



ARTHUR ANDERSEN & CO, SC

**SALOMON BROTHERS EUROPE LIMITED
AND SUBSIDIARY UNDERTAKINGS**

(Registered Number: 1548967)

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 1995



DIRECTORS' REPORT

for the year ended 31 December 1995

The directors present their annual report on the affairs of the Company and its subsidiaries (the Group) together with the financial statements and auditors' report for the year ended 31 December 1995.

Principal Activities and Business Review

The Company is a holding company. During the year, the Group conducted business in three separate areas: securities, mortgages and asset management. During 1996 the Group has disposed of its mortgage business. No other significant future changes in the Group's business activities are anticipated.

The Group's securities activities are principally conducted through Salomon Brothers International Limited (SBIL), Salomon Brothers UK Limited (SBUK) and Salomon Brothers UK Equity Limited (SBUKE). These companies act as dealers and market makers in fixed income securities, equity securities and related products in the domestic and international capital markets. SBIL acts as an underwriter, provider of corporate finance services and also markets securities owned by its affiliates on a commission basis to customers.

The Group's mortgage activities were primarily conducted through various companies owned by The Mortgage Corporation Group Limited (TMC). The principal activities of these companies were to provide mortgage loans secured on residential properties within England, Wales and Scotland and issue mortgage backed floating rate notes.

The Group's asset management activities are conducted through Salomon Brothers Asset Management Limited (SBAM). SBAM provides specialised investment and portfolio management services to institutional investors, for which it receives management and performance fees.

The Group's investment business activities are regulated either under the Financial Services Act 1986 by the appropriate Self Regulatory Organisation or by the Bank of England. In addition, companies within the Group are members of both the International Stock Exchange of the United Kingdom and the Republic of Ireland Limited, the London International Financial Futures Exchange and other overseas exchanges. SBAM is authorised to conduct investment business by the Investment Management Regulatory Organisation Limited in accordance with the Financial Services Act 1986 and other overseas regulatory agencies.

Results and Dividends

For the year ended 31 December 1995, the profit on ordinary activities after tax and minority interests for the Group was £128.8 million (1994: Loss £372.5 million).

A dividend of £48.8 million (1994: £38.7 million) was paid on the preference shares of the Company.

Interim dividends of £78.4 million were paid on the ordinary shares of the Company during the year (1994: £313.7 million). The directors do not propose to pay a final dividend on the ordinary shares of the Company (1994: £nil).

DIRECTORS' REPORT

for the year ended 31 December 1995

Directors and their Interests

The directors of the Company are listed below and, unless stated otherwise, served throughout the year ended 31 December 1995.

C.S. McVeigh III

S.M. Rosen

P.J. Middleton

Chief Executive

(Appointed 20 December 1995)

None of the directors or their immediate families had at any time during the year any interest in the shares or contracts of the Company or Group which is required to be disclosed under the terms of the Companies Act 1985.

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 Group and of the profit or loss of the Group 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and of the Group 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 of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Tangible Fixed Assets

Information relating to changes in tangible fixed assets is given in Note 9 to the financial statements.

Charitable and Political Contributions

Charitable contributions made by the Group amounted to £73,989 (1994: £176,527). No political contributions were made during the year.

Employment of Disabled People

Applications for employment by disabled persons are fully and fairly considered having regard to the aptitudes and abilities of each applicant. Efforts are made to enable any employees who become disabled during employment to continue their careers within the Group. Training, career development and promotion of disabled persons is, as far as possible, identical to that of other employees who are not disabled.

DIRECTORS' REPORT

for the year ended 31 December 1995

Employee Consultation

The Group places considerable value on the involvement of its employees and has continued its previous practice of keeping them informed by formal and informal meetings on matters affecting them as employees and on the various factors affecting the Group.

Subsequent Events

On 1 January 1996, the regulated entities in the Group commenced reporting to their respective regulators under the Capital Adequacy Directive (CAD) regulations.

Under the new CAD regulations the Group's financial resources requirement is substantially lower than under the previous regulations. During the period 1 January 1996 to 23 October 1996 the Group made net repayments of \$300 million and £40 million on its subordinated loans due to other group undertakings, under the facilities existing at 31 December 1995. The directors will continue to monitor the Group's regulatory capital requirements. Regulatory approval would be sought for any further reductions in the Group's regulatory capital.

On 15 February 1996, SBUK paid a dividend of £6.0 million on its preference shares, representing payment in full of the outstanding cumulative dividends due on SBUK's preference shares owned by a minority interest in the Group at that date.

Also on 15 February 1996, the Company declared a dividend of £48.9 million on its new redeemable preference shares and a dividend of \$28 million on its 'A' and 'B' ordinary shares.

On 21 February 1996, the Company entered into an agreement with its subsidiary SBUK, for SBUK to purchase from SBEL 79,000,000 of its own ordinary shares of £1 each. These shares were purchased by SBUK out of its capital (within the meaning of section 171 (2) of the Companies Act 1985) for cash at par, pursuant to Section 173(2) of the said Act on 28 March 1996, having obtained Bank of England approval.

On 15 March 1996, SBIL renewed a 364 day \$1 billion committed revolving credit facility with a syndicate of banks on a secured basis. This renewed facility is substantially similar to the facility entered into on 20 March 1995 and can be used for general corporate purposes.

On 19 March 1996, the Company confirmed its intention, during the year immediately following 31 December 1995, to ensure that financial resources are made available such that SBAM will be able to pay its debts as they fall due.

On 28 June 1996, the Company declared a dividend of £22.6 million on its 'A' and 'B' ordinary shares.

On 1 June 1996, the Company entered into an agreement to sell the principal subsidiaries involved in the mortgage origination and servicing business. The sale was completed on 6 August 1996 for a consideration of £52.9 million (subject to completion financial statements). Under the agreement the Company has entered into certain warranties and representations. Subject to the completion financial statements, warranties and representations, the Company made a gain of £16.3 million and the Group made a gain of £31.5 million on disposal, after expenses.

On 16 October 1996, SBIL was granted a five year \$800 million facility by another group company to provide SBIL with long term subordinated debt in accordance with SFA rules. Also on 16 October 1996, SBIL drew down \$200 million under this facility.

DIRECTORS' REPORT

for the year ended 31 December 1995

On 22nd October 1996, SBIL's 364 day \$1 billion committed revolving credit facility was replaced with a 364 day \$1 billion committed securities repurchase facility with a syndicate of banks.

Liability Insurance for Company Officers

As permitted by the Companies Act 1985, the Group maintains insurance cover for directors and officers against liabilities in relation to the Group.

Victoria Plaza
111 Buckingham Palace Road
LONDON SW1W 0SB

BY ORDER OF THE BOARD

A handwritten signature in black ink, appearing to read 'I.A. Pellow', written in a cursive style.

I.A. Pellow
Company Secretary

24 October 1996

London

Auditors' Report to the Shareholders of SALOMON BROTHERS EUROPE LIMITED:

We have audited the financial statements on pages 6 to 34 which have been prepared under the historical cost convention (as modified by the revaluation of current asset investments) and the accounting policies set out on pages 11 to 14.

