PolyGram Record Operations Limited

Directors' report and financial statements

31 December 1996
Registered number 950138

Directors' report and financial statements

Contents

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 1996.

Results and dividends

The results for the year are set out on page 5. The profit on ordinary activities, after taxation, amounted to £240,000 *(1995: profit of £14,136,000)*. The directors do not recommend the payment of a dividend *(1995:£14,000,000)*. A profit of £240,000 has been retained for the period.

Principal activities and review of the business

The principal activities of the company were distribution and marketing of gramophone records and music cassettes together with compact discs and videos. This situation is expected to continue in the coming year. The directors aim to maintain the management policies which have resulted in the company's growth and success in recent years.

Tangible fixed assets

The movements in tangible fixed assets during the year are set out in note 8.

Directors and directors' interests

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

GN Rigg	(resigned 1 July 1996)
AG Pye	
TC Fisher	(appointed 1 July 1996)
NB Hartley	(appointed 24 January 1996)
JP Kennedy	(appointed 1 July 1996)
R Ames	(resigned 1 July 1996)
PolyGram U.K. Limited	

At no time during the year did any director have any interest which is required by section 324 of the Companies Act 1985 to be notified to the company.

Disabled employees

The group gives every consideration to applications for employment from disabled persons where the requirements of the job may be adequately fulfilled by a handicapped or disabled person.

Where existing employees become disabled, it is the group's policy wherever practicable to provide continuing employment under normal terms and conditions and to provide training and career development and promotion wherever appropriate.

Charitable donations

During the year the company made charitable donations of £30,229.

Employee involvement

During the year, the policy of providing employees with information about the group has been continued. Employees have also been encouraged to present their suggestions and views on the company's performance. Regular meetings are held between local management and employees to allow a free flow of information and ideas.

Directors' report *(continued)*

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

MA Howle
Director

1 Sussex Place
London
W6 9XS

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that 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 company will continue in business.

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

KPMG
PO Box 695
8 Salisbury Square
London EC4Y 8BB
United Kingdom

Report of the auditors to the members of PolyGram Record Operations Limited

We have audited the financial statements on pages 5 to 18.

Respective responsibilities of directors and auditors

As described on page 3 the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 1996 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG

11 November 1997

Chartered Accountants
Registered Auditors

Profit and loss account
for the year ended 31 December 1996

	Note	1996 £000	1995 £000
Turnover	2	**214,585**	221,770
Cost of sales		**(152,359)**	(147,919)
Gross profit		**62,226**	73,851
Other costs		**-**	(150)
Distribution costs		**(8,890)**	(8,890)
Administrative expenses		**(46,673)**	(43,718)
Operating profit		**6,663**	21,093
Interest receivable and similar income		**43**	3,652
Interest payable and similar charges	6	**(3,182)**	(2,120)
Profit on ordinary activities before taxation		**3,524**	22,625
Tax on profit on ordinary activities	7	**(3,284)**	(8,489)
Profit on ordinary activities after taxation		**240**	14,136
Dividends	8	**-**	(14,000)
Retained profit for the year	18	**240**	136

The results, as disclosed above, are all derived from continuing activities.

A statement of total recognised gains and losses has not been provided since there are no recognised gains or losses other than those stated above.

There is no material difference between the results as stated above and those on an unmodified historical cost basis.

Balance sheet
at 31 December 1996

	Note	1996		1995	
		£000	**£000**	£000	£000
Fixed assets					
Tangible assets	*9*		**19,114**		15,759
Investments	*10*		**23**		11
			19,137		15,770
Current assets					
Stocks	*11*	**1,200**		1,176	
Debtors	*12*	**221,226**		192,086	
Cash at bank and in hand		**9,479**		15,449	
		231,905		208,711	
Creditors: amounts falling due within one year	*13*	**(239,598)**		(222,668)	
Net current (liabilities)/assets			**(7,693)**		13,957
Total assets less current liabilities			**11,444**		1,813
Provisions for liabilities and charges					
Deferred taxation	*14*		**(10,500)**		(1,109)
Net assets			**944**		704
Capital and reserves					
Called up share capital	*15*		**15**		15
Profit and loss account	*19*		**929**		689
			944		704

