

CARDNET MERCHANT SERVICES LIMITED

ANNUAL REPORT AND ACCOUNTS 2004



CARDNET MERCHANT SERVICES LIMITED

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Registered number: 735844

Registered office:

25 Gresham Street
London
EC2V 7HN

Directors:

N. R. Leacock
P. J. Martin (Chairman)
R. Schimenz
D. G. Yates

Company Secretary:

S. Slattery

Member of Lloyds TSB Group

CARDNET MERCHANT SERVICES LIMITED

REPORT OF THE DIRECTORS

Principal activities

The company is a joint venture between Lloyds TSB Bank plc and FDR Limited. The company's principal activity during the year was the provision of services to merchants enabling the acceptance, authorisation and clearing of plastic card transactions.

Results and dividends

The profit after taxation for the year ended 31 December 2004 amounted to £27,437,000 (2003: £25,757,000) as set out in the profit and loss account on page 4. An interim dividend of £12,942,000 was paid on 1st October 2004 (2003: £12,078,000) to the A & B shareholders. The directors approved the payment of further dividends totalling £14,495,000 (2003: £13,679,000) to the A & B shareholders.

Directors

The names of the directors of the company are shown on page 1.

The following changes in directors have taken place during the year and since the year end:

| | Appointed | Resigned |
|-------------------------|--------------------------------|--------------------------------|
| D.R. Gagie (Chairman) | | 18 th February 2005 |
| G. E. R. Hawkins | | 1 st November 2004 |
| P. J. Martin (Chairman) | 18 th February 2005 | |
| D. G. Yates | 1 st November 2004 | |

Reference is made on page 8 in note 8 to the directors' interests in the capital of Lloyds TSB Group plc, the ultimate parent company, and its subsidiaries.

Policy and practice on payment of creditors

The company follows "The Better Payment Practice Code" published by the Department of Trade and Industry, regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from The DTI Publications orderline 08701502500, quoting ref URN04/606.

The company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The number of days required to be shown on this report, to comply with the provisions of the Companies Act 1985, is 23 (2003: 25). This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2004 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board



Sharon Slattery
Secretary

~~20/04~~ 2005

Independent auditors' report to the members of Cardnet Merchant Services Limited

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the cashflow statement and the related notes, which have been prepared under the historical cost convention and the accounting policies set out in Note 1.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the annual report including, as described below, the financial statements. The United Kingdom Companies Act 1985 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 as at the end of the year and of the profit or loss for that year. In preparing those financial statements the directors are required to:

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

The directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which 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.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

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 is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs at 31 December 2004 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Bristol

28th October, 2005

CARDNET MERCHANT SERVICES LIMITED

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2004

| | Notes | 2004 £'000 | 2003 £'000 |
|---|-------|---------------|---------------|
| Turnover | 1 | 49,155 | 44,690 |
| Administrative expenses | | (13,401) | (10,577) |
| Operating profit | | <u>35,754</u> | <u>34,113</u> |
| Interest receivable | 3 | 3,441 | 2,682 |
| Profit on ordinary activities before taxation | 4 | <u>39,195</u> | <u>36,795</u> |
| Taxation on profit on ordinary activities | 7 | (11,758) | (11,038) |
| Profit on ordinary activities after taxation | | <u>27,437</u> | <u>25,757</u> |
| Dividends – paid | | (12,942) | (12,078) |
| - proposed | | (14,495) | (13,679) |
| Retained profits/(losses) transferred to profit and loss reserves | | <u>-</u> | <u>-</u> |

The company had no recognised gains or losses other than those disclosed in the profit and loss account, and therefore no separate statement of total recognised gains and losses has been presented.

All income and expenditure arose from continuing activities.

The company has no movement in shareholders' funds other than those included in the profit and loss account, and therefore no separate reconciliation of movement in shareholders' funds has been presented.

There are no differences between the profit on ordinary activities before taxation and the retained profit for the year stated above and their historical cost equivalents.

The notes on pages 7 to 11 form part of these accounts.