Respective responsibilities of directors and auditors

As described on page 2 the Company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

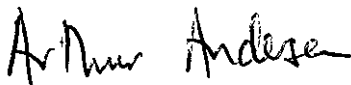
Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the 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 and of the Group as at 31 December 1995 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Arthur Andersen
Chartered Accountants and Registered Auditors
1 Surrey Street
London WC2R 2PS

24 October 1996

CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 December 1995

| | Notes | 1995 £ Millions | 1994 £ Millions |
|---|-------|--------------------|--------------------|
| Net revenue | 1(c) | (14.6) | (769.5) |
| Commission income and fees | 1(c) | 110.6 | 119.4 |
| Interest income | 4 | 2,119.6 | 2,256.6 |
| Interest expense | 4 | (1,692.3) | (1,826.0) |
| Exceptional item: Charge for resolution of unreconciled balances | 3 | - | (130.7) |
| | | <hr/> | <hr/> |
| GROSS PROFIT/(LOSS) | | 523.3 | (350.2) |
| Operating expenses | 5 | (312.6) | (268.8) |
| | | <hr/> | <hr/> |
| PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION | | 210.7 | (619.0) |
| Tax on profit/(loss) on ordinary activities | 8 | (79.9) | 248.0 |
| | | <hr/> | <hr/> |
| PROFIT/(LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION | | 130.8 | (371.0) |
| Minority interests | 18 | (2.0) | (1.5) |
| | | <hr/> | <hr/> |
| PROFIT/(LOSS) ATTRIBUTABLE TO MEMBERS OF THE PARENT COMPANY | | 128.8 | (372.5) |
| Dividends paid on preference shares | | (48.8) | (38.7) |
| Dividends paid on ordinary shares | | (78.4) | (313.7) |
| | | <hr/> | <hr/> |
| RETAINED PROFIT/(LOSS) FOR THE YEAR | 17 | 1.6 | (724.9) |
| | | <hr/> | <hr/> |
| RETAINED AS FOLLOWS | | | |
| Parent company | | 28.8 | (74.5) |
| Subsidiary undertakings | | (27.2) | (650.4) |
| | | <hr/> | <hr/> |
| | | 1.6 | (724.9) |
| | | <hr/> | <hr/> |

All items are derived from continuing operations. The accompanying notes are an integral part of this consolidated profit and loss account. A statement of movements on reserves is given in Note 17.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 1995

| | 1995 £ Millions | 1994 £ Millions |
|---|--------------------|--------------------|
| Profit/(loss) attributable to members of the parent company | 128.8 | (372.5) |
| Exchange difference on retranslation of net assets of subsidiary undertaking | 0.3 | (2.5) |
| | <hr/> | <hr/> |
| Total recognised gains/(losses) relating to the year | 129.1 | (375.0) |
| | <hr/> | <hr/> |

RECONCILIATION OF SHAREHOLDERS' FUNDS

| | 1995 £ Millions | 1994 £ Millions |
|---|--------------------|--------------------|
| Total recognised gains/(losses) | 129.1 | (375.0) |
| Dividends | (127.2) | (352.4) |
| Other movements: | | |
| New redeemable preference shares issued | 10.4 | 126.8 |
| Goodwill written off on purchase of minority interest | (2.4) | - |
| | <hr/> | <hr/> |
| Total movements during the year | 9.9 | (600.6) |
| Shareholders' funds at 1 January | 862.6 | 1,463.2 |
| | <hr/> | <hr/> |
| Shareholders' funds at 31 December | 872.5 | 862.6 |
| | <hr/> | <hr/> |

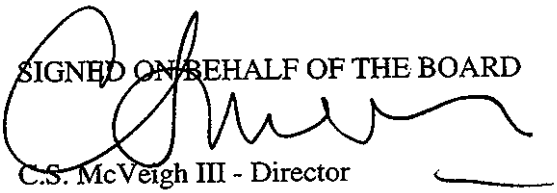
The accompanying notes are an integral part of this consolidated statement of total recognised gains and losses.

CONSOLIDATED BALANCE SHEET

as at 31 December 1995

| | Notes | 1995 £ Millions | 1995 £ Millions | 1994 £ Millions | 1994 £ Millions |
|--|-------|--------------------|--------------------|--------------------|--------------------|
| FIXED ASSETS | | | | | |
| Tangible fixed assets | 9 | | 24.0 | | 27.6 |
| Investments | 10 | | 14.3 | | 13.7 |
| | | | <u>38.3</u> | | <u>41.3</u> |
| MORTGAGE ADVANCES | 11 | | 1,270.6 | | 1,574.4 |
| CURRENT ASSETS | | | | | |
| Debtors | 12 | 25,938.5 | | 19,083.3 | |
| Investments | 13 | 23,831.7 | | 24,043.8 | |
| Cash at bank and in hand | | 305.1 | | 168.7 | |
| | | <u>50,075.3</u> | | <u>43,295.8</u> | |
| CREDITORS: Amounts falling due within one year | 14 | 47,386.2 | | 42,094.1 | |
| NET CURRENT ASSETS | | | 2,689.1 | | 1,201.7 |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | | <u>3,998.0</u> | | <u>2,817.4</u> |
| CREDITORS: Amounts falling due after more than one year | 14 | | 3,109.3 | | 1,900.8 |
| PROVISION FOR LIABILITIES AND CHARGES | 15 | | 8.2 | | 40.0 |
| NET ASSETS | | | <u>880.5</u> | | <u>876.6</u> |
| CAPITAL AND RESERVES | | | | | |
| Called-up share capital | 16 | | 719.4 | | 709.0 |
| Capital reserve | 17 | | 5.6 | | 5.6 |
| Profit and loss account | 17 | | 147.5 | | 148.0 |
| SHAREHOLDERS' FUNDS | | | <u>872.5</u> | | <u>862.6</u> |
| Equity interests | | 174.2 | | 174.7 | |
| Non-equity interests | | 698.3 | | 687.9 | |
| | | <u>872.5</u> | | <u>862.6</u> | |
| MINORITY INTERESTS | | | | | |
| Equity interests | 18 | | 8.0 | | 14.0 |
| TOTAL CAPITAL EMPLOYED | | | <u>880.5</u> | | <u>876.6</u> |

SIGNED ON BEHALF OF THE BOARD


 C.S. McVeigh III - Director
 24 October 1996

The accompanying notes form an integral part of this consolidated balance sheet.

PARENT COMPANY BALANCE SHEET

as at 31 December 1995

| | Notes | 1995 £ Millions | 1995 £ Millions | 1994 £ Millions | 1994 £ Millions |
|--|-------|--------------------|--------------------|--------------------|--------------------|
| FIXED ASSETS | | | | | |
| Tangible fixed assets | 9 | | 8.1 | | 8.9 |
| Investments | 10 | | 841.8 | | 800.6 |
| | | | <u>849.9</u> | | <u>809.5</u> |
| CURRENT ASSETS | | | | | |
| Debtors | 12 | 405.5 | | 423.8 | |
| Cash at bank and in hand | | 0.3 | | 0.4 | |
| | | <u>405.8</u> | | <u>424.2</u> | |
| CREDITORS: Amounts falling due within one year | 14 | 155.1 | | 175.9 | |
| | | <u>155.1</u> | | <u>175.9</u> | |
| NET CURRENT ASSETS | | | 250.7 | | 248.3 |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | | 1,100.6 | | 1,057.8 |
| CREDITORS: Amounts falling due after more than one year | 14 | | 300.5 | | 298.1 |
| PROVISION FOR LIABILITIES AND CHARGES | 15 | | 1.7 | | 0.5 |
| | | | <u>1.7</u> | | <u>0.5</u> |
| NET ASSETS | | | 798.4 | | 759.2 |
| CAPITAL AND RESERVES | | | | | |
| Called-up share capital | 16 | | 719.4 | | 709.0 |
| Capital reserve | 17 | | 5.6 | | 5.6 |
| Profit and loss account | 17 | | 73.4 | | 44.6 |
| | | | <u>798.4</u> | | <u>759.2</u> |
| SHAREHOLDERS' FUNDS | | | | | |
| | | | <u>798.4</u> | | <u>759.2</u> |
| Equity interests | | | 100.1 | | 71.3 |
| Non-equity interests | | | 698.3 | | 687.9 |
| | | | <u>798.4</u> | | <u>759.2</u> |
| TOTAL CAPITAL EMPLOYED | | | <u>798.4</u> | | <u>759.2</u> |

SIGNED ON BEHALF OF THE BOARD

C.S. McVeigh III - Director
24 October 1996

The accompanying notes form an integral part of this balance sheet.