These financial statements were approved by the board of directors on 10/4/97 and were signed on its behalf by:

NB Hartley

Director

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

Cash flow statement

The company is exempt for the requirement of Financial Reporting Standard No.1 (revised) to prepare a cash flow statement as it is a subsidiary undertaking where 90% or more of the voting rights are controlled within the PolyGram N.V. group and the consolidated financial statements of PolyGram N.V., in which the company is included, are publicly available.

Fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follow:

Land	-	Nil
Buildings	-	2%
Piping and wiring	-	5%
Machinery, equipment and installations in rented premises	-	10% and 20%
Fixtures and fittings	-	10% and 25%
Office machinery	-	15%
Leased equipment	-	2 - 25%
Motor vehicles	-	25%

No depreciation is provided on freehold land.

For the purpose of the statutory accounts all assets come under the heading of Plant and equipment. This category includes all the specified categories except Land, Buildings or Motor vehicles; these categories currently contain no assets.

Notes *(continued)*

1 Accounting policies *(continued)*

Leases

Where the company 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 rental charges are charged to the profit and loss account on a straight line basis over the life of the lease.

Pension and other post-retirement benefits

The company is a member of the Phillips Pension Fund which is a funded defined benefit scheme. Contributions to this group scheme are based on a common rate throughout the Phillips group and are assessed on a triennial basis in accordance with the advice of a qualified actuary using the projected unit method. Pension costs are charged to the profit and loss account so as to spread the cost over employees' working lives within the group. Actuarial surpluses and deficits are amortised on a straight line basis over the average remaining service lives of the employees.

Investments

Investments are stated at cost less amortisation where appropriate, to arrive at a net value equating to estimated recoverable amounts.

Advance royalties paid

For advances to artists and repertoire owners, each contract is appraised individually and the value of the unrecouped portion is determined by the prospects of future recopment taking into account current popularity and sales.

Non-consolidation of subsidiaries

Consolidated accounts have not been prepared as the company is a wholly owned subsidiary of PolyGram N.V., a company incorporated in the European Community, and is therefore exempt under section 228 of the Companies Act 1985 from the obligation to prepare and deliver group accounts.

Notes *(continued)*

Accounting policies (continued)

Stock

Stock and work-in-progress are stated at the lower of cost and estimated net realisable value. Cost represents actual cost and consists, in the case of own manufactured products, of direct material and labour costs together with the relevant proportion of factory fixed and variable overheads. Net realisable value is the estimated selling price less estimated costs to disposal.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Provision is made for deferred tax only to the extent that it is probable that an actual liability will crystallise.

Related parties

The company has taken advantage of the exemption in Financial Reporting Standard 8 not to disclose related party transactions with PolyGram N.V. and its subsidiaries.

2 Turnover

Turnover represents the invoiced value of goods and services excluding value added tax. Turnover is attributable to one activity, recorded music.

Turnover by destination is as follows:

	1996	1995
	£000	£000
United Kingdom	**211,174**	179,416
Europe	**2,253**	41,809
US	**343**	247
Other	**815**	298
	214,585	221,770

Turnover by source is exclusively derived in the United Kingdom. Consequently, profit on ordinary activities before tax and net assets are all attributable to United Kingdom activities. All turnover is derived from the single class of business described in the directors' report.

