Priory Hospitals Limited

Directors' report and financial statements

Year ended 31 December 2002

Registered number 1505382

Contents

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

Principal activities

The company's principal activity is the provision of private psychiatric and chemical dependency hospital and rehabilitation services.

Business review

The results for the year are set out in the profit and loss account on page 5.

On 17 December 2002, the company subscribed for additional share capital in subsidiary undertakings: Priory Behavioural Health Limited (£60,000), Sturt House Clinic Limited (£68,000), Nottcor6 Limited (£1,718,000) and Employee Management Services Limited (£351,000).

On 23 December 2002, as part of a general re-organisation of the Group's structure, the company:

- acquired the beneficial ownership of the acute hospitals at Altrincham, Bristol, Chelmsford, Hayes Grove, Lancashire, Marchwood, North London, Nottingham. Roehampton, Sturt, Woking and Woodbourne and certain liabilities from Priory Healthcare Limited (a fellow subsidiary undertaking) for a consideration of £22,936,000 to be left outstanding as a debt repayable on demand;
- acquired the beneficial ownership of the acute hospital at Glasgow and certain liabilities from Priory Healthcare Services Limited (a fellow subsidiary undertaking) for a consideration of £2,740,000 to be left outstanding as a debt repayable on demand;
- sold the beneficial ownership of Sheridan House to Priory Childcare Services Limited (a fellow subsidiary undertaking) for a consideration of £245,000 to be left outstanding as a debt repayable on demand;
- acquired the leasehold of the Priory Clinic Canterbury from Priory Specialist Health Limited (a fellow subsidiary undertaking) for a consideration of £1;
- sold its investments in Care Continuums Limited, Employee Management Services Limited, Public Health Solutions Limited, Nottcor6 Limited, Sturt House Clinic Limited, Priory Behavioural Health Limited, Jacques Hall Foundation Limited, Jacques Hall Limited and The Nottingham Clinic Limited to Priory Healthcare Acquisition Co Limited (a fellow subsidiary undertaking) for a consideration of £668,000 to be left outstanding as a debt repayable on demand. The resulting profit on sale was £225,000;
- sold its investment in Priory Childcare Services Limited to Priory Securitisation Limited (a fellow subsidiary undertaking) for a consideration of £1;
- acquired the entire issued share capital of Farm Place Limited from Priory Specialist Health Limited (a fellow subsidiary undertaking) for a consideration of £3,500,000 to be left outstanding as a debt repayable on demand;
- acquired the entire issued share capital of Priory Healthcare Services Limited from Priory Healthcare Limited (a fellow subsidiary undertaking) for a consideration of £123,134,000 to be left outstanding as a debt repayable on demand;
- acquired the entire issued share capital of Libra Health Limited from Libra Health Group Limited (a fellow subsidiary undertaking) for a consideration of £5,253,000 to be left outstanding as a debt repayable on demand;
- acquired the legal title, beneficial ownership, trades and assets of the acute healthcare businesses of Libra Health Limited at book value;
- acquired the legal title, beneficial ownership, trades and assets of the business of Farm Place Limited at book value; and
- sold the legal title of Eden Grove and Jacques Hall to Priory Childcare Services Limited for a consideration of £1.

Directors' report *(continued)*

Dividends

The directors do not recommend the payment of a dividend *(2001: £nil)*.

Directors and directors' interests

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

AG Heywood	(resigned 30 April 2002)
Dr CB Patel	
JD Weight	(resigned 10 June 2002)
Ms S J Stewart	(appointed 10 June 2002, resigned 5 December 2002)
PJ Greensmith	(appointed 13 September 2002)

In accordance with the articles of association, no directors retire by rotation. None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company.

The interests of Dr CB Patel and PJ Greensmith in the shares of Priory Healthcare Investments Limited (the ultimate parent company) are disclosed in the financial statements of that company.

Auditors

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

By order of the board

PJ Greensmith
Company Secretary

Priory House
Randalls Way
Leatherhead
Surrey
KT22 7TP

8 May 2003

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 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 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.

