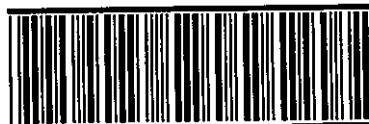


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INNS REPORT & ACCOUNTS 1997

REPORT  
ACCOUNT  
1997

Surrey Elec. Inc.



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COMPANIES HOUSE 23/12/97

## *The SPI Group*

*intends to be the most successful regional  
licensed retailer in the UK*

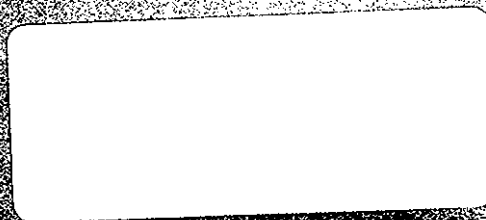
*as measured by*  
sales and profit growth  
earnings per share increase  
return on capital  
shareholder EVA

*This means an on-going commitment to*  
excellence in customer care, value and product choice,  
highest housekeeping standards,  
quality entertainment appropriate to our at home leisure  
success in every aspect of our business

*Ensuring the opportunity of career development for  
our people through*

*training and motivation  
developing their skills and talents to  
exercising responsibility  
fulfilling their potential*

*Providing employee rewards which reflect  
outstanding performance*

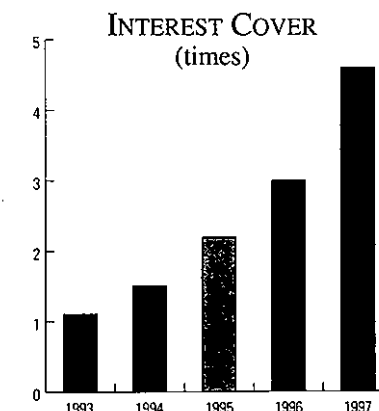
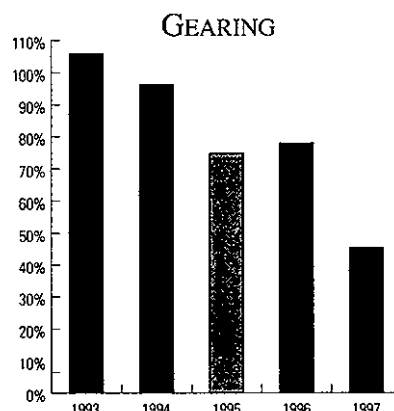
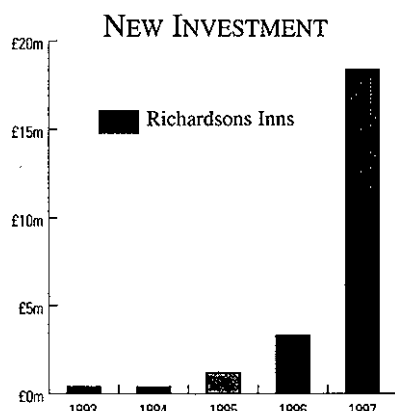
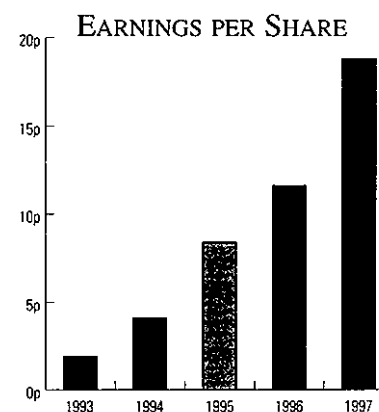
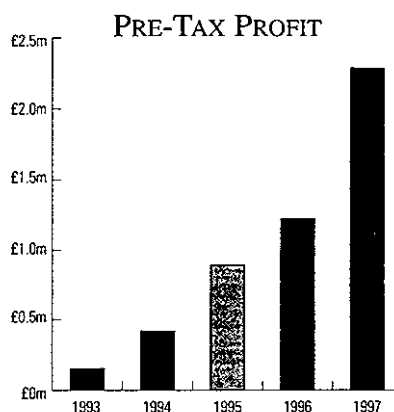
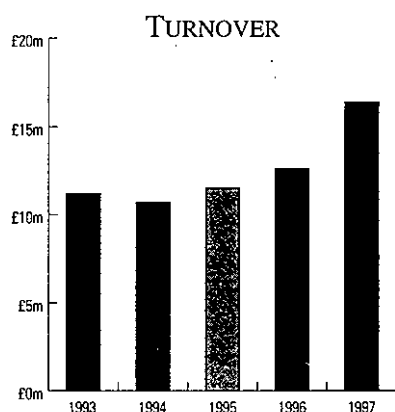


# FINANCIAL HIGHLIGHTS

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## 1997: Successful brand driven expansion and investment

- Earnings per share up 62% to 18.8p
- 39 outlets at 31 May compared to 24 last year
- Richardsons Inns acquisition earnings-enhancing from day one
- Interest covered 4.6 times; gearing reduced to 44.7%
- Necessary funding in place to cover investment plans
- *Bar Med* café bar brand now complements *Litten Tree*



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# CHAIRMAN'S STATEMENT

Surrey Free Inns plc 2



"This has been an outstanding year for your Company, both in terms of corporate activity and profitable growth. It is now appropriate for the Company to seek admission to the Full List"

Patrick Townsend, Chairman

We maintained our rapid expansion programme, increasing significantly the number of our branded outlets, successfully launching our new café bar concept *Bar Med*, and acquiring Richardsons Inns, whilst almost doubling our profits.

Profit before tax reached a record £2.3 million, which represents a 93% increase on the same period last year. Turnover has increased to £16.4 million, up 30% and operating cash flow leapt ahead by 60% to £3.4 million. Earnings per share were also 60% higher at 18.8p. Interest was covered 4.6 times and gearing fell to below 45%. These are outstanding results, that do not include a contribution from the Richardsons Inns outlets, which were acquired just prior to our year end.

Your Board is pleased to propose an increased final dividend of 1.6p net per share, which makes a total of 2.85p for the year, a 27% increase.

We again achieved our target rate of expansion of opening a new outlet on average every six weeks. Our branded outlets, the new flagships of our business, have increased to 13 and are consistently producing results that confirm their crucial role in the future of the Group. Branded outlets were responsible for 85% of the increased sales, although only five of these outlets were open throughout the year. £7 million was invested in opening new outlets and developing our estate. The benefits are already evident. Return on capital employed, excluding the Richardsons transaction, has improved by 46% to 11.7%, which I believe is acceptable at this phase of our development.

The *Litten Tree* is now strongly established as a main-

stream pub brand within our geographical area of operations and the pilot testing of our new café bar concept *Bar Med* is performing extremely well. The Richardsons Inns businesses, acquired in April this year, have added eight quality, high-volume outlets which complement our business strategy, add strength to our management team and are immediately earnings enhancing.

The Company is now well positioned to maintain its significant rate of growth. In the current year we intend to increase the rate of new openings by 25% and to undertake some large scale refurbishment of existing properties. We expect to have opened at least six new branded outlets before Christmas. Our strong cash flow, now enhanced further by the Richardsons estate, will materially fund this expansion and financing is no longer a restraint.

Your Board believes that it is now appropriate for the Company to seek admission to the Stock Exchange Full List. It is anticipated that this will take place early in September. We believe this move will enable more institutional investors to take holdings in the Company and should increase liquidity in our shares. Under transitional arrangements for established Alternative Investment Market (AIM) companies, this will be achieved at a modest cost.