CARDNET MERCHANT SERVICES LIMITED

BALANCE SHEET

AS AT 31 DECEMBER 2004

| | Notes | 2004 £'000 | 2003 £'000 |
|--|-------|---------------|---------------|
| Fixed assets | 9 | 56 | 60 |
| Current assets | | | |
| Debtors | 10 | 123,060 | 135,846 |
| Cash at bank and in hand | | 118 | 320 |
| | | 123,178 | 136,166 |
| Creditors: amounts falling due within one year | 11 | (122,744) | (135,580) |
| Net current assets | | 434 | 586 |
| Total assets less current liabilities | | 490 | 646 |
| Provisions for liabilities and charges | 12 | (487) | (643) |
| Total Assets | | 3 | 3 |
| Capital and reserves | | | |
| Called up share capital | 13 | 3 | 3 |
| Profit and loss account | | - | - |
| Total shareholders' funds | | 3 | 3 |
| Analysis of shareholders' funds | | | |
| Equity | 13 | 2 | 2 |
| Non-equity | | 1 | 1 |
| | | 3 | 3 |



P.J. Martin
Chairman

The notes on pages 7 to 11 form part of these accounts.

CARDNET MERCHANT SERVICES LIMITED

CASHFLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2004

| | 2004 £'000 | 2003 £'000 |
|--|-----------------------------|-----------------------------|
| Net cash inflow from operating activities | 34,862 | 30,675 |
| Returns on investment and servicing of finance | | |
| Interest received | 3,441 | 2,682 |
| Taxation paid | (11,849) | (9,873) |
| Capital expenditure and financial investment | (35) | |
| Purchase of tangible fixed asset | | (51) |
| Equity dividends paid | (26,621) | (23,316) |
| (Decrease) / Increase in cash | <u>(202)</u> | <u>117</u> |

Reconciliation of operating profit to net cash inflow from operating activities

| | 2004 £'000 | 2003 £'000 |
|--|-----------------------------|-----------------------------|
| Operating profit | 35,754 | 34,113 |
| Decrease / (Increase) in debtors | 12,786 | (8,655) |
| (Increase) / Decrease in creditors and provisions | (13,717) | 5,169 |
| Depreciation on fixed assets | 39 | 48 |
| Net cash inflow from continuing operating activities | <u>34,862</u> | <u>30,675</u> |

Refer to Note 15 on page 11 for an explanation of the reconciliation of net cash flow to movement in net funds for the year ended 31 December 2004 and analysis of changes in net funds.

CARDNET MERCHANT SERVICES LIMITED

Notes to the accounts

1 Accounting Policies

The accounts are prepared in accordance with applicable accounting standards and under the historical cost convention using the following accounting policies. Certain prior period balance sheet amounts have been reclassified to conform with current year presentation.

a) Turnover

Turnover comprises merchant service charges and other fees receivable from merchants net of deductions for interchange payable to card issuers and costs of processing and settlement services.

b) 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. No material timing differences existed in the current or prior years.

c) Provisions for bad and doubtful debts

Provisions for chargebacks are established when specific losses are identified with respect to merchants where recovery is at risk.

d) Other provisions and liabilities

Provisions in respect of obligations of the company are made in line with prudent estimates of the likely outcome.

e) Interest receivable

Interest income is recognised in the profit and loss accounts as it accrues.

f) Fixed assets

Equipment is depreciated by equal instalments over the estimated useful lives of the assets, which are 3-8 years.

g) Foreign Currency Translation

Assets, Liabilities and results in foreign currencies are expressed in sterling at the rates of exchange ruling on the date of the balance sheet. All exchange profits or losses, which arise from normal trading activities, are included in the profit and loss account.

2 Segmental analysis

In the opinion of the directors, the company has one class of business, the provision of services to merchants enabling the acceptance, authorisation and clearing of plastic card transactions. In addition, during the year it had no significant activities outside the United Kingdom. Accordingly, no segmental analysis by class of business or geographical location is provided.

3 Interest receivable

| | 2004 £'000 | 2003 £'000 |
|--|---------------|---------------|
| Interest receivable from Lloyds TSB Bank plc | 3,441 | 2,682 |

4 Profit on ordinary activities before taxation

| | 2004 £'000 | 2003 £'000 |
|---|---------------|---------------|
| Profit on ordinary activities before taxation is stated after charging: | | |
| Auditors' remuneration – audit services | 20 | 20 |
| Depreciation | 39 | 48 |

CARDNET MERCHANT SERVICES LIMITED

Notes to the accounts (continued)

5 Directors' emoluments

The aggregate of the emoluments of the directors directly attributable to services provided to Cardnet Merchant Services Limited was £140,940 (2003: £93,565). These comprise amounts paid by the parent undertaking to the directors for their services to this company, which relate to the management of the affairs of this company.