Independent auditors' report to the members of Priory Hospitals Limited

We have audited the financial statements, which comprise the profit and loss account, the balance sheet and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

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 into 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 as at 31 December 2002 and of its profit 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
London

8 May 2003

Profit and loss account
for the year ended 31 December 2002

	Note	2002 £000	2001 £000
Turnover		**63,400**	59,914
Cost of sales		**(44,285)**	(41,588)
Gross profit		**19,115**	18,326
Administrative expenses *(including operating exceptional income of £2,197,000: 2001 – exceptional costs of £60,000)*		**(3,812)**	(6,568)
Operating profit		**15,303**	11,758
Profit on disposal of fixed assets		**198**	-
Profit on ordinary activities before interest and taxation		**15,501**	11,758
Income from shares in group undertakings		**109,708**	-
Amounts written off investments		**(94,108)**	-
Other interest receivable and similar income	5	**-**	4
Interest payable and similar charges	6	**(13)**	(3)
Profit on ordinary activities before taxation	2	**31,088**	11,759
Tax on profit on ordinary activities	7	**(3,883)**	(3,819)
Retained profit for the financial year	16	**27,205**	7,940

The results for the both the current year and prior year derive from continuing activities.

The company has no recognised gains or losses other than the profit for the year.

The historical cost profit and the reported profit are the same.

Balance sheet
at 31 December 2002

	Note	£000	2002 £000	£000	2001 £000
Fixed assets					
Tangible assets	8		**54,115**		4,272
Investments	9		**39,976**		443
			94,091		4,715
Current assets					
Stocks	10	**113**		87	
Debtors	11	**44,840**		18,385	
Cash at bank and in hand		**3,686**		19,897	
		48,639		38,369	
Creditors: amounts falling due within one year	12	**(80,154)**		(9,266)	
Net current (liabilities)/assets			**(31,515)**		29,103
Total assets less current liabilities			**62,576**		33,818
Creditors: amounts falling due after one year	13		**(255)**		(114)
Provisions for liabilities and charges	14		**(1,412)**		-
Net assets			**60,909**		33,704
Capital and reserves					
Called up share capital	15		**2,760**		2,760
Share premium account	16		**2,102**		2,102
Profit and loss account	16		**56,047**		28,842
Shareholders' funds - equity	16		**60,909**		33,704

These financial statements were approved by the board of directors on 8 May 2003 and were signed on its behalf by:

PJ Greensmith
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.

The company is exempt by virtue of section 228 of the Companies Act 1985 from the requirement to prepare group accounts. These financial statements present information about the company as an individual undertaking and not about its group.

Under Financial Reporting Standard 1 (revised) the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of Priory Healthcare Investments Limited, the company has taken advantage of the exemption contained in Financial Reporting Standard 8 and has therefore not disclosed transactions or balances with entities which form part of the group.

Fixed assets and depreciation

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

Freehold buildings and long leasehold properties	-	50 years
Short leasehold properties	-	over the period of the lease
Plant, fixtures and fittings	-	3 to 10 years
Motor vehicles	-	4 years

No depreciation is provided on freehold land.

Fixed asset investments are stated at cost less provision for any impairment in value.

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight-line basis over the year of the lease.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred. Deferred tax is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Notes *(continued)*

1 Accounting policies *(continued)*

Group relief

Payment is generally made for group relief at a rate of 30% at the time of first estimating the tax provision. To the extent that amendments are subsequently made to the group relief plan, there is generally no payment or receipt in respect of change.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to third party customers.

Pension costs

The company makes payments to pension schemes on behalf of certain employees on a fixed percentage contribution basis. Contributions are charged against profits of the year in which they become payable.