Notes *(continued)*

3 Profit on ordinary activities before taxation

	1996	1995
	£000	£000
Profit/[loss] on ordinary activities before taxation is stated		
after charging		
Auditors' remuneration:		
Audit	**55**	73
Depreciation and other amounts written off tangible fixed assets	**2,331**	1,843
Exchange losses	**16**	35
Rental payable under operating leases:		
Hire of plant and machinery	**902**	965
Other assets	**2,081**	2,097

4 Directors' emoluments

	1996	1995
	£000	£000
Directors' remuneration (including pension contributions)	**2,410**	1,612
Emoluments of the chairman (excluding pension contributions) who was also the highest paid director	**1,201**	1,148

The number of directors whose emoluments (excluding pension contributions) fell within the following ranges were:

			Number of directors	
			1996	1995
£0	-	£5,000	1	-
£25,001	-	£30,000	-	1
£65,001	-	£70,000	1	1
£110,001	-	£115,000	1	-
£120,001	-	£125,000	-	1
£130,001	-	£135,000	1	-
£240,001	-	£245,000	-	1
£250,001	-	£255,000	1	-
£635,001	-	£640,000	1	-
£1,145,001	-	£1,150,000	-	1
£1,200,001	-	£1,205,000	1	-

Notes *(continued)*

5 Staff numbers and costs

	1996	1995
Commercial and administrative	**702**	733

The aggregate payroll costs of these persons were as follows:

	1996 **£000**	1995 £000
Wages and salaries	**18,782**	17,591
Social security costs	**1,706**	1,609
Other pension costs	**73**	89
	20,561	19,289

6 Interest payable and similar charges

	1996 **£000**	1995 £000
On bank overdraft	**1,280**	112
On other loans	**1,902**	2,008
	3,182	2,120

Of the above amount £1,280 *(1995: £112)* was payable to group undertakings.

7 Taxation

	1996		1995	
	£000	**£000**	£000	£000
UK corporation tax at 33% *(1995: 33%)* on the profit for the year on ordinary activities		**(7,207)**		7,260
Deferred taxation		**10,427**		(140)
Group relief		**-**		776
Adjustment relating to an earlier year				
UK corporation tax	**-**		1,369	
Deferred taxation	**64**		337	
Group relief	**-**		(1,418)	
Other	**-**		305	
		64		593
		3,284		8,489

Notes *(continued)*

8 Dividends paid

	1996	1995
	£000	£000
Interim	-	-
Final	-	14,000
	-	14,000

9 Tangible fixed assets

	Plant and equipment
	£000
Cost:	
At 1 January 1996	20,908
Additions	6,683
Transfers from group undertakings	72
Disposals	(3,399)
At 31 December 1996	24,264
Depreciation	
At 1 January 1996	5,150
Charge for year	2,331
On disposals	(2,331)
At 31 December 1996	5,150
Net book value	
At 31 December 1996	**19,114**
At 1 January 1996	15,759

Notes *(continued)*

10 Investments

	Limited partnership £000
Cost	
1 January 1996	161
Additions	12
At 31 December 1996	173
Amounts written off:	
At 1 January 1996 and 31 December 1996	(150)
Net book value:	
At 31 December 1996	**23**
At 1 January 1996	11

During this year the investment in an associated undertaking of the ordinary shares of Know Existence Limited, a company involved in the distribution and licensing of recorded music and incorporated in the United Kingdom was increased from 49% to 100%. Know Existence Limited is constituted by ordinary shares of £1 nominal value only.

The company's investment in a Limited Partnership represents a 50% share in Def American, which is involved in licensing and distributing recorded music in the United Kingdom. The aggregate investment in associated undertakings and in the limited partnership under equity accounting at 31 December 1996 is £nil *(1995:£nil)*.

Notes *(continued)*

11 Stocks

	1996 £000	1995 £000
Finished goods and goods for resale	**1,200**	1,176

12 Debtors

	1996 £000	1995 £000
Trade debtors	**70,108**	56,207
Group undertakings:		
Overseas group undertakings	**17,959**	16,835
UK group undertakings	**68,263**	84,258
Other debtors	**2,409**	2,810
Corporation tax	**7,200**	-
Prepayments	**9,404**	2,313
Other taxes	**3,235**	-
Advances to artists	**42,648**	29,663
	221,226	192,086

In accordance with industry practice advances to artists include certain amounts recoverable after one year.