Retirement benefits are accruing to one director under a defined benefit pension scheme (2003: one).

These costs are recharged to the company and included within expenses recharged by Lloyds TSB Bank plc in Note 14 to the accounts.

6 Employee information

The company has no employees (2003: Nil). All activities of the company are carried out by the joint venture partners Lloyds TSB Bank plc and FDR Limited for which the company is recharged.

7 Taxation on profit on ordinary activities

| | 2004 £'000 | 2003 £'000 |
|---|---------------|---------------|
| UK corporation tax on profit for the year | 11,758 | 11,038 |

The charge for tax on the profit for the year is based on the UK corporation tax rate of 30 per cent (2003: 30 per cent).

8 Directors' interests

The interests of the directors of the company at the end of the year in the capital of Lloyds TSB Group plc were:

| Shares | At 31 December 2004 | At 1 January 2004 (or later date of appointment) |
|---------------|---------------------------|---|
| D. R. Gagie | 3,313 | 2,076 |
| N. R. Leacock | 7,158 | 6,328 |
| R. Schimenz | - | - |
| D. G. Yates | - | - |

| Options to acquire shares | At 1 January 2004 (or later date of appointment) | During the year or since appointment | | At 31 December 2004 |
|---------------------------|---|---|-----------|------------------------|
| | | Granted | Exercised | |
| D. R. Gagie | 35,880 | 167,561 | - | 203,441 |
| N. R. Leacock | 16,817 | 5,963 | - | 22,780 |
| R. Schimenz | - | - | - | - |
| D. G. Yates | - | - | - | - |

None of the directors had any other interest in the capital of Lloyds TSB Group plc or its subsidiaries.

CARDNET MERCHANT SERVICES LIMITED

Notes to the accounts (Continued)

9 Fixed assets

| | Equipment £'000 |
|---|--------------------|
| Cost: | |
| At 1 January 2004 | 200 |
| Additions | 35 |
| Disposals | - |
| At 31 December 2004 | <u>235</u> |
| Depreciation: | |
| At 1 January 2004 | 140 |
| Charge for the year | 39 |
| Disposals | - |
| At 31 December 2004 | <u>179</u> |
| Balance Sheet amount at 31 December 2004 | <u>56</u> |
| Balance Sheet amount at 31 December 2003 | <u>60</u> |

10 Debtors

| | 2004 £'000 | 2003 £'000 |
|------------------------------------|----------------|----------------|
| Accrued Income | 12,184 | 12,772 |
| Amount owed by Card Schemes | 36,610 | 9,183 |
| Amount owed by Lloyds TSB Bank plc | 74,266 | 113,891 |
| | <u>123,060</u> | <u>135,846</u> |

Amounts owed by group undertakings are unsecured and have no fixed date of repayment.

11 Creditors: amounts falling due within one year

| | 2004 £'000 | 2003 £'000 |
|------------------------------|----------------|----------------|
| Bank loans and overdrafts | 142 | 12 |
| Taxation | 5,867 | 5,957 |
| Accruals and other creditors | 5,270 | 4,273 |
| Proposed dividend | 14,495 | 13,679 |
| Liability to merchants | 96,970 | 111,659 |
| | <u>122,744</u> | <u>135,580</u> |

CARDNET MERCHANT SERVICES LIMITED

Notes to the accounts (continued)

12 Provisions for liabilities and charges

| | | |
|---|--------------|--------------|
| The movement in provisions is as follows: | 2004 | 2003 |
| | £'000 | £'000 |
| Balance brought forward 1 January | 643 | 1,378 |
| Amounts written off | (582) | (619) |
| Additional provisions made | 426 | (116) |
| Balance carried forward 31 December | <u>487</u> | <u>643</u> |

Under the rules of the card schemes that govern the card industry, card issuers can seek reimbursement from the company for any amounts they have refunded to cardholders for goods and services paid for but not received. In turn, the company normally recovers from the merchants the value of these chargebacks. Provisions for chargebacks are based on an appraisal of specific merchants where this recovery is at risk. Charges for the year are included within administrative expenses.