2 Profit on ordinary activities before taxation

	2002	2001
	£000	£000
Profit on ordinary activities before taxation is stated after charging		
Auditors' remuneration (inclusive of VAT):		
Audit	**30**	27
Depreciation and other amounts written off tangible fixed assets:		
Owned	**1,209**	1,457
Leased	**55**	5
Hire of plant and machinery – operating leases	**124**	208
Hire of other assets - operating leases	**153**	238
Rent of property from group undertakings	**5,838**	6,083
Operating exceptional items:		
- Write-back of provisions against inter-company debt	**(2,197)**	-
- Provision against inter-company debt	**-**	60
Profit on disposal of fixed assets:		
- *profit on disposal of investments in subsidiary undertakings*	**(225)**	-
- loss on disposal of tangible assets	**27**	-

3 Remuneration of directors

The directors received no emoluments for services to the company during the year *(2001: £nil)*.

Notes *(continued)*

4 Staff numbers and costs

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

	Number of employees	
	2002	2001
Nursing and other clinical staff	**969**	880
Administrative staff	**434**	495
	1,403	1,375

The aggregate payroll costs of these persons were as follows:

	2002	2001
	£000	£000
Wages and salaries	**21,493**	22,375
Social security costs	**1,832**	401
Other pension costs	**405**	408
	23,730	23,184

5 Other interest receivable and similar income

	2002	2001
	£000	£000
On bank deposits	**-**	4

Notes *(continued)*

6 Interest payable and similar charges

	2002 £000	2001 £000
On bank loans and overdrafts	-	3
Finance lease charges	13	-
	13	3

7 Taxation

	2002 £000	2001 £000
UK corporation tax		
Current tax on income for the year at 30%	3,872	3,819
Deferred tax	11	-
	3,883	3,819

The tax charge of £3,872,000 *(2001: £3,819,000)* on profits for the year has been relieved by the surrender of losses by other group companies in exchange for payment of the same amount.

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30%. The actual tax charge for the year is below the standard rate for the reasons set out in the following reconciliation:

	2002 £000	2001 £000
Profit on ordinary activities before tax	31,088	11,759
Tax on profit on ordinary activities at standard rate	9,326	3,528
Factors affecting charge for the year		
Capital allowances for year in excess of depreciation	(66)	3
Other timing differences	(18)	-
Depreciation of non-qualifying assets	16	-
Income from shares in group undertakings	(32,912)	-
Profit/loss on non-qualifying assets	28,187	-
Expenses not deductible for tax purposes	(661)	288
Total actual amount of current tax	3,872	3,819

Notes *(continued)*

8 Tangible assets

	Land and buildings £000	Assets in course of construction £000	Fixtures, fittings and equipment £000	Motor vehicles £000	Total £000
Cost					
At beginning of the year	-	67	14,264	337	14,668
Additions	1,864	44	1,977	151	4,036
Disposals	-	(75)	(1,977)	(18)	(2,070)
Inter-company additions	47,053	153	2,473	123	49,802
Transfers	(168)	(19)	221	(34)	-
At end of the year	48,749	170	16,958	559	66,436
Depreciation					
At beginning of the year	-	-	10,209	187	10,396
Charge for the year	60	-	1,146	58	1,264
On disposals			(1,874)	(18)	(1,892)
On inter-company additions	1,091	-	1,410	52	2,553
Other transfers	-	-	26	(26)	-
At end of the year	1,151	-	10,917	253	12,321
Net book value					
At 31 December 2002	**47,598**	**170**	**6,041**	**306**	**54,115**
At 31 December 2001	-	67	4,055	150	4,272

Included in the total net book value of motor vehicles is £300,000 *(2001: £141,000)* in respect of assets held under finance leases. Depreciation for the year on these assets was £55,000 *(2001: £5,000).*

Notes *(continued)*

9 Fixed asset investments

	Shares in group undertakings £000
Cost	
At beginning of the year	3,162
Additions	134,084
Disposals	(5,359)
At end of the year	131,887
Provisions	
At beginning of the year	2,719
Provided in the year	94,108
On disposals	(4,916)
At end of the year	91,911
Net book value	
At 31 December 2002	**39,976**
At 31 December 2001	443

The principal companies in which the company's interest at the year end is more than 20% are:

	Country of incorporation	Principal activity	Class and Percentage of shares held
Subsidiary undertakings			
Farm Place Limited	England	Non-trading	100% ordinary
Priory Healthcare Services Limited	England	Non-trading	100% ordinary
Libra Health Limited	England	Non-trading	100% ordinary

All subsidiary undertakings are registered in England and Wales.