There are two significant changes which Shareholders will be asked to approve at the Annual General Meeting (AGM). Both reflect the Company's increased size. The first is to change the name from Surrey Free Inns to "SFI Group plc". Your Board believes that the present name no longer reflects the scale and status of

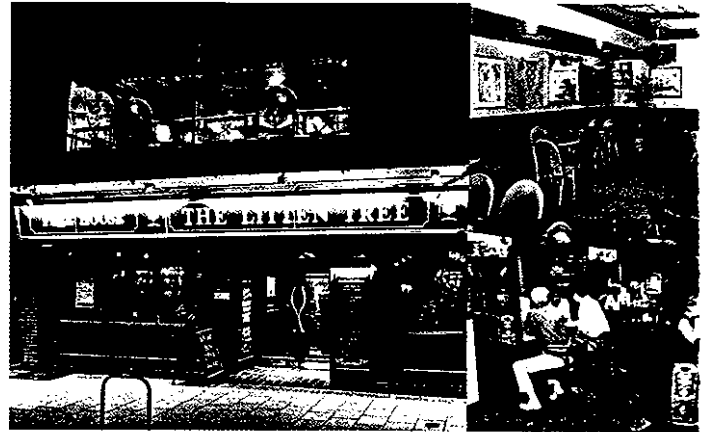
SFI Group

the Company. The proposed new name provides a necessary continuity and is more appropriate for the expected future growth of the business. The second is to authorise a share split to convert our shares from units of £1 nominal to 25p. This will in no way alter the value of your holding, but it will mean that the number of shares you own will increase four times and new share certificates will be issued. We believe the change will have a positive influence on the liquidity of our shares.

On a personal note, I shall be retiring at the AGM. My tenure of office has given me great pleasure and I have been proud to lead the Company out of the recession and through a period of remarkable growth. Your Board has invited Tony Hill to become Chairman and Chief Executive and Gerald Richardson to become Managing Director. I leave the Company in excellent hands. Both are leading figures in our industry. Tony has been the architect of our expansion and the innovator of our brand development. Gerald has established a solid reputation as an outstanding operator with particular success in very large pub outlets. They make a formidable team. Angus Lamont will also be retiring as a Non-executive Director after 10 years of service. I know you would want me to express your thanks to him for the tireless contribution he has made over the years. We intend to announce the appointment of a replacement Non-executive Director in due course.

**Current Trading and Prospects** The current year has started well. The smooth integration of the former Richardsons outlets is now underway and these are contributing strongly to the Group as a whole. In previous years, the poor weather experienced this June, which affected much of the industry adversely, would have been a setback for us too. However, the repositioning of our core business towards urban centre day-through trading has proved resilient to seasonal factors of this kind. We are well organised for another year of substantial growth through opening new, previously unlicensed outlets and will benefit from a full year of those brought on stream since last Christmas, in addition to the significant earnings from the Richardsons estate.

I am confident 1998 will be another equally successful year for your Company.



*Litten Tree*



*Bar Med*



*Minster Pavement Café Bar*

# MANAGING DIRECTOR'S REVIEW

Surrey Free Inns plc 4



"This has been another year of excellent progress and profit improvement, whilst maintaining our target rate of expansion"

Anthony Hill, Managing Director

Pre-tax profits increased 93% to £2.3 million. Costs were contained and operating margins before interest and depreciation increased from 16.9% to 20.8%. Gross margins at trading level increased by over a percentage point to 71%, reflecting economies of scale in purchasing and a more profitable mix of business being generated by our new town centre outlets. The Richardsons Inns operations were acquired only a few days before the year end and have not impacted on these results.

The significant growth in operating profit was achieved after increased central costs, which remained around 8.5% of turnover. This was necessary to support a rapidly growing organisation. We have prepared the way with a firm commitment to investment in people, in information technology (IT) and in retail brands to ensure the necessary infrastructure is in place in advance of further expansion. These results illustrate that we are already receiving a return on this investment. It has allowed us to integrate the Richardsons Inns outlets very easily - an increase that in real terms is equivalent to a year's growth. It enables us to move forward with confidence and to continue to increase the rate of our new outlet expansion programme.

Our business now consists of three main components: branded outlets, the pub complex at Portsmouth and the traditional pub estate. It is the branded operations that have driven us forward. They accounted for 53% of trading contribution and grew by 111% over the previous year. Our traditional outlets remain an important part of our business, being responsible for 25% of contribution, and it is pleasing to note a 56% increase over

last year - largely due to developments such as the 30 bedroom *Innlodge* extension at Bristol. Portsmouth continues to be our flagship and remains one of the largest and most profitable operations of its kind in the UK. It was our first move towards the superpub concept back in 1991 before the term became fashionable. It has stood the test of time very well, but it was refurbished at the turn of the year to bring the main part of the business in line with the standards of the *Litten Tree* brand.

Surrey Free Inns has come a long way since the first pilot *Litten Tree* in Sutton early in 1994, which was instrumental in repositioning our business. We are now well established as a brand-focused licensed retailer. The *Litten Tree* concept has evolved and developed as we have rolled it out. Results have clearly proven it is a town centre brand with the potential for further expansion and the flexibility to adjust to the needs of different locations. The concept is designed to utilise very large sites with day-through trading, extending the hours where appropriate through late licenses - in effect, achieving a multiple use of property. It may be food-led during the day and changes to being liquor-driven in the evening, enjoying lower operating costs than where food is the main focus. It achieves a high retail profit margin with above average levels of turnover. Similar features have been built into our café bar concept, *Bar Med*, which has performed so well in its first test site that we are confident it can become a second town centre brand. In Bournemouth we already have both *Litten Tree* and *Bar Med* working in close proximity, servicing different customer groups. This creates the prospect of significantly increasing the number of potential sites.



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The heavy fixed costs in licensed retailing mean that size, scale and efficiency are crucial. Our strategy of repositioning our business in favour of very large urban sites is producing tangible rewards. Our brands are succeeding by attracting a much wider customer profile, in lively and accessible town centre locations, where there is often the opportunity for longer retailing hours. These are producing above average levels of turnover and achieving significant economies of scale. Last year, our top dozen sites achieved an average net turnover well in excess of £20,000 per week, pro rata to a full year of trading, a performance that compares favourably to the best in our industry.

Looking to the future, we will progress the strategy which has served us so well. Your Board has authorised £10 million of capital investment for developing new sites, already identified, which meet the criteria for *Litten Tree* or *Bar Med* brands. This will support an increase of at least 25% in our rate of expansion this year and take us into the start of next year. The expansion programme will be funded essentially from cash flow but we plan to dispose of part of the traditional estate to generate supporting finance. We will continue to have a strong presence in high quality traditional pubs where overt branding or themes are not considered

appropriate. This gives balance to our estate, extends buying power (particularly with food), and provides a good training ground for management development.

The Richardsons Inns outlets are integrating well and the four London sites are strategically very important. In January we plan to start work converting the Beaconsfield theme pub into a *Litten Tree*. In London we will re-brand the Finsbury Square café bar into a *Bar Med* and upgrade the Seething Lane outlet to a *Litten Tree* format. We are still assessing the *For Your Eyes Only* business in order to maximise potential shareholder value in an eventual disposal or demerger. Gerald Richardson's management team is a welcome addition to the Company and is already adding real value.

Surrey Free Inns future looks exciting under its new corporate identity of the "SFI Group plc". We have travelled a long way in a relatively short period of time. Growth is being sustained and is gathering pace. We have made the critical investments to support a larger business than we are today. We are focused in striving to be the best regional operator in the industry. Central to our mission statement is the goal to achieve excellence in all aspects of customer service. I believe we are building on a very solid foundation for the future.