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 1995

| | Notes | 1995 £ Millions | 1995 £ Millions | 1994 £ Millions | 1994 £ Millions |
|---|-------|--------------------|--------------------|--------------------|--------------------|
| NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES | 19 | | 738.6 | | (114.5) |
| Servicing of finance | | | | | |
| Dividends paid | | (127.2) | | (352.4) | |
| Net cash outflow from servicing of finance | | | (127.2) | | (352.4) |
| Taxation | | | | | |
| Corporation tax paid | | (87.0) | | (0.3) | |
| ACT paid | | (8.6) | | (36.8) | |
| Tax paid | | | (95.6) | | (37.1) |
| Investing activities | | | | | |
| Mortgages advanced | | (0.2) | | - | |
| Mortgages acquired | | (14.0) | | - | |
| Mortgages redeemed | | 317.9 | | 394.3 | |
| Purchase of tangible fixed assets | | (6.4) | | (18.3) | |
| Sale of tangible fixed assets | | 1.3 | | 1.2 | |
| Purchase of minority interest | | (10.4) | | - | |
| Purchase of unlisted investment | | (0.6) | | - | |
| Net cash inflow from investing activities | | | 287.6 | | 377.2 |
| Net cash inflow/(outflow) before financing | | | 803.4 | | (126.8) |
| Financing | | | | | |
| Issue of new preference shares | 21 | 10.4 | | 126.8 | |
| (Decrease)/increase in group loans and subordinated debt | 21 | (125.3) | | 498.4 | |
| Repayment of floating rate notes | 21 | (334.4) | | (364.9) | |
| Decrease in short term loans | 21 | (88.5) | | (28.1) | |
| Net cash (outflow)/inflow from financing | | | (537.8) | | 232.2 |
| INCREASE IN CASH AND CASH EQUIVALENTS | 20 | | 265.6 | | 105.4 |

The accompanying notes form an integral part of this consolidated cash flow statement.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 1995

1. Principal Accounting Policies

The principal accounting policies, which have been applied consistently throughout the current year and the preceding year, are set out below:

(a) Basis of accounting

The financial statements have been prepared under the historical cost convention, except for marketable investments, contractual commitments and foreign exchange transactions and positions which are stated at market or fair value at the balance sheet date. The financial statements have been prepared in accordance with applicable accounting standards.

The Group has changed its accounting presentation for interest income and interest expense in respect of certain short term financing agreements which in 1995 are disclosed on a gross basis, rather than on a net basis. The directors consider that this provides a fairer presentation. The prior year comparative figures in the profit and loss account and Note 4 have been restated to reflect the new presentation. There has been no effect on net interest as a result of this change.

(b) Basis of consolidation

The consolidated financial statements include the audited financial statements of the parent company and all its subsidiary undertakings drawn up to 31 December each year. Associated undertakings are dealt with by the equity method of accounting. Goodwill arising on consolidation is written off against reserves on acquisition.

No profit and loss account is presented for the Company, as provided by Section 230 of the Companies Act 1985. Under the provisions of Financial Reporting Standard Number 1, the Company has not prepared a cash flow statement. The consolidated cash flow statement includes the Company's cash flows.

(c) Net revenue and commission income

Net revenue includes trading profit earned from dealing, market making and arbitrage activities in marketable investments, contractual commitments and foreign exchange contracts, the substantial majority of which have liquid markets.

In the opinion of the directors, to present a true and fair view, movements in the market or fair value of investments, contractual commitments and foreign exchange contracts are included within the profit and loss account rather than a revaluation reserve. This represents a departure from statutory accounting principles. The net movement included in the profit and loss account is a loss of £561.2 million (1994: Loss £418.1 million).

Commission income is derived from underwriting activities, marketing securities for foreign affiliates, corporate finance fees associated with mergers and acquisitions and other corporate finance advisory activities.

Gains and losses, including commission revenues and expenses, are credited on the trade date of the related transaction.

NOTES TO THE FINANCIAL STATEMENTS - Continued

(d) Trading inventory

Trading inventory is recorded in the balance sheet on a trade date basis. Long positions are described as current asset investments as outlined in Note 13. Short positions are included within creditors due within one year and comprise both securities sold, but not yet purchased, and options and other contractual commitments. Contractual commitments include obligations with counterparties which may extend for more than one year.

Trading inventory is recorded at either market or, when prices are not readily available, fair value which includes related accrued interest or dividends. The determination of market or fair value considers various factors, including: closing exchange or over-the-counter market price quotations; time and volatility factors underlying options, warrants and contractual commitments; price activity for equivalent or synthetic instruments in markets located in different time zones, counterparty credit quality, and the potential impact on market prices of liquidating the Group's positions in an orderly manner over a reasonable period of time under prevailing market conditions. Further, in determining the fair value of its long term contractual commitments, the Group considers future maintenance costs.

(e) Tangible fixed assets

Tangible fixed assets are stated at cost, less accumulated depreciation. Depreciation is provided at rates calculated to write-off the cost of each asset on a straight-line basis over its expected useful economic life, as follows:

| | |
|------------------------|-----------------|
| Leasehold improvements | - 5 to 15 years |
| Equipment and cars | - 3 to 5 years |

(f) Fixed asset investments

Fixed asset investments are stated at cost or directors' valuation.

Fixed asset investments include the market value of properties which have been sold to unrelated companies organised under a business expansion scheme ("BES"). As more fully described in Note 14, the Group has granted an option which may require the Group to repurchase these properties at a future date. Therefore, the Group has not accounted for these transactions as sales and has included the corresponding liability in creditors.

The liability is adjusted at each year end based on management's estimate of the future liability that may arise and is charged to the profit and loss account.

Investments in subsidiary undertakings and associates are stated in the Company's balance sheet at cost less any write down for reductions in value.

NOTES TO THE FINANCIAL STATEMENTS - Continued

(g) Taxation

Corporation tax is recognised on taxable profits/(losses) at the current rate. Deferred taxation, calculated on the liability method at the rate at which the liability is likely to be paid, is provided to take account of timing differences arising from the different treatment of certain items for taxation purposes and for financial statement purposes. No deferred taxation is provided on those differences where, in the opinion of the directors, it is probable that they will not reverse. The tax benefits arising from group relief are recognised in the financial statements of the surrendering and recipient companies.

Advance corporation tax payable on dividends paid or provided for in the year is written off except when recoverability against corporation tax payable is considered to be reasonably assured. Credit is taken for advance corporation tax written off in previous years when it is recovered against corporation tax liabilities.

(h) Pension costs

Group companies account for pension costs in accordance with Statement of Standard Accounting Practice Number 24. For defined contribution schemes, the charge against profit is the amount of contributions payable in respect of the year. For defined benefit obligations, the pension cost is calculated using actuarial valuation methods which give rise to a regular pension cost that is a substantially level percentage of the current and expected future pensionable payroll. Variations from the regular cost are allocated over the average remaining service lives of current employees in the scheme.

(i) Foreign currency

Monetary assets and liabilities denominated in currencies other than sterling have been translated into sterling at the rates of exchange prevailing at the year-end. Non-monetary assets and liabilities denominated in currencies other than sterling have been translated at the relevant historical exchange rate.

Transactions in foreign currencies in the individual companies are translated into sterling at rates of exchange approximating to those at the transaction date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included under operating expenses in the profit and loss account.

For the purposes of consolidation the closing rate method is used, under which translation gains or losses are shown as a movement in reserves.

(j) Leases

The Group enters into operating leases which are charged to the profit and loss account on a straight line basis over the term of the lease (see Note 22 (e)). Where the Group has vacated or intends to vacate space a provision is established for the estimated net future liability of the space vacated.

NOTES TO THE FINANCIAL STATEMENTS - Continued

(k) Mortgage advances

Mortgage advances comprise loans which are secured by way of a mortgage over freehold and leasehold residential properties located in England, Wales and Scotland.

Mortgage advances include properties in possession and are stated after deducting a provision for loan losses. The provision is maintained at a level that is considered adequate by management to absorb losses inherent in the loan portfolio of the Group. A judgement as to the adequacy of the provision is made at year end and includes anticipated recoveries under mortgage indemnity guarantee and other insurance policies. Should the provision be judged inadequate either because of reductions due to write-offs or because of changes to the size and characteristics of the portfolio, the provision is increased and charged to other operating expenses in the current year.

