non-audit services	**9**	-
Depreciation and other amounts written off fixed assets	**10,270**	9,349
Operating lease rentals (land and buildings)	**24,512**	23,369

4. Other operating income and expenses

	2004	2003
	£000	£000
Royalties and management fees	**136**	(338)

5. Directors' emoluments

	2004	2003
	£000	£000
Emoluments	**1,270**	687
Amounts (excluding shares) receivable under long-term incentive schemes	**94**	209
Pension contributions	**12**	25
	1,376	921

Brian McLaughlin was paid by HMV Group plc for his services to the Group as a whole. His 2004 annual bonus included the sum of £150,000 in recognition of the additional role of Managing Director of Waterstone's Booksellers Limited, undertaken during the period under review. This amount is not included in the figures stated above.

Retirement benefits are accruing to all of the Directors under defined benefit pension schemes. In addition, the Company contributes to a separate money purchase plan in respect of four of the Directors (2003: three).

Five of the Directors exercised options over Ordinary Shares in the parent company, HMV Group plc. Six of the Directors are entitled to receive shares in HMV Group plc under a long-term incentive scheme.

Notes to the financial statements (continued)

5. Directors' emoluments (continued)

The amounts in respect of the highest paid Director were as follows:

	2004	2003
	£000	£000
Aggregate emoluments	**249**	272
Pension contributions	**8**	20
	257	292

The pension entitlements of the highest paid Director were as follows:

	2004	2003
	£000	£000
Accumulated total accrued pension	**29**	11

The highest paid Director exercised options over shares in the parent company, HMV Group plc, during the financial year and is entitled to shares in HMV Group plc under a long-term incentive scheme.

6. Employee costs

The aggregate payroll costs, including Directors' emoluments, were as follows:

	2004	2003
	£000	£000
Wages and salaries	**33,617**	31,333
Social security costs	**2,710**	2,331
Other pension costs	**847**	648
	37,174	34,312

The average number of people employed by the Company during the period was 2,646 (2003: 2,789). All staff were engaged in retailing.

7. Interest receivable

	2004	2003
	£000	£000
On bank deposits	-	16
From parent and fellow subsidiary undertakings	**3,101**	2,405
	3,101	2,421

Notes to the financial statements (continued)

8. Tax on profit on ordinary activities

	2004 £000	2003 £000
UK corporation tax, current period at 30.0% (2003: 30.0%)	**7,219**	5,400
UK corporation tax, prior period	-	(1,000)
Double tax relief	-	(50)
	7,219	4,350
Overseas tax, current period	-	50
Overseas tax, prior period	**(22)**	-
Total current tax	**7,197**	4,400
Deferred tax (note 16)	**(170)**	(42)
Tax on profit on ordinary activities	**7,027**	4,358

The tax charge for the period was £7,027,000 (2003: £4,358,000). This reflects a tax rate on ordinary activities before exceptional items of 33.7% (2003: 25.0%).

The total current tax charge is reconciled with the standard rate of UK corporation tax as follows:

	2004 £000	2003 £000
Profit before taxation	**20,869**	22,013
Corporation tax at UK statutory rate of 30.0%	**6,261**	6,604
Effects of:		
Permanent disallowables	**262**	(1,236)
Timing differences	**696**	32
Prior period overprovision	**(22)**	(1,000)
Total current tax charge	**7,197**	4,400

There are no significant factors that are expected to materially affect future tax charges.

9. Non-operating exceptional gain

In the prior period, on 23 November 2002, the Company sold the net assets of its branch in Ireland to Waterstone's Booksellers Ireland Limited, realising a profit on disposal of £4,644,000.

10. Dividends

	2004 £000	2003 £000
Equity – Ordinary		
Interim: 28.16p per £1 share (2003: 14.08p)	**20,000**	10,000

Notes to the financial statements (continued)

11. Tangible fixed assets

	Plant, fixtures, fittings and vehicles
	£000
Cost:	
At 26 April 2003	97,676
Additions	12,309
Disposals	(4,705)
At 24 April 2004	**105,280**
Depreciation:	
At 26 April 2003	57,026
Provided during the period	10,270
Disposals	(4,371)
At 24 April 2004	**62,925**
Net book value:	
At 24 April 2004	**42,355**
At 26 April 2003	40,650

12. Fixed asset investments

	Shares in subsidiary undertaking
	£000
At 24 April 2004 and 26 April 2003	**20,000**

The Company's principal subsidiary undertaking, which is 100% directly owned, is as follows:

Name of company	*Country of incorporation*	*Principal activity*
Fine Recordings Club Limited	England	Non-trading

In the opinion of the Directors, the aggregate value of the assets of the Company, consisting of shares in the Company's subsidiary, is not less than the aggregate of the amounts at which those assets are stated in the balance sheet.