Tony Hill, Group Managing Director, with the staff of the new Bar Med café bar, in Bournemouth

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# FINANCE DIRECTOR'S REPORT

Surrey Free Inns plc 6



"From a financial perspective we have had an extremely busy and productive year. We now have the funding and the infrastructure in place to support our growth intentions"

Clive Eplett, Finance Director

**Results** This year's results give a clear picture of the benefits of our now well established development strategy. Pre-tax profits are virtually six times those of 1994, the year we opened our first *Litten Tree*. Turnover has increased just 60% over the same period. In that time EPS have risen from 4p per share to 19p per share.

These statistics demonstrate the success of the *Litten Tree* brand. Large pubs generate excellent gross margins whilst labour and other operating costs form a lower percentage of total take. Together, these give a higher profit percentage on a high turnover level.

**Taxation** For the first time we have had to provide for a Corporation Tax charge. The very low effective rate of 6% arises from the tax allowances available as a consequence of our capital investment programme. However, we will offset Advance Corporation Tax already paid on dividends, hence no further cash will be payable on this liability. Our continued development plans should ensure that the effective tax rate remains at a low level.

**Cashflow and Funding** A record amount of cash flowed through the business this year. In total, we invested over £18m in the business, an amount equivalent to 112% of our turnover for the year. £5.5m of this was invested in creating new trading outlets from previously unlicensed property and a further £1.5m was used for developments within our existing estate, including £0.25m as part of our continuing investment in information technology. However the main part,

£11.35m, was used to acquire the Richardsons Inns businesses. Importantly, the deal was immediately earnings enhancing and is already creating Added Value for Shareholders. The substantial cash generative powers of these units places us in a stronger position to fund future developments from trading cash flow.

Free cash flow for the year increased 250% to £3.0m this year. A placing of half a million shares in October at £3.20 raised £1.6m and £100,000 of equity at the same price was used to part fund the purchase of the *Bar Med* site in Bournemouth. Latterly, we funded the Richardsons acquisition by issuing 3 million shares at £4.20, raising £12m after costs. The Board took the decision to fund the whole of the Richardsons acquisition through the issue of shares in the knowledge that this would inhibit improvements in our Added Value in the immediate term. However, we believe the benefits of that decision are important. Our gearing at year-end was reduced to 45% whereas it would otherwise have been near to the 70% level.

During the year, we also put our banking arrangements out to tender resulting in our facilities increasing from £11m to £17m. The repayment schedule has also improved, now being spread over a 10-year term.

**Interest** Our close management of cash and borrowing helped to contain the increase in interest cost to just 10% at £0.7m. Interest cover for the year improved to 4.6 times, compared to 3 times last year. We now have 70% of our debt protected from rate rises above 7.5% for at least two years.

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### Systems and Information Technology (IT)

We continued the rollout of Electronic Point of Sale (EPoS) systems during the year. All of our outlets, including the Richardsons sites, have the 'back-of-house' system and the larger ones all have full EPoS systems, including Portsmouth where we have just completed implementation. We consciously took the decision in 1995 to phase our EPoS rollout, anticipating substantial improvements in till systems. This plan has worked well and the touch-screen tills we are now installing provide much easier, quicker customer service than their predecessors. They also enable us to change prices during the day, whilst retaining full control of stocks and margins. In those sites we now use three price levels during a trading day: standard price, 'happy hour' discounts and premium prices (generally up 10p) from 8 o'clock in the evening. This pricing strategy creates substantial increases in profit and a very quick payback on the system cost.

In December, I took the major step of instigating a complete change in our accounting software. This has gone according to plan and enabled us to fully integrate the Richardsons units into all of our financial systems from day one.

**Accounting Policies** We are committed to applying best accounting practice and consequently have made a minor change to the basis on which our accounts are prepared. We have set aside the process of having pubs revalued periodically and will in future simply use a more prudent historic cost. To fully revalue the whole

estate each year is prohibitively expensive. Furthermore, individual valuations do not reflect the premium that a portfolio of outlets such as ours attract.

Conceptually, we (and valuers) largely view a pub as a business rather than an organised collection of bricks and mortar and perform valuations on that basis. Valuations are therefore a measure of trading performance rather than the inflationary gains or losses associated with property generally.

Otherwise, our accounting policies remain unchanged. Like the rest of our industry, we await with interest for further developments in the Accounting Standards Board's current reviews on the topics of the depreciation of properties and deferred taxation. It is likely that any changes will reduce reported profits across the industry, but underlying cash generation and business fundamentals will remain unaltered.

**Return to Shareholders** Between 31 May 1996 and 31 May 1997, the mid-market price of SFI's shares rose from £2.36 to £5.00, an increase of 112%.

The Board has consistently practised a progressive dividend policy and will continue to do so. We propose a final dividend of 1.6p per share (up 27%), to follow the 1.25p interim dividend paid in April (1996: 1p). Dividend cover rises 5.6 times, up from 4.9 times. The profits retained, amounting to £1.8m will be invested in further pub developments in the forthcoming year.



*Celebrating another successful Litten Tree development. Clive Eplett, FCA (centre), with "Pat" Purtell, Commercial Director (right) and Tony Hill*

*SFI*

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# DIRECTORS

Surrey Free Inns plc 8

**Patrick Townsend, Chairman** Patrick was Chairman and Chief Executive of Matthew Brown plc, one of the UK's largest regional brewers, until its take-over by Scottish & Newcastle in 1987. He had previously led a spirited and successful resistance to their first two hostile bids. Patrick will be retiring from the Board after the AGM.

**Anthony Hill, Managing Director** After a scholarship to Oxford, where he read Theology, Tony followed a career in marketing and general management. Formative experience was gained with Hoover, Gillette and General Mills Inc. Prior to taking the lead role in setting up the Company, Tony had been Marketing Director of Martini & Rossi and General Manager of Seiko. He is currently a council member of the Association of Licensed Multiple Retailers and Chairman of its licensing committee.

**Gerald Richardson, Deputy Managing Director** Gerald's career has been centred in licensed retailing where he has a considerable reputation for successfully operating high volume outlets. Richardsons Inns was a partnership involving Whitbread plc, where Gerald was the Managing Partner. It was highly innovative and set demanding performance standards. Gerald's status as an industry leader is reflected in his Chairmanship of the British Institute of Innkeeping.

**Clive Eplett FCA, Finance Director** Clive joined the Group in Autumn 1991 from Coopers & Lybrand and joined the Board in July 1993. He had previously acted as Finance Director to several small companies and specialises in information technology. He was appointed Company Secretary in July 1997.

**Charles Purtell, Commercial Director** "Pat" Purtell has over 30 years senior experience in licensed catering. He was instrumental in developing new concepts for Berni Inns. Prior to joining the Board, he was Managing Director of the hotel and restaurant division of Matthew Brown and became Deputy Retail Director of Scottish & Newcastle Northern.

**Angus Lamont, Non-executive** Angus is an authority on computerised management and control systems. He founded Crown Management Systems Limited which is a supplier of specialist software to the hospital industry. Between 1976 and 1982 he was proprietor of the Crown Inn at Chiddingfold in Surrey. Angus has been involved with the Company from its inception and will also be retiring from the Board after the AGM.

**Ian Cottle, Non-executive** Ian's whole career has been spent in the drinks industry. For 16 years he was with Allied Breweries, latterly as Marketing Director of Grants of St. James Limited. Subsequently he was Managing Director of Martini & Rossi Limited and is currently Managing Director of a Consortium of wine and champagne producers.