2. Turnover and Results

In the opinion of the directors, financial disclosure of turnover is most appropriately represented for the Group by net revenue, commission income and fees. As outlined in Note 1(b), net revenue, commission income and fees comprises the amounts derived from the Group's ordinary activities. This is a more relevant measure of turnover for the Group than that disclosed in prior financial statements.

In the opinion of the directors, the particulars of turnover as required by Schedule 4, Paragraph 55 of the Companies Act 1985, are not valid measures of activity in view of the nature of the business.

An analysis of profit before taxation and net assets by geographical region has not been provided because the directors are of the opinion that such information would be misleading given the nature of the Group's business.

3. Exceptional Item: Charge for Resolution of Unreconciled Balances

The Group has been engaged in a continuing effort to strengthen the internal control structure. In connection with such efforts, a detailed review of all general ledger accounts was commissioned. The results of the review identified certain unreconciled balances. These balances were resolved and resulted in an exceptional pre-tax charge of £130.7 million in 1994. There was no equivalent charge in 1995.

4. Interest Income and Expense

| | 1995 £ Millions | 1994 £ Millions |
|---|--------------------|--------------------|
| Interest income comprises: | | |
| Interest income on current asset investments, interest bearing debtors and cash assets | 1,892.5 | 2,051.8 |
| Interest income from mortgage advances | 130.2 | 163.6 |
| Interest income on loans to other group undertakings | 96.9 | 41.2 |
| | <u>2,119.6</u> | <u>2,256.6</u> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

4. Interest Income and Expense - continued

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Interest expense comprises: | | |
| Interest on floating rate notes | 91.2 | 85.8 |
| Interest on third party borrowings | 1,352.4 | 1,491.7 |
| Interest on borrowings from other group undertakings | 248.7 | 248.5 |
| | <hr/> | <hr/> |
| | 1,692.3 | 1,826.0 |
| | <hr/> | <hr/> |

As explained in Note 1(a), the comparative for interest income on current asset investments, interest bearing debtors and cash assets and interest on third party borrowings has been restated to conform with the Group's change in accounting presentation.

5. Operating Expenses

Operating expenses comprise:

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Employee remuneration | 168.9 | 68.2 |
| Social security costs | 11.0 | 8.8 |
| Pension costs (Note 6) | 18.2 | 7.2 |
| | <hr/> | <hr/> |
| | 198.1 | 84.2 |
| Directors' emoluments (Note 7) | 0.5 | 0.7 |
| Depreciation on tangible fixed assets (Note 9) | 8.6 | 8.2 |
| Hire of computers and other equipment | 1.5 | 1.7 |
| Amortisation of issue costs | 1.4 | 1.7 |
| Exchange adjustment on translation | (58.6) | 43.4 |
| Auditors' remuneration | | |
| - Audit fees | 0.8 | 0.7 |
| - Other non-audit related fees | 1.5 | 2.5 |
| Loss on sale of fixed assets | 0.1 | 1.2 |
| Other operating expenses | 158.7 | 124.5 |
| | <hr/> | <hr/> |
| | 312.6 | 268.8 |
| | <hr/> | <hr/> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

5. Operating Expenses - continued

The Company has no employees. Services are provided by employees of subsidiary undertakings.

The Group employed an average of 1,264 (1994: 1,142) employees during the year. In addition, foreign affiliate staff are seconded on a temporary basis to the Group. All costs relating to such personnel are borne by the Group.

6. Pension Arrangements

The substantial majority of employees in the Group's securities activities are employed by Salomon Brothers International Limited (SBIL). The SBIL Pension and Life Assurance Scheme ("the Scheme") is a funded pension scheme providing benefits primarily based on final pensionable salary. There is also a defined contribution section in the Scheme which applies to earnings which are not pensionable under the defined benefit provisions. The assets of the Scheme are held separately from those of the Group, in a trustee administered fund. Employees are not required to contribute to the Scheme, which is contracted-out of the State Earnings Related Pension Scheme.

The pension cost in respect of defined benefit obligations is assessed in accordance with the advice of a qualified actuary using the projected unit method. The most recent actuarial valuation of the pension cost for the Scheme was as at 1 January 1994. The assumptions which have the most significant effect on the results of the valuation are those relating to the return on investments and the rates of increase in salaries and pensions.

It was assumed that the investment return would be 8.5% per annum, that salary increases would be 7% per annum, that statutorily required increases would apply to present and future guaranteed minimum pensions in payment and that increases of 5% per annum would apply to the remainder of pensions in payment.

At the date of the last actuarial valuation the market value of the assets, excluding those held in respect of defined contribution benefits, was £30.3 million and the actuarial value of those assets represented 95.4% of the value of benefits that had accrued to members, including allowance for future salary increases. The deficiency is being removed through an increase in the employer's pension cost. The current deficit is being allocated over the average remaining service lives of current employees in the Scheme, which is 9 years.

Costs of the Scheme in respect of defined benefit obligations are charged to the profit and loss account so as to spread the cost of pensions over the remaining service lives of current employees in the Scheme. The pension charge for the year comprises £7.2 million (1994: £5.5 million) in respect of the defined benefit obligations. The pension cost in respect of defined contribution benefits represents contributions paid and payable in respect of the year, namely £10.7 million (1994: £1.4 million).

The Group's mortgage activities have their own pension scheme. The Mortgage Corporation Pension Plan ("the Plan") is a funded pension scheme providing defined contribution benefits and insured death benefits. The assets of the Plan are held separately from those of the Group and are administered by a trustee. Total costs for the year relating to the Plan were £0.3 million (1994: £0.3 million).

NOTES TO THE FINANCIAL STATEMENTS - Continued

7. Directors' Emoluments

Directors' remuneration in respect of directors of the Company was as follows:

| | 1995 | 1994 |
|-----------------------|------|------|
| Directors' emoluments | 0.5 | 0.7 |

Directors' emoluments shown above (excluding pensions and pension contributions) include the following:

| | 1995 £ Millions | 1994 £ Millions |
|-----------------------|--------------------|--------------------|
| Highest paid director | 0.4 | 0.6 |

The Company does not have an elected Chairman of the Board of Directors.

Directors received emoluments (excluding pensions and pension contributions) in the following ranges:

| | 1995 | 1994 |
|---------------------|------|------|
| £Nil - £5,000 | 1 | 1 |
| £10,000 - £15,000 | 1 | - |
| £405,001 - £410,000 | 1 | - |
| £600,001 - £605,000 | - | 1 |

8. Tax on Profit/(Loss) on Ordinary Activities

The charge/(credit) for taxation comprises:

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| UK Corporation Tax at 33% (1994: 33%) | 104.1 | 192.8 |
| Adjustment in respect of Corporation Tax for earlier years | 15.4 | (5.7) |
| Deferred tax at 33% (1994: 33%) | (32.4) | (445.8) |
| Adjustment in respect of deferred tax for earlier years | (13.4) | 4.1 |
| Advance Corporation Tax on franked investment income | 6.2 | 6.6 |
| | 79.9 | (248.0) |

The Group receives the benefit of Advance Corporation Tax surrendered by other group undertakings. The above charge/(credit) includes the benefit of certain amounts for which the Group will not be required to pay.