Movements in provisions are shown net of recoveries made within the year.

13 Called up share capital and non-equity shareholder funds

| | | |
|------------------------------------|--------------|--------------|
| | 2004 | 2003 |
| Authorised issued and fully paid | | |
| 650 "A" ordinary shares of £1 each | 650 | 650 |
| 651 "B" ordinary shares of £1 each | 651 | 651 |
| 1,300 deferred shares of £1 each | 1,300 | 1,300 |
| | <u>2,601</u> | <u>2,601</u> |

The ordinary shareholders (the holders of the 'A' ordinary shares and/or the 'B' ordinary shares) have priority over the deferred shareholders (the holders of the deferred shares) to receive dividends distributed up to the 'deferred share threshold' as defined in the company's articles of association. Dividends above the threshold are distributed as follows: 99% amongst the ordinary shareholders and 1% amongst the deferred shareholders.

On winding up, the deferred shareholders have priority over the ordinary shareholders to receive repayment of capital. The ordinary shareholders have equal voting rights and the deferred shareholders have no voting rights.

14 Related party disclosures

Financial Reporting Standard 8 required disclosure of material transactions with related parties. As shareholders, Lloyds TSB Bank plc and FDR Limited are related parties to the company.

| | | |
|--|--------------|--------------|
| Lloyds TSB Bank plc | 2004 | 2003 |
| | £'000 | £'000 |
| - expenses recharged by Lloyds TSB Bank plc | 13,401 | 7,914 |
| - interest receivable from Lloyds TSB Bank plc | 3,441 | 2,682 |
| - amounts owed by Lloyds TSB Bank plc | 74,266 | 113,891 |
| - cash held with Lloyds TSB Bank plc | 2 | 211 |

CARDNET MERCHANT SERVICES LIMITED

Notes to the accounts (continued)

Related party disclosures (continued)

Net income collected by Lloyds TSB Bank plc on behalf of the company amounted to £48.2m (2003: 43.7m). Turnover includes £1m (2003: £1m) from Lloyds TSB Bank plc relating to an adjustment for fees received and receivable for those cash disbursements to cardholders at counters of branches of Lloyds TSB Bank plc which are acquired by the company.

Certain management costs of the company are paid by Lloyds TSB Bank plc and recharged.

For certain merchants, the risk of irrecoverable chargebacks is underwritten by Lloyds TSB Bank plc. The credit risk underwritten by Lloyds TSB Bank plc amounted to £27.4m at 31 December 2004 (2003: £19.5m).

| | 2004 £'000 | 2003 £'000 |
|---|---------------|---------------|
| FDR Limited | | |
| - expenses recharged by FDR Limited | 2,430 | 2,663 |
| - amounts owed to FDR Limited (included in Accruals and other creditors) | 3,745 | 2,004 |
| - fees charged by FDR Limited | 9,581 | 9,590 |

Fees charged by FDR Limited include contractual credits received of £3.2m (2003: £3m).

For certain merchants, the risk of irrecoverable chargebacks is underwritten by FDR Limited. Underwriting fees paid to FDR Limited during the year ended 31 December 2004 amount to £2.1m (2003: £1.7m).

15 Cash flows

| | 2004 £'000 | |
|--|----------------|------------------|
| a) Reconciliation of net cash flow to movement in net funds | | |
| Net funds at 1 January | 308 | |
| Increase in cash in the year and change in net funds | (202) | |
| Net funds at 31 December | <u>118</u> | |
| | | |
| | At 1 | Cashflows |
| | January | during |
| | 2004 | 2004 |
| | £'000 | £'000 |
| b) Analysis of changes in net funds | | At 31 |
| | | December |
| | | 2004 |
| | | £'000 |
| Cash in hand and at bank | 320 | (202) 118 |

16 Ultimate parent company

The company regarded by the directors as the ultimate parent company is Lloyds TSB Group plc, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the company is a member. Lloyds TSB Bank plc is the parent undertaking of the smallest such group of undertakings. Copies of the accounts of both companies may be obtained from the company secretary's office, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN.

17 Date of approval

The directors approved the accounts on 28/10/05.