**Robert Lo, Non-executive** Robert is a Director of Johnson Fry plc and has many years experience of the unquoted company sector, principally through Johnson Fry's role as a sponsor of BES issues, of which the company was one. Prior to joining Johnson Fry, he practised as a solicitor, specialising in corporate and taxation matters, and was a partner of a central London firm.



*The Minories, London EC3. A quality traditional outlet in the City, developed by Richardsons Inns*

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<b>Compliance</b>	The directors are pleased to report that the company complied with all the provisions of the Code of Best Practice of the Committee on Financial Aspects of Corporate Governance throughout the year. The Auditors have reported to the Board on compliance with Corporate Governance. Their report is set out on page 15.
<b>The Board</b>	<p>At the year end, the Board comprised four executive directors and four experienced, independent non-executive directors, including a non-executive chairman. Until 1 July 1997 one of the non-executive directors also acted as company secretary. The Board meets at least bimonthly to review the current state of the business and to determine its future development. It has a formal schedule of matters specifically reserved for its decision including corporate strategy, business acquisitions and disposals, capital expenditure authorisation, budget approval and performance review. Other matters requiring Board approval include changes in funding arrangements, whether of debt or equity and share option schemes.</p> <p>Non-executive directors have formal access to all information and, if required, external advice at the company's expense. They also have access to the company secretary.</p>
<b>Audit committee</b>	The audit committee comprises the non-executive directors with the Managing Director, Finance Director and external auditors in attendance as appropriate. This committee meets at least twice a year to fulfil its responsibility for a critical review of the annual and interim financial statements (including the Board's statement on internal control in the annual report) prior to their submission to the full board for approval.
<b>Remuneration committee</b>	The remuneration committee also comprises the non-executive directors. It meets at least twice a year and performs the key role of setting the remuneration of executive directors, including levels for individual components of salary, performance related pay, benefits, pension provisions and contracts of service.
<b>Nomination committee</b>	A nomination committee comprising I G Cottle, R A Lo and A S Hill recommends to the Board the appointment of all executive and non-executive directors.
<b>Going concern basis</b>	The directors consider, after making appropriate enquiries, that the company has adequate resources to continue operations for the foreseeable future. Accordingly, the financial statements continue to be prepared on the going concern basis.
<b>Internal control</b>	<p>The directors have overall responsibility for the company's system of internal financial control. This system is designed to provide reasonable but not absolute assurance that the assets of the group are safeguarded, that proper accounting records are maintained and that reliable financial information is produced. The more important elements of this system include:</p> <ul style="list-style-type: none"> <li>■ a comprehensive corporate governance policy with clearly defined rules relating to the delegation of authority,</li> <li>■ preparation of annual budgets by all operating outlets. Budgets are reviewed by executive management and are subject to Board approval,</li> <li>■ weekly and monthly reviews of sales, cash and profitability compared to budget and prior year with written commentary on significant variances,</li> <li>■ a clearly defined framework for capital expenditure and contracts including appropriate authorisation procedures and levels. There is a prescribed format for capital expenditure which identifies the commercial and strategic reasoning for the investment as well as its financial implications.</li> </ul> <p>The group does not have an internal audit department. Responsibility for monitoring the integrity of financial information and compliance with approved procedures is vested in head office finance staff. The external auditors meet with the audit committee and report formally to them on internal financial controls annually.</p>

**Employees**

The company maintained its policy of encouraging the involvement and participation of employees in matters which affect their interests as employees. It is the group's policy to promote health and safety at work, equality of opportunity in both recruitment and career development, and to recognise opportunities for the employment and development of the disabled.

**Supplier payment policy**

It is the company's policy to have mutually beneficial long term trading relationships with its suppliers. Unless specific arrangements are agreed otherwise, the company's standard terms are for invoices to be paid at the end of the month following that in which the invoice is submitted. Contract building work is paid for in accordance with the specific contract. At 31 May 1997 the period of credit taken from the company's suppliers amounted to approximately 26 days.

**Taxation status**

The company's proposed move to the Official List of the London Stock Exchange (full listing) will change the taxation status for shareholders of the company's shares.

- *Capital Gains Tax - reinvestment relief*

At present, reinvestment relief is available when an individual reinvests the proceeds from a sale of a chargeable asset into the company's shares. The Inland Revenue confirmed in July 1996 that the company's shares are qualifying shares for these purposes and the directors see no reason why this should have changed.

When the company becomes fully listed the shares will cease to be qualifying investments for reinvestment relief purposes. Reinvestment relief given on the acquisition of shares before the company becomes fully listed will not be withdrawn. There is a specific provision in the tax legislation which prevents a clawback of relief within the normal three year qualifying period when shares move from AIM to the Official List.

- *Capital Gains Tax - holdover relief for gifts*

Shareholders can make a gift of the company's shares and the resultant capital gain can be held-over until the recipient sells the shares. This benefit will not be available after a full listing is obtained unless the individual making the gift owns 5% or more of the company's shares.

- *Inheritance tax*

For inheritance tax purposes, 100% Business Property Relief was available to a shareholder who made a gift of the company's shares, provided that the shares had been held for at least two years prior to the date of the gift. After a full listing is obtained the shares will no longer qualify for this relief.

The directors recommend that shareholders should take professional financial advice before acting on this information, which represents the directors' understanding and advice received at the date of this document.

**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 group at the end of the year and profit and loss of the group for that year. In preparing those financial statements the directors are required to:

- select suitable accounting policies and apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to assume 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 to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud or other irregularities.

By Order of the Board  
C R Eplett



Secretary  
30 July 1997

## REMUNERATION COMMITTEE REPORT

## Policy

The company aims to provide executive directors' remuneration packages commensurate with attracting, retaining and motivating directors of the necessary quality. The company has complied throughout the year with Section A of the best practice provisions annexed to the Listing Rules. In setting its remuneration policy the remuneration committee has given full consideration to Section B of the best practice provisions annexed to the Listing Rules.

## Service contracts

With the exception of P W Townsend and A R Lamont who are not offering themselves for re-election at the AGM, all directors have entered into contracts with the company under the following terms:

- *A S Hill*  
Service contract subject to termination on two year's notice by the company or one year by the director. It provides for a profit share calculated by reference to pre-tax profits and earnings per share.
- *G B Richardson*  
Service contract for an initial two year fixed term commenced on 23 May 1997, thereafter terminable by one year's notice by the company or the director. It provides for a performance bonus of up to 30% of annual gross salary based on company performance.
- *C Purtell*  
Service contract subject to termination on two year's notice by the company or six months by the director. In the event of a change in control of the company, the contract provides for an increase in the period of notice by the company of one year. It also provides for a performance bonus of up to 30% of annual gross salary based on company performance.
- *C R Eplett*  
Service contract subject to termination on one year's notice by the company or six months by the director. In the event of a change in control of the company, the contract provides for an increase in the period of notice by the company of one year. It also provides for a performance bonus of up to 30% of annual gross salary based on company performance.
- *I G Cottle and R A Lo*  
Non-executive directors have fixed term service contracts under which they do not participate in any of the company's bonus, share option or other incentive schemes.

## Directors' remuneration

An analysis of the directors' emoluments is set out below:

	Salary and fees £'000	Benefits £'000	Pension £'000	Bonus £'000	1997 £'000	1996 £'000
Executive directors						
C R Eplett	49	1	6	31	87	55
A S Hill	75	4	16	35	130	79
C Purtell	46	4	11	15	76	62
G B Richardson	-	-	-	-	-	-
Non-executive directors						
I G Cottle	7	-	-	-	7	7
W F Hannon	-	-	-	-	-	2
A R Lamont	10	-	-	-	10	10
R A Lo	8	-	-	-	8	8
P W Townsend	15	-	-	-	15	14
	210	9	33	81	333	237

- A R Lamont's fees were paid to Crown Management Systems Limited, a company of which he is a director and major shareholder.
- R A Lo's fees were paid to Johnson Fry Corporate Finance Limited, a company of which he is a director.