NOTES TO THE FINANCIAL STATEMENTS - Continued

9. Tangible Fixed Assets

The movement in tangible fixed assets for the year was as follows:

| | Group | Company |
|---------------------------------------|--|--|
| | Leasehold Improvements, Plant, Equipment & Cars £ Millions | Leasehold Improvements, Plant, Equipment & Cars £ Millions |
| COST - | | |
| Balance at 1 January 1995 | 73.5 | 19.0 |
| Additions | 6.4 | 1.2 |
| Disposals | (3.0) | (1.1) |
| | <hr/> | <hr/> |
| Balance at 31 December 1995 | 76.9 | 19.1 |
| | <hr/> | <hr/> |
| DEPRECIATION - | | |
| Balance at 1 January 1995 | 45.9 | 10.1 |
| Charges for the year | 8.6 | 1.6 |
| Disposals | (1.6) | (0.7) |
| | <hr/> | <hr/> |
| Balance at 31 December 1995 | 52.9 | 11.0 |
| | <hr/> | <hr/> |
| Net Book Value at 1 January 1995 | 27.6 | 8.9 |
| | <hr/> | <hr/> |
| Net Book Value at 31 December 1995 | 24.0 | 8.1 |
| | <hr/> | <hr/> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

10. Fixed Asset Investments

Investments comprise:

| | Group | | Company | |
|-------------------------|-------------|-------------|--------------|--------------|
| | 1995 | 1994 | 1995 | 1994 |
| | £ Millions | £ Millions | £ Millions | £ Millions |
| Subsidiary undertakings | - | - | 841.8 | 800.6 |
| Unlisted investments | 14.3 | 13.7 | - | - |
| | <u>14.3</u> | <u>13.7</u> | <u>841.8</u> | <u>800.6</u> |

Unlisted investments represent the market value of properties which have been sold to unrelated companies organised under a business expansion scheme ("BES"). As more fully described in Note 14, the Group has granted an option which may require the Group to repurchase these properties at a future date. Therefore, the Group has not accounted for these transactions as a sale, rather it has accounted for them as repurchase agreements. The corresponding liability to the above asset is reported in creditors.

The liability is adjusted at each year end based on management's estimate of the future liability that may arise.

The movement in the Group's fixed asset investments comprises:

| | Unlisted Investments £ Millions |
|--------------------------------|---------------------------------------|
| COST AND NET BOOK VALUE | |
| At 1 January 1995 | 13.7 |
| Additions | 0.6 |
| Disposals | - |
| At 31 December 1995 | <u>14.3</u> |

The movement in the Company's fixed asset investments comprises:

| | Subsidiary Undertakings £ Millions |
|--|--|
| COST AND NET BOOK VALUE | |
| At 1 January 1995 | 800.6 |
| Additions | 13.8 |
| Reversal of provision for permanent diminution in value | 34.4 |
| Reduction of investments in subsidiary | (7.0) |
| Disposals | - |
| At 31 December 1995 | <u>841.8</u> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

10. Fixed Asset Investments - Continued

In line with a group restructuring plan, on 13 December 1995, the Company issued 10,400,000 redeemable preference shares to purchase from Salomon Brothers Holding Company Inc the outstanding minority interest in the ordinary shares of the Company's subsidiary TMC Group Limited for £10,400,000. On 15 December 1995 the subsidiaries of TMC Group Limited were transferred from TMC Group Limited to the Company for £80,000,000 and TMC Group Limited was resolved to be liquidated under a member's voluntary liquidation. On 15 December 1995 the net investment in these subsidiaries was revalued upwards by £34,422,910 to £80,000,000 by the directors prior to disposal.

The Company's principal subsidiary undertakings, all of which are registered in England and Wales, are set out below. A schedule of all interests in subsidiary undertakings will be attached to the Company's Annual Return to the Registrar of Companies.

| Company | Class of Shares | Proportion of Shares Held by the Company | Principal Activity |
|---|-----------------|--|----------------------------|
| Salomon Brothers International Limited | Ordinary | 100 % | Financial services company |
| Salomon Brothers UK Limited | Ordinary | 100 % | Gilt edged market maker |
| Salomon Brothers UK Equity Limited | Ordinary | 100 % | Equity market maker |
| Salomon Brothers Asset Management Limited | Ordinary | 100 % | Asset management company |

11. Mortgage Advances

Mortgage advances comprise:

| | 1995 £ Millions | 1994 £ Millions |
|---------------------------|--------------------|--------------------|
| Completed advances | 1,279.9 | 1,583.6 |
| Provision for loan losses | (9.3) | (9.2) |
| | <u>1,270.6</u> | <u>1,574.4</u> |

Mortgage advances are all due to be repaid after more than one year.

The movement in mortgage advances in the year was as follows:

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Balance at 1 January | 1,574.4 | 1,954.5 |
| Advances made | 0.2 | - |
| Advances acquired | 14.0 | - |
| Advances redeemed | (317.9) | (394.3) |
| Net changes in provision for loan losses | (0.1) | 14.2 |
| | <u>1,270.6</u> | <u>1,574.4</u> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

12. Debtors

The following amounts are included in debtors:

| | Group | | Company | |
|---|--------------------|--------------------|--------------------|--------------------|
| | 1995 £ Millions | 1994 £ Millions | 1995 £ Millions | 1994 £ Millions |
| Amounts falling due within one year: | | | | |
| Trade debtors | 23,622.2 | 17,750.5 | - | - |
| Due from ultimate parent company | - | 0.1 | - | - |
| Due from subsidiary undertakings | - | - | 236.2 | 171.8 |
| Due from other group undertakings | 2,139.0 | 1,078.2 | - | - |
| Other debtors | 17.3 | 54.1 | 0.1 | 0.1 |
| Prepayments and accrued income | 8.6 | 8.6 | - | - |
| Taxes recoverable | 136.7 | 179.6 | - | - |
| VAT recoverable | 0.6 | 1.2 | - | 0.1 |
| ACT recoverable | 3.1 | 1.4 | - | - |
| | <u>25,927.5</u> | <u>19,073.7</u> | <u>236.3</u> | <u>172.0</u> |
| Amounts falling due after more than one year: | | | | |
| Due from subsidiary undertakings | - | - | 169.2 | 242.2 |
| Due from other group undertakings | - | 9.6 | - | 9.6 |
| Deferred tax | 11.0 | - | - | - |
| | <u>11.0</u> | <u>9.6</u> | <u>169.2</u> | <u>251.8</u> |
| | <u>25,938.5</u> | <u>19,083.3</u> | <u>405.5</u> | <u>423.8</u> |

The Group trade debtors include collateralised short-term financing agreements with counterparties of £17,865 million (1994: £9,577.9 million). These positions are entered into to cover short trading positions and to facilitate customer financing activity. The substantial majority of the collateral securing these positions is comprised of government bonds.

Included within the Group due from other group undertakings are secured financing arrangements, collateralised by current asset investments, of £651.1 million (1994: £825.2 million).

NOTES TO THE FINANCIAL STATEMENTS - Continued

13. Current Asset Investments

The investments comprise marketable securities and related instruments taken into inventory as part of the Group's principal trading activities.

The Group's accounting policy for such investments is explained in Note 1(d). Included within current asset investments are:

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Government bonds | 19,955.7 | 20,016.8 |
| Eurobonds and other corporate bonds | 1,214.7 | 1,633.1 |
| Equities - listed on a recognised UK exchange | 266.1 | 483.0 |
| - listed elsewhere | 453.3 | 535.2 |
| Certificates of deposit | 163.2 | - |
| Options and other contractual commitments (Note 22(b)) | 1,778.7 | 1,375.7 |
| | <u>23,831.7</u> | <u>24,043.8</u> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