13. Stock

Stock primarily comprise finished goods and goods for resale. The replacement cost of stock is considered to be not materially different from the balance sheet value.

14. Debtors

	2004	2003
	£000	£000
Amounts falling due within one year:		
Trade debtors	**1,520**	1,462
Amounts owed by parent and fellow subsidiary undertakings	**70,986**	39,889
Deferred tax (note 16)	**13**	326
Other debtors	**2,430**	3,137
Prepayments and accrued income	**12,161**	10,998
	87,110	55,812
Amounts falling due after more than one year:		
Deferred tax (note 16)	**2,213**	1,730
	89,323	57,542

Although amounts owed by parent and fellow subsidiary undertakings are repayable on demand and hence are included in debtors falling due within one year, in the ordinary course of business repayment within this timescale is not anticipated.

Notes to the financial statements (continued)

15. Creditors: amounts falling due within one year

	2004	2003
	£000	£000
Trade creditors	**28,027**	20,550
Amounts owed to parent and fellow subsidiary undertakings	**53,493**	46,994
Amounts owed to subsidiary undertakings	**20,000**	20,000
Corporation tax	**8,092**	6,247
Other creditors, including taxation and social security	**12,374**	8,807
Accruals and deferred income	**6,857**	6,345
	128,843	108,943

Although amounts due to parent and fellow subsidiary undertakings are repayable on demand and hence are included in creditors falling due within one year, in the ordinary course of business repayment within this timescale is not anticipated.

16. Deferred tax

	2004	2003
Deferred tax asset	£000	£000
Excess of accumulated tax allowances over depreciation provided against tangible fixed assets	**2,213**	1,730
Other timing differences	**13**	326
	2,226	2,056
Movements during the year:		
Opening balance	**2,056**	2,039
Credited to tax on ordinary activities	**170**	42
Other movements	-	(25)
Closing balance	**2,226**	2,056

There are no unprovided deferred tax liabilities as at 24 April 2004 or 26 April 2003.

17. Provisions for liabilities and charges

	Restructuring and store closures
	£000
At 26 April 2003	242
Provisions utilised	(12)
Charged to operating profit	1,049
At 24 April 2004	**1,279**

18. Share capital

	2004	2003
	No. & £000	No. & £000
Authorised:		
Ordinary shares of £1 each	**121,014**	121,014
Allotted, called up and fully paid:		
Ordinary shares of £1	**71,014**	71,014

Notes to the financial statements (continued)

23. Pensions

Waterstone's employees are members of a number of pension schemes. The main scheme is the HMV Group Pension Scheme (the "Scheme" – established with effect from July 1998). During the year ended 26 April 2003 and in the current year up to 31 May 2003, employees were also members of the EMI Group Pension Fund ("the Fund").

The majority of employees are members of the Scheme, which is based in the UK and has both defined benefit and defined contribution sections – the Pension Benefit Section and the Pension Saver Section. However, the defined benefit section of the Scheme was largely closed to new joiners in 1998 and subsequent joiners may join the defined contribution section of the Scheme.

The flotation of the parent undertaking, HMV Group plc, on the London Stock Exchange on 15 May 2002, and the concurrent dilution of EMI Group plc's investment in the parent undertaking started a process of separation of pension arrangements, which was completed with effect from 31 May 2003. The separation of pension arrangements provided each member of the Fund with the option of taking up membership of the Scheme. For the members who so elected (transferring members), a transfer was paid from the Fund to the Scheme in respect of their accrued rights.

The transitional implementation rules of FRS 17 introduced certain transitional balance sheet disclosures. However, on the basis that the Pension Benefit Section of the Scheme is a multi-employer scheme and that the Company is unable to identify its share of the underlying assets and liabilities on a reasonable and consistent basis, it has taken advantage of the exemption in FRS 17 and will account for both schemes on a defined contribution basis until the arrangement ceases. Accordingly, no transitional balance sheet or profit and loss account disclosures are required at 24 April 2004.

Relevant additional details of the Scheme are disclosed in the financial statements of HMV Group plc.

The total pension cost for the Company for the period ended 24 April 2004 was £847,000 (2003: £648,000).

24. Ultimate parent undertaking

The immediate and ultimate parent undertaking of the Company for which Group financial statements are drawn up and of which the Company is a member is HMV Group plc. Copies of these financial statements can be obtained from the Company Secretary, HMV Group plc, Shelley House, 2-4 York Road, Maidenhead, Berkshire, SL6 1SR.