**Non-executive directors** The remuneration of non-executive directors is set by the executive directors and consists of fees for their services in connection with the board and committee meetings.

**Directors' interests** The interests of the directors as at 31 May 1997 in the share capital of the company at that date, were:

<i>£1 Ordinary shares</i>	<i>Total 1997</i>	<i>Total 1996</i>
I G Cottle	125,736	213,026
C R Eplett	-	-
A S Hill	654,358	772,924
A R Lamont	315,540	519,276
R A Lo	27,171	24,000
C Purtell	56,064	10,000
G B Richardson	238,095	-
P W Townsend	49,339	52,000

**Directors' share options** The company believes that share ownership by executive directors strengthens the link between their personal interests and those of the shareholders. Share options are granted by the remuneration committee to attract, retain and motivate directors and to reflect their performance.

The executive directors who were in office at the year end had the following interests in options at 31 May 1997:

	<i>1996</i>	<i>Granted</i>	<i>Exercised</i>	<i>Lapsed</i>	<i>1997</i>	<i>Average exercise price</i>	<i>Dates exercisable</i>
C R Eplett	30,000	-	-	-	30,000	£1.00	1998-2005
A S Hill	50,000	-	-	-	50,000	£1.00	1998-2005
C Purtell	50,000	-	50,000	-	-	£1.20	-
G B Richardson	-	-	-	-	-	-	-

There have been no changes in the directors' interests in the shares and share options between the financial year end and 30 July 1997. Directors' interests in material contracts are set out in note 24.

The mid-market price of the shares at 31 May 1997 was 500p and the range during the year was 236p to 510p.

**Proposed 1997 share option scheme**

The company has had a discretionary share option scheme since 1987. Options cannot be granted under the scheme after this year so the remuneration committee proposes to introduce a new scheme which reflects changes in tax legislation. The scheme, which will be called the SFI Group plc 1997 Share Option Scheme, will comprise two sections. Inland Revenue approval will be sought for one and the other will permit the remuneration committee to grant options valued at more than £30,000 to an individual director or employee. The terms of the scheme are summarised below and, unless prohibited by the tax legislation, the provisions apply to both sections.

■ *Eligibility*

The participants in the scheme must be employees or full time directors of the company (or any subsidiary company) nominated by the company to participate.

■ *Grant of options*

Options will be granted at a price equal to the average middle-market quotation of the ordinary shares for the three dealing days prior to the date on which the remuneration committee issues an invitation to participants. The options may not be transferred or assigned.

Proposed 1997 share  
option scheme  
(continued)

- *Maximum grant*  
The maximum amount which a participant can subscribe for shares, pursuant to options under the approved section, at any time is £30,000. For these purposes options granted under the 1987 Scheme will be taken into account.
- *Performance criteria*  
Options will only be exercisable on satisfaction of a performance criterion. Reflecting ABI guidelines this requires the achievement of earnings per share growth over a three year period from the date of grant of 3% per annum above inflation as measured by the RPI.
- *Exercise of options*  
Normally an option may be exercised not less than three years, nor more than ten years, after the date of grant.
- *Rights attaching to shares*  
Shares issued under the scheme will rank pari passu in all respects with the issued ordinary shares of the company except that any shares issued between the date of announcement of a proposed dividend and the relevant record date will be without entitlements to participate in that dividend.
- *Rights on take-over or liquidation*  
In the event of a take-over or liquidation of the company, a participant will have the right to exercise his options immediately in full, or, if an acquiring company agrees, to exchange his options for options in the acquiring company.
- *Limitations*  
The following limitations apply to the number of shares which may be issued under the scheme:
  1. In any three year period, not more than 3% of the Company's issued ordinary share capital from time to time may in aggregate be issued or issuable under the scheme or any other selective employee shares adopted by the company,
  2. In any five year period, not more than 5% of the Company's issued ordinary share capital from time to time may in aggregate be issued or issuable under the scheme and any other employee shares adopted by the company,
  3. In any ten year period, not more than 5% of the Company's issued ordinary share capital from time to time may in aggregate be issued or issuable under the scheme and any other selective employee shares adopted by the company, and
  4. In any ten year period, not more than 10% of the Company's issued ordinary share capital from time to time may in aggregate be issued or issuable under the scheme and any other employee shares adopted by the company,

For the purposes of the above limits, options which lapse or are released without being exercised cease to count and options granted previously under the 1987 scheme will be disregarded.
- *Alterations*  
No alterations may be made to the scheme if it would prejudice its approval by the Inland Revenue. In addition, no alteration may be made to the advantage of participants without the prior approval of the shareholders unless it is a minor amendment to benefit the administration of the Scheme or to take account of a change in legislation.
- *Remuneration Committee*  
Any Board action will take into consideration the advice or recommendations that it may receive from the remuneration committee.
- *Life of the Scheme*  
No option will be granted more than ten years after the date on which the scheme is adopted unless the scheme is renewed by the shareholders in general meeting.

P W Townsend  
Chairman, Remuneration Committee  
30 July 1997



*Financial statements***To the members of Surrey Free Inns plc**

We have audited the financial statements on pages 16 to 31 which have been prepared under the accounting policies set out on pages 20 and 21. We have also examined the amounts disclosed relating to the share options of the directors on page 13.

**Respective responsibilities of directors and auditors**

As described in the directors' report the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial 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 and the group'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 of 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 the 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 the group as at 31 May 1997 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Clark Whitehill  
Chartered Accountants and Registered Auditors

London  
30 July 1997

*Corporate Governance matters*

In addition to our audit of the financial statements, we have reviewed the directors' statements on page 9 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of the company's system of internal control or its corporate governance procedures nor on the ability of the company to continue in operational existence.

**Opinion**

With respect to the directors' statements on internal financial control and going concern on page 9, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statements on page 9 appropriately reflects the company's compliance with the other paragraphs of the Code as specified for our review by Listing Rule 12.43(j).



Clark Whitehill  
Chartered Accountants and Registered Auditors

London  
30 July 1997

## GROUP PROFIT AND LOSS ACCOUNT

for the year ended 31 May 1997

	Notes	1997 £'000	1996 £'000
TURNOVER	1	16,398	12,612
Operating costs	2	(13,472)	(10,848)
OPERATING PROFIT		2,926	1,764
Interest payable and similar charges	3	(635)	(579)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	5	2,291	1,185
Taxation	6	(138)	-
PROFIT FOR THE YEAR ATTRIBUTABLE TO MEMBERS	7	2,153	1,185
Dividends	8	(382)	(240)
RETAINED PROFIT FOR THE YEAR		1,771	945
Earnings per share	9	pence 18.8p	pence 11.6p

The profit and loss account contains all gains and losses recognised in the current and preceding period.