14. Creditors

The following amounts are included in creditors:

| | Group | | Company | |
|---|-----------------|-----------------|--------------|--------------|
| | 1995 | 1994 | 1995 | 1994 |
| | £ Millions | £ Millions | £ Millions | £ Millions |
| Amounts falling due within one year: | | | | |
| Bank loans and overdrafts | 74.9 | 266.8 | - | - |
| Trade creditors | 25,078.6 | 22,315.8 | - | - |
| Due to ultimate parent company | 5.2 | 21.1 | - | - |
| Due to parent company | 3.0 | 3.4 | - | - |
| Due to subsidiary undertakings | - | - | 152.2 | 164.6 |
| Due to other group undertakings | 3,319.8 | 2,652.5 | 1.2 | 1.0 |
| Subordinated loans | - | 1,707.6 | - | - |
| Securities sold not yet purchased (Note 1(d)) | 12,238.5 | 10,621.6 | - | - |
| Options and other contractual commitments (Notes 1(d), 22(b)) | 2,346.0 | 1,634.1 | - | - |
| Other creditors and accruals | 4,194.1 | 2,780.7 | 1.7 | 1.7 |
| Taxation payable | 77.6 | 64.0 | - | - |
| Social security and PAYE | 31.4 | 17.9 | - | - |
| ACT payable | 17.1 | 8.6 | - | 8.6 |
| | <u>47,386.2</u> | <u>42,094.1</u> | <u>155.1</u> | <u>175.9</u> |
| Amounts falling due after more than one year: | | | | |
| Bank loans and overdrafts | 16.0 | 41.9 | - | - |
| Mortgage backed floating rate notes | 1,106.6 | 1,439.6 | - | - |
| Due to other group undertakings | - | 313.1 | 300.5 | 298.1 |
| Subordinated loans | 1,968.3 | 85.0 | - | - |
| Other creditors | 18.4 | 21.2 | - | - |
| | <u>3,109.3</u> | <u>1,900.8</u> | <u>300.5</u> | <u>298.1</u> |
| | <u>50,495.5</u> | <u>43,994.9</u> | <u>455.6</u> | <u>474.0</u> |

The Group bank loans due after more than one year are secured on the assets of the subsidiary undertakings which borrowed the funds, and are repayable within five years.

NOTES TO THE FINANCIAL STATEMENTS - Continued

14. Creditors - continued

Included within amounts due to other group undertakings falling due after more than one year are sterling and dollar subordinated loans on which interest is payable annually at a market rate which is reset quarterly. The loans are repayable within five years.

Trade creditors primarily represent amounts payable under repurchase and stock lending agreements, amounts due to counterparties including other financial institutions, and short-term borrowings from banks and other institutions.

Trade creditors include both unsecured and secured financing arrangements. Security for financing transactions is provided in the form of current asset investments and securities obtained from trade debtor financing. The value of secured financing arrangements at the balance sheet date was £21,903.4 million (1994: £17,382.5 million). Bank loans and overdrafts at 31 December 1995 on an unsecured basis amounted to £53.3 million (1994: £98.5 million).

Included within due to other group undertakings are secured financing arrangements, collateralised by current asset investments, of £1,031.1 million (1994: £718.8 million).

Included in other creditors and accruals is £18.4 million (1994: £16.6 million) which represents amounts provided through a business expansion scheme ("BES"). Under the terms of the transaction, the Group has sold repossessed properties to three BES companies, who in turn will market them as rental properties. In connection with the sale, the Group has granted an option to each of the BES companies. The option, if exercised, would require the Group to repurchase the properties at such a price that will enable the BES companies to make a distribution of £1.37 for each £1 invested by their shareholders. The option may be exercised at any time between 1 June 1997 and 10 July 1997.

Due to the number of economic factors affecting the future operating performance of the BES companies, it is uncertain as to whether or not the option will be exercised and, therefore, the Group has not accounted for the transaction as a sale.

The Group through its subsidiary undertakings has issued floating rate notes. The notes are repayable out of the proceeds from the redemptions of the underlying mortgage pools on a periodic basis and are wholly redeemed no later than the dates shown below.

Interest payable on the floating rate notes is at various margins over LIBOR.

NOTES TO THE FINANCIAL STATEMENTS - Continued

14. Creditors - continued

Mortgage backed floating rate notes fall due as follows:

| Year of latest redemption | | Amount of notes outstanding | |
|---------------------------|--------------------------------------|-----------------------------|--------------------|
| | | 1995 £ Millions | 1994 £ Millions |
| 2013 | TMC Private Placements No. 1 Limited | 12.3 | 16.0 |
| 2014 | TMC Mortgage Securities No. 1 Plc | 20.2 | 25.5 |
| 2014 | TMC Mortgage Securities No. 2 Plc | 12.3 | 14.8 |
| 2015 | TMC Mortgage Securities No. 3 Plc | 12.6 | 15.8 |
| 2015 | TMC Mortgage Securities No. 4 Plc | 12.0 | 15.1 |
| 2015 | TMC Mortgage Securities No. 5 Plc | 16.0 | 19.5 |
| 2015 | TMC Mortgage Securities No. 6 Plc | 11.9 | 14.6 |
| 2015 | TMC Mortgage Securities No. 7 Plc | 13.4 | 16.9 |
| 2018 | TMC Mortgage Securities No. 8 Plc | 21.6 | 26.8 |
| 2019 | TMC Mortgage Securities No. 9 Plc | 35.4 | 43.6 |
| 2019 | TMC Mortgage Securities No. 10 Plc | 42.5 | 52.4 |
| 2020 | TMC Mortgage Securities No. 11 Plc | 198.4 | 242.7 |
| 2028 | TMC P.I.M.B.S. Fifth Financing Plc | 78.1 | 99.7 |
| 2028 | Holmes Placement No. 1 Limited | 53.2 | 66.6 |
| 2029 | TMC P.I.M.B.S. First Financing Plc | 99.4 | 118.1 |
| 2029 | TMC P.I.M.B.S. Third Financing Plc | 58.4 | 70.2 |
| 2029 | TMC P.I.M.B.S. Fourth Financing Plc | 76.9 | 94.5 |
| 2029 | TMC P.I.M.B.S. Sixth Financing Plc | 73.3 | 92.5 |
| 2030 | TMC P.I.M.B.S. Second Financing Plc | 14.2 | 17.7 |
| 2030 | TMC P.I.M.B.S. Plc | 94.5 | 112.6 |
| 2030 | Holmes Placement No. 2 Limited | - | 71.2 |
| 2031 | TMC P.I.M.B.S. Seventh Financing Plc | 150.0 | 192.8 |
| | | <hr/> | <hr/> |
| | | 1,106.6 | 1,439.6 |
| | | <hr/> | <hr/> |

The terms of the various funding arrangements, under which the companies listed above issue floating rate notes, include:

- The assets of the individual companies are subject to a floating charge in favour of the trustees of the noteholders.
- The mortgages over the properties and the related endowment life assurance policies are subject to a fixed charge in favour of the trustees for the noteholders.
- The individual companies have given their undertakings to the trustees for the noteholders which limit the companies' operations including their ability to raise finance.

NOTES TO THE FINANCIAL STATEMENTS - Continued

14. Creditors - continued

The movement in floating rate notes was as follows:

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Floating rate notes at 1 January | 1,445.7 | 1,810.6 |
| Issue costs at 1 January | (6.1) | (7.8) |
| | <u>1,439.6</u> | <u>1,802.8</u> |
| Floating rate notes redeemed in year | (334.4) | (364.9) |
| Issue costs charged to profit and loss during year | 1.4 | 1.7 |
| | <u>1,106.6</u> | <u>1,439.6</u> |
| Floating rate notes at 31 December | 1,111.3 | 1,445.7 |
| Issue costs at 31 December | (4.7) | (6.1) |
| | <u>1,106.6</u> | <u>1,439.6</u> |

15. Provision for Liabilities and Charges

The provision for liabilities and charges comprises:

| | Group | | Company | |
|-------------------------------|--------------------|--------------------|--------------------|--------------------|
| | 1995 £ Millions | 1994 £ Millions | 1995 £ Millions | 1994 £ Millions |
| Lease costs | 1.2 | 1.9 | - | - |
| Mortgage related charges | 3.8 | - | - | - |
| Deferred taxation (see below) | 3.2 | 38.1 | 1.7 | 0.5 |
| | <u>8.2</u> | <u>40.0</u> | <u>1.7</u> | <u>0.5</u> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

15. Provision for Liabilities and Charges - continued

The movement in deferred tax comprises:

| | Group | | Company | |
|---|------------|------------|------------|------------|
| | 1995 | 1994 | 1995 | 1994 |
| | £ Millions | £ Millions | £ Millions | £ Millions |
| Balance at 1 January | 38.1 | 450.5 | 0.5 | - |
| (Credited)/charged to profit and loss in respect of accelerated capital allowances and other timing differences | (32.4) | (441.7) | 0.1 | 0.5 |
| Transfer to taxation payable | - | 29.3 | - | - |
| Adjustment in respect of prior years | (13.5) | - | 1.1 | - |
| Deferred tax asset transferred to debtors | 11.0 | - | - | - |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Balance at 31 December | 3.2 | 38.1 | 1.7 | 0.5 |
| | <hr/> | <hr/> | <hr/> | <hr/> |