10 Stocks

	2002 £000	2001 £000
Consumable supplies	**113**	87

Notes *(continued)*

11 Debtors

	2002 £000	Dec 2001 £000
Trade debtors	**8,949**	7,925
Amounts owed by group undertakings	**35,327**	8,044
Group relief recoverable	**-**	1,832
Corporation tax recoverable	**19**	-
Other debtors	**296**	220
Prepayments and accrued income	**249**	364
	44,840	18,385

12 Creditors: amounts falling due within one year

	2002 £000	2001 £000
Obligation under finance lease contracts (see note 13)	**73**	28
Trade creditors	**2,132**	1,466
Amounts owed to group undertakings	**70,040**	1,240
Corporation tax payable	**-**	3,794
Group relief payable	**3,872**	-
Other creditors	**1,049**	795
Other taxes and social security	**778**	200
Accruals and deferred income	**2,210**	1,743
	80,154	9,266

13 Creditors: amounts falling due after one year

	2002 £000	2001 £000
Obligation under finance lease contracts	**255**	114

Obligations under finance leases are payable as follows:

	2002 £000	2001 £000
Within one year or less	**73**	28
Within one to two years	**73**	114
Within two to five years	**182**	-
	328	142

Notes *(continued)*

14 Provisions for liabilities and charges

	£000
Deferred tax	
At beginning of the year	-
Transfers	1,401
Charge for the year	11
At end of the year	**1,412**

Deferred tax has been provided in full as follows:	**2002** **£000**	2001 £000
Difference between accumulated depreciation and capital allowances	**1,412**	-

No provision has been made for deferred tax on the excess of valuation over cost of the Company's properties as it is not the intention to dispose of any of the properties on which a revaluation surplus has arisen.

15 Called up share capital

	2002 **£**	2001 £
Authorised		
5,000,000 *(2001: 5,000,000)* Ordinary shares of £1 each	**5,000,000**	5,000,000
Allotted, called up and fully paid		
2,759,689 *(2001: 2,759,689)* Ordinary shares of £1 each	**2,759,689**	2,759,689

16 Reconciliation of movement in shareholders' funds

	Share Capital	**Share Premium**	**Profit and loss account** £000	**2002 Total £000**	2001 Total £000
At beginning of the year	2,760	2,102	28,842	**33,704**	25,764
Profit for the financial year	-	-	27,205	**27,205**	7,940
At end of the year	2,760	2,102	56,047	**60,909**	33,704

Notes *(continued)*

17 Contingent liabilities

(a) The company has entered into banking facilities set-off agreements in respect of which guarantees have been given. The aggregate amount outstanding under the agreements was £nil at 31 December 2002 *(2001: £396,000)*.

(b) An intermediate parent undertaking has obtained a secured bank loan amounting to £190,000,000 as at 31 December 2002 *(2001: £101,750,000)*. This loan is secured on the freehold and leasehold properties of the company and those of certain of its fellow subsidiaries. In addition, the company's share capital has been pledged as security for this loan.

18 Commitments

a) Capital commitments at the end of the financial year, for which no provision has been made, are as follows:

	2002 £000	2001 £000
Contracted	-	90

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

	2002		2001	
	Land and buildings £000	**Other £000**	Land and Buildings £000	Other £000
Operating leases which expire:				
Within one year	**7**	**34**	-	132
In the second to fifth years inclusive	**24**	**48**	45	21
Over five years	**123**	**1**	127	13
	154	**83**	172	166

Notes *(continued)*

19 Pension schemes

The company operates a defined contribution pension scheme. The pension cost charge for the year represents contributions payable by the company to the fund and amounted to £405,000 *(2001: £408,000)*.

20 Ultimate parent company

The company is a subsidiary undertaking of Priory Securitisation Limited which is incorporated in England.

The largest group in which the results of the company are consolidated is that headed by Priory Healthcare Investments Limited. No other group accounts include the results of the company.