# **BALANCE SHEETS**

As at 31 May 1997

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			Group		Company	
		Notes	1997	1996*	1997	1996*
			£'000	£'000	£'000	£'000
Fixed assets	Tangible assets	10	37,709	22,197	37,670	21,668
	Investments	12	-	-	581	1,655
Current assets			<u>37,709</u>	<u>22,197</u>	<u>38,251</u>	<u>23,323</u>
	Stocks	13	739	486	733	477
	Debtors	14	857	717	857	704
	Cash at bank and in hand		427	294	420	294
			<u>2,023</u>	<u>1,497</u>	<u>2,010</u>	<u>1,475</u>
	CREDITORS: amounts falling due within one year	15	(4,761)	(3,587)	(4,980)	(4,343)
	NET CURRENT LIABILITIES		<u>(2,738)</u>	<u>(2,090)</u>	<u>(2,970)</u>	<u>(2,868)</u>
	TOTAL ASSETS LESS CURRENT LIABILITIES		34,971	20,107	35,281	20,455
Other liabilities	CREDITORS: amounts falling due after more than one year	16	(9,350)	(7,681)	(9,350)	(7,456)
Net assets	Provisions for liabilities and charges	19	(60)	-	(60)	-
Capital and reserves			<u>25,561</u>	<u>12,426</u>	<u>25,871</u>	<u>12,999</u>
	Attributable to equity interests					
	Called up share capital	20	14,735	10,589	14,735	10,589
	Share premium account	21	10,475	357	10,475	357
	Capital reserve	21	-	17	-	626
	Profit and loss account	21	351	963	661	927
			<u>25,561</u>	<u>11,926</u>	<u>25,871</u>	<u>12,499</u>
	Attributable to non-equity interests					
	Called up share capital	20	-	500	-	500
	Shareholders' funds		<u>25,561</u>	<u>12,426</u>	<u>25,871</u>	<u>12,999</u>

The financial statements on pages 16 to 31 were approved by the Board of Directors on 30 July 1997 and were signed on its behalf by A S Hill and C R Eplett.

\* As restated



**GROUP CASH FLOW STATEMENT**  
for the year ended 31 May 1997

		Note	1997		1996	
			£'000	£'000	£'000	£'000
	Cash inflow from operating activities	A		3,958		1,689
Returns on investments and servicing of finance	Bank interest paid		(664)		(597)	
	Interest capitalised		29		21	
	Interest element of hire purchase payments		-		(3)	
				(635)		(579)
Taxation	UK advance corporation tax paid			(55)		(45)
Capital expenditure	Purchase of tangible fixed assets		(6,989)		(2,900)	
	Sale of tangible fixed assets		-		176	
				(6,989)		(2,724)
Acquisitions	Purchase of subsidiary undertakings		(11,350)		-	
	Purchase of minority interest		-		(348)	
				(11,350)		(348)
Equity dividends paid	Dividends			(242)		(202)
	Net cash (outflow) before financing			(15,313)		(2,209)
Financing	Issue of ordinary shares		13,721		766	
	Medium term loan repayments		(375)		(375)	
	New medium term loans		2,019		1,175	
	Principal payments under hire purchase agreements		(5)		(60)	
	Net cash inflow from financing			15,360		1,506
	Increase/(decrease) in cash	B		47		(703)

# NOTES TO THE GROUP CASH FLOW STATEMENT

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for the year ended 31 May 1997

		1997 £'000	1996 £'000
<b>A. Reconciliation of operating profit to operating cash flow</b>	Operating profit	2,926	1,764
	Depreciation of tangible fixed assets	487	363
	Loss on sales of fixed assets	-	3
	Increase in stocks	(253)	(87)
	Increase in debtors	(56)	(37)
	Increase/(decrease) in creditors	854	(317)
	<b>Net cash inflow from operating activities</b>	<b>3,958</b>	<b>1,689</b>

	At 1 June 1996 £'000	Cash flow £'000	Other non- cash changes £'000	At 31 May 1997 £'000
<b>B. Analysis of net debt</b>				
Cash in hand and at bank	294	133	-	427
Overdrafts	(1,643)	(86)	-	(1,729)
	(1,349)	47	-	(1,302)
Bank loans due within one year	(400)	375	(350)	(375)
Bank loans due after one year	(7,681)	(2,019)	350	(9,350)
Finance leases	(5)	5	-	-
	<b>(9,435)</b>	<b>(1,592)</b>	<b>-</b>	<b>(11,027)</b>

## ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable Accounting Standards and under the historical cost convention.

**Consolidation**

The consolidated financial statements include the company and all its subsidiary undertakings. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the date of their acquisition or up to the date of their disposal. Intra-group sales, profits and balances are eliminated fully on consolidation.

**Goodwill**

Goodwill arising on the acquisition of subsidiary undertakings is written off immediately against reserves.

**Valuation of properties and prior year adjustment**

Up to 31 May 1996, the values of freehold and leasehold properties were reviewed regularly and, if considered appropriate, valuations were performed and incorporated into the financial statements. These valuations were carried out by independent professional valuers, or by the directors based on independent advice. If the valuation was in excess of the original cost or previous revaluation, the surplus was credited to a revaluation reserve. A permanent deficit on valuation of a particular asset was charged to profit before tax to the extent that it was not covered by surpluses arising on prior revaluations, which were previously credited to the revaluation reserve. A temporary deficit on valuation of a particular asset was debited to the revaluation reserve, to the extent of the credits on that reserve looked at on a portfolio basis. Any excess was charged to the profit and loss account.

The directors have decided to change this accounting policy to one which the board considers is more prudent. All properties are now stated at historic cost less provisions for permanent diminution in value as determined by the directors. All such provisions are charged to the profit and loss account at the time they are recognised.

This change in accounting policy has given rise to a prior year adjustment to the financial statements and comparative figures have been restated where appropriate. The change in accounting policy had no material effect on the group's profit before taxation in either the current or preceding year.

**Fixed assets and depreciation**

Subject to the foregoing, no depreciation is charged on freehold land and buildings and long leasehold property because the directors consider that expenditure on refurbishment and maintenance keeps the residual value at a level such that any depreciation charge would not be significant. The directors' assessment of residual values is based on prices prevailing at the time of acquisition or subsequent reassessment.

Depreciation is calculated so as to write off the cost of other tangible fixed assets less their estimated residual values on a straight line basis over the expected useful economic lives of the assets concerned. The principal annual rates used for this purpose are:

Short leasehold property	over the unexpired term of the lease
Fixtures and fittings	between 8% and 20%
Equipment	20%
Computers	33%
Motor vehicles	25%

Attributable pre-opening costs (including interest) incurred in the course of major refurbishment or construction are capitalised. Launch marketing, advertising and promotion costs for these developments are written-off over the three months following the opening.

<b>Leasing and hire purchase</b>	<p>Assets acquired under finance leases and hire purchase contracts are included in tangible fixed assets and the obligations to pay future instalments are included in creditors. The total finance charge under finance leases and hire purchase contracts is allocated to accounting years during the contract term so as to produce a constant yearly rate of charge on the remaining balance of the obligation.</p> <p>Operating lease rentals are charged to the profit and loss account on a straight line basis over the term of the lease.</p>
<b>Stocks</b>	<p>Stocks are stated at the lower of cost and net realisable value.</p>
<b>Turnover</b>	<p>Turnover represents the total amounts receivable for goods and services provided, after deducting VAT and excluding sales between group companies.</p>
<b>Deferred taxation</b>	<p>Provision is made for deferred taxation using the liability method where it is considered likely that a liability will arise in the foreseeable future.</p>
<b>Pension costs</b>	<p>The group operates a defined contribution pension scheme. The pension cost charged to the profit and loss account represents the contributions payable to the pension scheme in respect of the accounting year.</p>



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997

## 1. Turnover

Turnover is derived from the principal activity of the group and arises wholly from public houses, restaurants and hotels located in the United Kingdom.