16. Called-Up Share Capital

The Company's share capital comprises:

| | 1995 | 1994 |
|---|------------|------------|
| | £ Millions | £ Millions |
| Authorised: | | |
| 908,935,000 ordinary shares of £1 each (1994: 908,935,000) | 908.9 | 908.9 |
| 15,798,750 (1994: 15,798,750) 'A' ordinary shares of £1 each | 15.8 | 15.8 |
| 5,266,250 (1994: 5,266,250) 'B' ordinary shares of £1 each | 5.3 | 5.3 |
| 561,175,212 (1994: 561,175,212) new redeemable preference shares of £1 each | 561.2 | 561.2 |
| 126,742,712 (1994: 338,824,788) 2nd tranche new redeemable preference shares of £1 each | 126.7 | 338.8 |
| 212,082,076 (1994: none) 3rd tranche new redeemable preference shares of £1 each | 212.1 | - |
| | <hr/> | <hr/> |
| | 1,830.0 | 1,830.0 |
| | <hr/> | <hr/> |
| Allotted, called-up and fully paid: | | |
| 15,798,750 (1994: 15,798,750) 'A' ordinary shares of £1 each | 15.8 | 15.8 |
| 5,266,250 (1994: 5,266,250) 'B' ordinary shares of £1 each | 5.3 | 5.3 |
| 561,175,212 (1994: 561,175,212) new redeemable preference shares of £1 each | 561.2 | 561.2 |
| 126,742,712 (1994: 126,742,712) 2nd tranche new redeemable preference shares of £1 each | 126.7 | 126.7 |
| 10,400,000 (1994: none) 3rd tranche new redeemable preference shares of £1 each | 10.4 | - |
| | <hr/> | <hr/> |
| | 719.4 | 709.0 |
| | <hr/> | <hr/> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

16. Called-Up Share Capital - Continued

On 13 December 1995, the outstanding authorised but unissued 212,082,076 2nd tranche new redeemable preference shares of £1 each were reclassified as 3rd tranche new redeemable preference shares of £1 each and 10,400,000 such shares were issued at par, the proceeds of which were used to purchase the outstanding minority interest in the ordinary shares of the Company's subsidiary TMC Group Ltd.

17. Reserves

Group

| | Capital Reserve £ Millions | Profit & Loss Account £ Millions | Total £ Millions |
|--|----------------------------------|--|---------------------|
| Balance at 1 January 1995 | 5.6 | 148.0 | 153.6 |
| Exchange difference on retranslation of net assets and results of subsidiary undertakings | - | 0.3 | 0.3 |
| Retained profit | - | 1.6 | 1.6 |
| Goodwill written off | - | (2.4) | (2.4) |
| | <hr/> | <hr/> | <hr/> |
| Balance at 31 December 1995 | 5.6 | 147.5 | 153.1 |
| | <hr/> | <hr/> | <hr/> |

Company

| | Capital Reserve £ Millions | Profit & Loss Account £ Millions | Total £ Millions |
|-----------------------------|----------------------------------|--|---------------------|
| Balance at 1 January 1995 | 5.6 | 44.6 | 50.2 |
| Profit for the year | - | 28.8 | 28.8 |
| | <hr/> | <hr/> | <hr/> |
| Balance at 31 December 1995 | 5.6 | 73.4 | 79.0 |
| | <hr/> | <hr/> | <hr/> |

During 1981, the shareholders made a capital contribution in cash to the Company of £5.6 million. This contribution forms part of the shareholders' funds.

18. Minority Interests

| | 1995 £ Millions | 1994 £ Millions |
|-------------------------------|--------------------|--------------------|
| Balance at 1 January | 14.0 | 12.5 |
| Share of profit for the year | 2.0 | 1.5 |
| Purchase of minority interest | (8.0) | - |
| | <hr/> | <hr/> |
| Balance at 31 December | 8.0 | 14.0 |
| | <hr/> | <hr/> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

19. Reconciliation of Profit/(Loss) Before Taxation to Net Cash Inflow/(Outflow) from Operating Activities

| | 1995 £ Millions | 1994 £ Millions |
|--|--------------------|--------------------|
| Profit/(loss) before taxation | 210.7 | (619.0) |
| Amortisation of issue costs | 1.4 | 1.7 |
| Increase in interest receivable and prepaid expenses | (17.2) | (5.0) |
| Decrease in interest payable and accrued expenses | (17.3) | (71.9) |
| Depreciation | 8.6 | 8.2 |
| Loss on the sale of tangible fixed assets | 0.1 | 1.2 |
| Lease costs | (0.7) | (1.0) |
| Net charge/(recovery) for provision for mortgage related charges | 3.8 | (14.2) |
| | <hr/> | <hr/> |
| Net cash inflow/(outflow) from trading | 189.4 | (700.0) |
| Decrease in securities held | 212.1 | 5,829.4 |
| Increase in other debtors | (6,828.8) | (739.6) |
| (Increase)/decrease in other creditors | 7,172.1 | (4,497.8) |
| Tax attributable to franked investment income | (6.2) | (6.5) |
| | <hr/> | <hr/> |
| Net cash inflow/(outflow) from operating activities | 738.6 | (114.5) |
| | <hr/> | <hr/> |

20. Analysis of the Balances of Cash and Cash Equivalents as shown in the Balance Sheet

| | 1995 £ Millions | 1994 £ Millions | Change in 1995 £ Millions |
|--|--------------------|--------------------|---------------------------------|
| Cash at bank and in hand (including balances with central banks) | 305.1 | 168.7 | 136.4 |
| Bank loans and overdrafts | (74.9) | (204.1) | 129.2 |
| | <hr/> | <hr/> | <hr/> |
| | 230.2 | (35.4) | 265.6 |
| | <hr/> | <hr/> | <hr/> |

NOTES TO THE FINANCIAL STATEMENTS - Continued

21. Analysis of Changes in Financing During the Year

| | Ordinary Shares £ Millions | Preference Shares £ Millions | Floating Rate Notes £ Millions | Group Loans £ Millions | Bank Loans £ Millions |
|--------------------------------------|----------------------------------|------------------------------------|--------------------------------------|------------------------------|-----------------------------|
| Balance at 1 January 1994 | 21.1 | 561.1 | 1,810.6 | 1,595.2 | 132.6 |
| Cash inflow/(outflow) from financing | - | 126.8 | (364.9) | 498.4 | (28.1) |
| Balance at 1 January 1995 | 21.1 | 687.9 | 1,445.7 | 2,093.6 | 104.5 |
| Cash inflow/(outflow) from financing | - | 10.4 | (334.4) | (125.3) | (88.5) |
| Balance at 31 December 1995 | 21.1 | 698.3 | 1,111.3 | 1,968.3 | 16.0 |

22. Contractual Commitments and Contingencies

(a) Risk Management

The Group derives revenues from trading activities that expose it to market, credit and operational risks. These risks are principally managed on a global basis. Global procedures in place to manage such risks and initiatives under way to enhance their management are disclosed in the 1995 consolidated accounts of Salomon Inc. The Group undertakes local risk management procedures that are integral and consistent with those described for Salomon Inc.

(b) Notional Commitments and Market Values of Contractual Commitments

In the normal course of its operations, certain companies within the Group enter into various contractual commitments involving forward settlement. These include futures contracts, commitments to buy and sell foreign currencies, interest rate swap, cap and floor agreements, and options or similar contractals. As discussed in Note 1(d), the Group records all contractual commitments involving future settlement at market or fair value. Consequently, changes in market prices are included in the profit and loss account.