13 Creditors: amounts falling due within one year

	1996 £000	1995 £000
Trade creditors	**62,078**	79,930
Group undertakings:		
Overseas group undertakings	**3,451**	5,168
UK group undertakings	**105,625**	39,193
Proposed dividends	**-**	14,000
Associated undertakings	**28,005**	28,188
Other creditors including taxation and social security:		
Corporation tax	**2,908**	10,617
Other taxes and social security	**2,136**	8,780
Other creditors	**21,423**	17,431
Accruals and deferred income	**13,972**	19,361
	239,598	222,668

Notes *(continued)*

14 Provisions for liabilities and charges

	Deferred taxation £000
At beginning of year	1,109
Charge for the year in the profit and loss account	10,491
Adjustment relating to a previous year	(1,100)
	10,500

All amounts relating to deferred taxation are provided and these amounts are set out below:

	1996 £000	1995 £000
Difference between accumulation depreciation and amortisation and capital allowances	1,565	35
Recording costs	15,500	6,747
Other timing differences	(6,615)	(5,673)
	10,500	1,109

15 Called up share capital

	1996 £000	1995 £000
Authorised		
Ordinary shares of £1 each	15	15
Allotted, called up and fully paid		
Ordinary shares of £1 each	15	15

Notes *(continued)*

16 Reconciliation of movement in equity shareholders' funds

	1996 £000	1995 £000
Profit for the financial year	**240**	14,136
Dividends	**-**	(14,000)
Retained profit for the year	**240**	136
Opening equity shareholders' funds	**704**	568
Closing equity shareholders' funds	**944**	704

17 Commitments

Annual commitments under non-cancellable operating leases are as follows:

	1996		1995	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
Operating leases which expire:				
Within one year	**827**	**23**	827	207
In the second to fifth years inclusive	**-**	**811**	-	602
Over five years	**1,234**	**-**	1,234	-
	2,061	**834**	2,061	2,463

Notes *(continued)*

18 Pension scheme

As explained in the accounting policies set out on page 8, the companys' employees are entitled to membership of the Phillips Pension fund which is a funded defined benefit scheme.

Valuations are carried out on a triennial basis. The most recent valuation was undertaken by the independent actuaries, Bacon & Woodrow, as at 31 March 1995 using the projected unit method. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that investment returns would be 9% per annum, that salary increases would average 7% per annum and that present and future pensions would increase at the rate of 4.5% per annum.

The 31 March 1995 valuation showed that the market value of the scheme's assets was £1,312 million and that the actuarial value of those assets represented 121% of the benefits which had accrued to members, after allowing for expected future increases in earnings.

The pension charge for the period of £nil *(1995:£nil)* included £1.3 million *(1995:£1.3 million)* in respect of the amortisation of the actuarial surplus that is being recognised over 27 years, the average remaining service lives of employees.

There are no outstanding or prepaid contributions at either the beginning or end of the financial year as the company has followed the actuarial recommendation that its contributions to the fund be suspended until 31 December 1999. The company's and employees' contributions, currently at rates of 12.3% and 6% of earnings receptively, will continue after this 'holiday' period.

19 Movement on reserves

	Profit and loss account £000
At beginning of year	689
Retained profit for the year	240
At end of year	929

Notes *(continued)*

20 Parent undertaking

The parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the company is a member is Philips Electronics N.V., incorporated in The Netherlands, and the parent undertaking of the smallest such group is PolyGram N.V., incorporated in The Netherlands. Copies of Philips Electronics N.V.'s accounts can be obtained from:

Philips Electronics N.V.
Corporate Finance Securities
Groenewoudseweg 1
5621 BA Eindhoven
The Netherlands

and copies of PolyGram N.V.'s accounts can be obtained from:

PolyGram N.V.
Gerrit van der Veelaan 4
3743 DN Baarn
The Netherlands