## 2. Operating costs

Cost of goods sold

Staff costs

Depreciation of tangible fixed assets

Loss on asset sales

Other operating charges

1997

£'000

4,800

4,002

487

-

4,183

13,472

1996

£'000

3,837

3,247

363

3

3,398

10,848

## 3. Operating profit

Operating profit is stated after charging:

Auditors' remuneration

Parent company

Subsidiary undertakings

Operating lease rentals

Plant and machinery

Leasehold properties

1997

£'000

28

-

5

681

1996

£'000

24

2

5

553

Fees paid to auditors for non-audit related work amounted to £22,000 (1996:£18,000). In addition, £30,000 was incurred in respect of the acquisition of the Richardsons Inns businesses.

## 4. Directors and employees

Fees

Other emoluments (including pension contributions)

1997

£'000

293

40

333

1996

£'000

41

196

237

Full details of directors' emoluments are given in the report of the remuneration committee on pages 12 to 14.

Wages and salaries

Social security costs

Pension costs

Total direct costs of employment

1997

£'000

3,671

245

86

4,002

1996

£'000

2,988

199

60

3,247

The average weekly number of persons employed by the group (including executive directors) during the year was:

Public house management and staff

Administration

1997

585

19

604

1996

459

16

475

# NOTES TO THE FINANCIAL STATEMENTS

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for the year ended 31 May 1997 (continued)

		1997 £'000	1996 £'000
5.	Interest payable		
	Interest payable on:		
	Bank loans and overdrafts	92	65
	Bank loans repayable within 5 years not by instalments	47	408
	Bank loans repayable by instalments within 5 years	70	124
	Bank loans repayable by instalments in more than 5 years	455	-
	Hire purchase agreements	-	3
		<u>664</u>	<u>600</u>
	Interest capitalised (cumulatively £52,000)	(29)	(21)
		<u>635</u>	<u>579</u>

		1997 £'000	1996 £'000
6.	Taxation		
	UK corporation tax	138	-

There was no current corporation tax charge in 1996 principally as a result of the tax allowances arising from capital expenditure.

7.	Profit for the year attributable to members	As permitted by section 230 of the Companies Act 1985, the company has not presented its profit and loss account. The group results include a profit for the year of £1,890,000 (1996:£1,196,000) which has been dealt with in the financial statements of the company.	
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		1997 £'000	1996 £'000
	Dealt with in the accounts of the parent company	2,143	1,196
	Retained by subsidiary undertakings	10	(11)
		<u>2,153</u>	<u>1,185</u>

		1997 £'000	1996 £'000
8.	Dividends		
	Interim of 1.25p net per share paid in April 1997 (1996: 1.0p)	146	101
	Proposed final of 1.6p net per share payable in November 1997 (1996: 1.25p)	236	139
		<u>382</u>	<u>240</u>

9.	Earnings per share	Earnings per share have been calculated under the net basis on earnings of £2,153,000 (1996:£1,185,000) and on 11,471,000 shares (1996: 10,229,000) being the weighted average number of ordinary shares in issue and ranking for dividends during the year.	
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The exercise of the outstanding share options would not have had a material effect on the group's reported earnings per share.

## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997 (continued)

Group	Freehold land and buildings	Long leasehold property	Short leasehold property	Plant and vehicles	Total
	£'000	£'000	£'000	£'000	£'000
<b>10. Tangible fixed assets</b>					
<b>COST</b>					
At 1 June 1996	13,123	8,141	1,136	4,026	26,426
Prior year adjustment	(2,172)	(216)	-	-	(2,388)
As restated	10,951	7,925	1,136	4,026	24,038
Acquisition of subsidiary undertakings	3,000	2,530	680	2,800	9,010
Other additions	1,151	3,389	16	2,433	6,989
<b>At 31 May 1997</b>	<b>15,102</b>	<b>13,844</b>	<b>1,832</b>	<b>9,259</b>	<b>40,037</b>
<b>DEPRECIATION</b>					
At 1 June 1996	-	-	146	1,695	1,841
Prior year adjustment	-	-	-	-	-
As restated	-	-	146	1,695	1,841
Provided	-	-	26	461	487
<b>At 31 May 1997</b>	<b>-</b>	<b>-</b>	<b>172</b>	<b>2,156</b>	<b>2,328</b>
<b>NET BOOK VALUE</b>					
At 31 May 1997	15,102	13,844	1,660	7,103	37,709
At 31 May 1996	13,123	8,141	990	2,331	24,585
Prior year adjustment	(2,172)	(216)	-	-	(2,388)
As restated	10,951	7,925	990	2,331	22,197

On 21 May 1997, the company acquired the business and certain assets of Richardsons Inns, which consisted of six pubs and a café bar, together with a café bar business and certain assets from Highnoon Limited. The assets acquired as a result of these transactions are shown above at their fair value of £9,010,000. The cost of these acquisitions was £11.35 million which was funded by a subscription, placing and open offer of shares. Goodwill arising on these acquisitions of £2.4 million has been offset against reserves.

Further consideration of up to £450,000 may become payable to Highnoon Limited, dependent on the level of profits generated during the year to May 1998 by the outlet acquired from that company.

Additions to freeholds and leaseholds above include £103,000 (1996: £74,000) of capitalised pre-opening costs, including interest.

Long leasehold properties include The Farmhouse which is the subject of a legal mortgage held by National Westminster Bank plc.

## NOTES TO THE FINANCIAL STATEMENTS

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for the year ended 31 May 1997 (continued)

	Company	Freehold land and buildings £'000	Long leasehold property £'000	Short leasehold property £'000	Plant and vehicles £'000	Total £'000
10. Tangible fixed assets (continued)	COST					
	At 1 June 1996	12,741	8,141	1,089	3,852	25,823
	Prior year adjustment	(2,212)	(216)	-	-	(2,428)
	As restated	10,529	7,925	1,089	3,852	23,395
	Acquisition of subsidiary undertakings	3,000	2,530	680	2,800	9,010
	Other additions	1,151	3,389	16	2,433	6,989
	Transfers	422	-	20	143	585
	At 31 May 1997	15,102	13,844	1,805	9,228	39,979
	DEPRECIATION					
	At 1 June 1996	-	-	125	1,602	1,727
	Prior year adjustment	-	-	-	-	-
	As restated	-	-	125	1,602	1,727
	Provided	-	-	26	458	484
	Transfers	-	-	21	77	98
	At 31 May 1997	-	-	172	2,137	2,309
	NET BOOK VALUE					
	At 31 May 1997	15,102	13,844	1,633	7,091	37,670
	At 31 May 1996	12,741	8,141	964	2,250	24,096
	Prior year adjustment	(2,212)	(216)	-	-	(2,428)
	As restated	10,529	7,925	964	2,250	21,668

## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997 (continued)

		1997 £'000	1996 £'000
11. Capital commitments	Authorised but not contracted for	<u>10,000</u>	<u>2,690</u>
	Contracted for but not incurred	<u>2,400</u>	<u>275</u>
12. Investment in subsidiaries	Company		£'000
	At 1 June 1996, at cost		1,655
	Adjustments to net asset value		(1,074)
	At 31 May 1997, at cost		<u>581</u>

At 31 May 1997 the principal operating subsidiary was Arun Inns Limited which also operates public houses.