NOTES TO THE FINANCIAL STATEMENTS - Continued

22. Contractual Commitments and Contingencies - continued

Commitments involving future settlement give rise to market risk, which represents the potential loss that can be caused by a change in the market value of a particular instrument. The Group's exposure to market risk is influenced by a number of factors, including the size, composition and diversification of positions held, the absolute and relative levels of interest rates and foreign currency exchange rates as well as market volatility and liquidity. For instruments such as options and warrants, the time period during which the options or warrants may be exercised and the relationship between the current market price of the underlying instrument and the options or warrants strike or exercise price also affects the level of market risk. The most significant factor influencing the overall level of market risk to which the Group is exposed is its use of hedging techniques to mitigate such risk.

The notional amounts of financial instruments that give rise to off-balance sheet risk are disclosed below. The determination of notional amounts does not consider any of the factors discussed above. Notional amounts are indicative only of the volume of activity; they are not a measure of market risk. Market risk is influenced by the nature of the items that comprise a particular category of financial instrument. It is also influenced by the relationship among the various off-balance sheet categories as well as the relationship between off-balance sheet items and items recorded in the Group's balance sheet. For all of the reasons noted above, the interpretation of the following notional amounts as a measure of market risk could be materially misleading.

| | 1995 £ Billions | 1994 £ Billions |
|--|--------------------|--------------------|
| Financial futures contracts | 91.5 | 122.5 |
| Swap agreements | 209.7 | 90.6 |
| Options and similar contractals sold or written | 25.0 | 11.2 |
| Options and similar contractals purchased | 25.5 | 23.4 |
| Forward rate agreements | 3.9 | 1.6 |
| Forward currency contracts | 8.2 | 2.8 |
| Interest rate cap and floor agreements sold or written | 24.0 | 18.2 |

NOTES TO THE FINANCIAL STATEMENTS - Continued

22. Contractual Commitments and Contingencies - continued

As discussed in Note 1(d), the balance sheet includes the market or fair value of financial instrument options and contractual commitments involving future settlement. At 31 December 1995 and 1994, the market or fair value of options and contractual commitments recorded by the Group as assets and liabilities was as follows:

| | Assets | | Liabilities | |
|--|----------------|----------------|----------------|----------------|
| | 1995 | 1994 | 1995 | 1994 |
| | £ Millions | £ Millions | £ Millions | £ Millions |
| Swap agreements, swap options and interest rate cap and floor agreements | 585.0 | 630.3 | 1,114.8 | 788.6 |
| Index and equity options and similar contractals | 1,028.9 | 564.4 | 1,055.0 | 663.3 |
| Currency options | - | 8.5 | - | 14.4 |
| Other options and contractals | 164.8 | 172.5 | 176.2 | 167.8 |
| | <u>1,778.7</u> | <u>1,375.7</u> | <u>2,346.0</u> | <u>1,634.1</u> |

(c) Capital Commitments

There were capital commitments of £0.3 million as at 31 December 1995 (1994: £0.1 million).

(d) Letters of Credit

The Group had £642.0 million of unsecured letters of credit outstanding from banks as at 31 December 1995 (1994: £1,034.1 million), to satisfy collateral requirements under securities borrowing agreements and margin requirements.

(e) Lease Commitments

At 31 December 1995, the Company and certain other companies within the Group had entered into lease agreements for office accommodation, the last of which expires in 2012. During the year lease rental payments of £8.2 million (1994: £8.2 million) were made.

In addition, the Group leases certain land and buildings on short and long term leases. The annual rental on these leases for 1995 was £1.5 million (1994: £1.5 million). The rents payable under these leases are subject to re-negotiation at various intervals specified in the leases. The Group pays all insurance, maintenance and repairs of these properties.

The Group has also entered into non-cancellable operating leases in respect of equipment, the payments for which extend over a period of up to 3 years. The total annual rental for 1995 was £0.1 million (1994: £0.4 million).

NOTES TO THE FINANCIAL STATEMENTS - Continued

22. Contractual Commitments and Contingencies - continued

The minimum annual rentals under the foregoing leases are as follows:

| | 1995 | | 1994 | |
|------------------------------------|------------------------|-------------------------|------------------------|-------------------------|
| | Property £ Millions | Equipment £ Millions | Property £ Millions | Equipment £ Millions |
| Operating leases which expire:- | | | | |
| within 1 year | - | - | - | 0.1 |
| within 2-5 years | - | - | - | - |
| after 5 years | 9.7 | - | 9.7 | - |
| | <u>9.7</u> | <u>-</u> | <u>9.7</u> | <u>0.1</u> |

The minimum annual rental will be reduced by £617,000 through the sub letting of vacated space commencing in 1996.

(f) Other Commitments

Commitments to buy and sell current asset investments arose in the ordinary course of business.

23. Subsequent Events

On 1 January 1996, the regulated entities in the Group commenced reporting to their respective regulators under the Capital Adequacy Directive (CAD) regulations.

Under the new CAD regulations the Group's financial resources requirement is substantially lower than under the previous regulations. During the period 1 January 1996 to 23 October 1996 the Group made net repayments of \$300 million and £40 million on its subordinated loans due to other group undertakings, under the facilities existing at 31 December 1995. The directors will continue to monitor the Group's regulatory capital requirements. Regulatory approval would be sought for any further reductions in the Group's regulatory capital.

On 15 February 1996, SBUK paid a dividend of £6.0 million on its preference shares, representing payment in full of the outstanding cumulative dividends due on SBUK's preference shares owned by a minority interest in the Group at that date.

Also on 15 February 1996, the Company declared a dividend of £48.9 million on its new redeemable preference shares and a dividend of £18.1 million on its 'A' and 'B' ordinary shares.

NOTES TO THE FINANCIAL STATEMENTS - Continued

23. Subsequent Events - continued

On 21 February 1996, the Company entered into an agreement with its subsidiary SBUK, for SBUK to purchase from SBEL 79,000,000 of its own ordinary shares of £1 each. These shares were purchased by SBUK out of its capital (within the meaning of section 171 (2) of the Companies Act 1985) for cash at par, pursuant to Section 173(2) of the said Act on 28 March 1996, having obtained Bank of England approval.

On 15 March 1996, SBIL renewed a 364 day \$1 billion committed revolving credit facility with a syndicate of banks on a secured basis. This renewed facility is substantially similar to the facility entered into on 20 March 1995 and can be used for general corporate purposes.

On 19 March 1996, the Company confirmed its intention, during the year immediately following 31 December 1995, to ensure that financial resources are made available such that SBAM will be able to pay its debts as they fall due.

On 28 June 1996, the Company declared a dividend of £22.6 million on its 'A' and 'B' ordinary shares.

On 1 June 1996, the Company entered into an agreement to sell the principal subsidiaries involved in the mortgage origination and servicing business. The sale was completed on 6 August 1996 for a consideration of £52.9 million (subject to completion financial statements). Under the agreement the Company has entered into certain warranties and representations. Subject to the completion financial statements, warranties and representations, the Company made a gain of £16.3 million and the Group made a gain of £31.5 million on disposal, after expenses.

On 16 October 1996, SBIL was granted a five year \$800 million facility by another group company to provide SBIL with long term subordinated debt in accordance with SFA rules. Also on 16 October 1996, SBIL drew down \$200 million under this facility.

On 22nd October 1996, SBIL's 364 day \$1 billion committed revolving credit facility was replaced with a 364 day \$1 billion committed securities repurchase facility with a syndicate of banks.

24. Group Structure

The Company's immediate and ultimate parent companies are Salomon International Limited and Salomon Inc, respectively, both of which are incorporated in the State of Delaware, United States of America.

The smallest group in which the results of the Company are consolidated is that headed by Salomon Brothers Holding Company Inc, incorporated in the State of Delaware, United States of America. The largest group in which they are consolidated is that headed by Salomon Inc. The audited consolidated financial statements of Salomon Inc are made available to the public annually in accordance with Securities and Exchange Commission regulations and may be obtained from Corporate Communications, 7 World Trade Center, New York, New York 10048.