		Group		Company	
		1997 £'000	1996 £'000	1997 £'000	1996 £'000
13. Stocks	Goods held for resale	<u>317</u>	<u>190</u>	<u>313</u>	<u>183</u>
	Base stocks	<u>422</u>	<u>296</u>	<u>420</u>	<u>294</u>
		<u>739</u>	<u>486</u>	<u>733</u>	<u>477</u>
14. Debtors	Amounts falling due within one year:				
	Trade debtors	<u>391</u>	<u>195</u>	<u>391</u>	<u>195</u>
	UK corporation tax recoverable	<u>13</u>	<u>13</u>	<u>13</u>	<u>13</u>
	Advance corporation tax	<u>138</u>	<u>-</u>	<u>138</u>	<u>-</u>
	Prepayments and accrued income	<u>264</u>	<u>404</u>	<u>264</u>	<u>391</u>
		<u>806</u>	<u>612</u>	<u>806</u>	<u>599</u>
	Amounts falling due in more than one year:				
	Advance corporation tax	<u>51</u>	<u>105</u>	<u>51</u>	<u>105</u>
		<u>857</u>	<u>717</u>	<u>857</u>	<u>704</u>

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997 (continued)

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		Group		Company	
		1997	1996	1997	1996
		£'000	£'000	£'000	£'000
15. Creditors: amounts falling due within one year	Bank loans and overdrafts	2,104	2,043	2,104	1,943
	Trade creditors	645	552	645	552
	Corporation tax	227	60	227	60
	Taxation and social security costs	287	29	287	29
	Dividends	236	139	236	139
	Amounts owed to group undertakings	-	-	221	879
	Other creditors (including capital items)	786	508	786	508
	Accruals and deferred income	476	251	474	228
	Hire purchase obligations	-	5	-	5
		<u>4,761</u>	<u>3,587</u>	<u>4,980</u>	<u>4,343</u>
		Group		Company	
		1997	1996	1997	1996
		£'000	£'000	£'000	£'000
16. Creditors: amounts falling due after more than one year	Bank loans	9,350	7,681	9,350	7,456

## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997 (continued)

		Group		Company	
		1997	1996	1997	1996
		£'000	£'000	£'000	£'000
17. Total borrowings	Bank overdrafts (secured)	1,729	1,643	1,729	1,543
	Bank loans (secured)	9,725	8,081	9,725	7,856
	Hire purchase liability	-	5	-	5
		<u>11,454</u>	<u>9,729</u>	<u>11,454</u>	<u>9,404</u>
	Repayable as follows:				
	In one year or less	2,104	2,048	2,104	1,948
	Between one and two years	375	400	375	400
	Between two and five years	1,125	7,281	1,125	7,056
	After five years	7850	-	7850	-
		<u>11,454</u>	<u>9,729</u>	<u>11,454</u>	<u>9,404</u>

During the year the company negotiated new bank facilities with Barclays Bank plc in order to provide the funding necessary for the future development of new public houses. At 31 May 1997 loans of £6,275,000 remained with National Westminster Bank plc under LIBOR interest arrangements that expire in January 1998. On expiry, the loans with NatWest will be transferred to Barclays.

The bank loans and overdrafts are secured by fixed and floating charges on all of the assets of the group. Interest is charged at 1% above LIBOR. Loans are repayable by quarterly instalments of £93,750.

18. Deferred Taxation No provision for deferred taxation has been made (1996 £nil). An analysis of the amounts of potential deferred taxation is as follows:

	Group		Company	
	1997	1996	1997	1996
	£'000	£'000	£'000	£'000
Tax effect of timing differences arising from the excess of tax allowances over depreciation	<u>1,075</u>	<u>54</u>	<u>1,075</u>	<u>61</u>

The group and the company have a potential liability of £243,000 (1996: £200,000) in respect of chargeable gains rolled over, net of capital losses.



# NOTES TO THE FINANCIAL STATEMENTS

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for the year ended 31 May 1997 (continued)

		1997 £'000
19. Provisions for liabilities and charges	Refurbishment provision made during the year	60

		Authorised		Allotted, called-up and fully paid	
		1997 £'000	1996 £'000	1997 £'000	1996 £'000
20. Share capital	Attributable to equity interests:				
	£1 ordinary shares	18,500	13,500	14,735	10,589
	Attributable to non-equity interests:				
	£1 convertible preference shares	-	500	-	500
		<u>18,500</u>	<u>14,000</u>	<u>14,735</u>	<u>11,089</u>

- In July 1996 the preference shares were converted to ordinary shares.
- In October 1996 500,000 £1 ordinary shares were issued at £3.20 for a cash consideration of £1.6 million, giving rise to a share premium of £1.1 million.
- In December 1996 31,250 £1 ordinary shares were issued at the same price as part of the consideration for a property acquisition, giving rise to a share premium of £69,000.
- In May 1997 3,000,000 £1 ordinary shares were issued to fund the acquisition of Richardsons Inns at a price of £4.20 giving rise to a share premium, after expenses of £9 million.
- At various times during the year 103,500 shares were issued under the executive share option scheme.
- 11,173 shares were issued under the company's scrip dividend scheme.

Options have been granted for the following number of £1 ordinary shares:

	Exercisable between		
	1997- 1998	1997- 2000	1998- 2005
Subscription price per share	£1.00	£1.50	£1.00
At 1 June 1996	99,500	36,000	184,500
Lapsed during the year	(2,000)	-	(9,000)
Exercised	(72,500)	(31,000)	-
At 31 May 1997	<u>25,000</u>	<u>5,000</u>	<u>175,500</u>

No options were granted during the year.

**NOTES TO THE FINANCIAL STATEMENTS**  
for the year ended 31 May 1997 (continued)

**21. Reserves**

	Share premium	Capital reserve	Re- valuation reserve	Profit and loss account
	£'000	£'000	£'000	£'000
<b>Group</b>				
At 1 June 1996	357	17	1,171	2,180
Prior year adjustment	-	-	(1,171)	(1,217)
As restated	357	17	-	963
Retained profit for the year	-	-	-	1,771
Goodwill written-off	-	-	-	(2,400)
Transfer	-	(17)	-	17
Issue of shares (net of expenses)	10,118	-	-	-
<b>At 31 May 1997</b>	<b>10,475</b>	<b>-</b>	<b>-</b>	<b>351</b>
<b>Company</b>				
At 1 June 1996	357	626	1,415	1,940
Prior year adjustment	-	-	(1,415)	(1,013)
As restated	357	626	-	927
Retained profit for the year	-	-	-	1,508
Goodwill written-off	-	-	-	(2,400)
Transfer	-	(626)	-	626
Issue of shares (net of expenses)	10,118	-	-	-
<b>At 31 May 1997</b>	<b>10,475</b>	<b>-</b>	<b>-</b>	<b>661</b>

With the exception of the profit and loss account all the above reserves are non-distributable.

The cumulative amount of goodwill offset against consolidated reserves amounts to £2,662,000 (1996:£262,000).

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 May 1997 (continued)

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		1997 £'000	1996 £'000
22. Movement in shareholders' funds	Issue of ordinary shares	13,764	766
	Retained profit for the year attributable to shareholders	1,771	945
	Goodwill written off	(2,400)	(279)
	Net additions/(reductions) to shareholders' funds	13,135	1,432
	Opening shareholders' funds	12,426	13,382
	Prior year adjustment	-	(2,388)
	As restated	12,426	10,994
	Closing shareholders' funds	25,561	12,426

23. Substantial shareholdings In addition to the interests of directors the following have notified the company as being interested in 3% or more of the company's issued ordinary share capital as at 30 July 1997.

Shareholder:	% held
Regent Inns plc	6.0
Prudential Corporation	4.9

24. Related party transactions G B Richardson was a partner in Richardsons Inns and, together with members of his family, owned the majority of the shares in Highnoon Limited at the time of the transactions described in note 10. He became a director of the company only on completion of these transactions.

During the year the company continued its implementation of electronic point of sale (EPoS) systems acquired from Crown Management Systems Limited, a company of which A R Lamont is a director and major shareholder. Transactions to the value of £185,000 (1996:£84,000) were made under normal commercial, arms length terms.

25. Lease commitments The group has financial commitments in respect of non-cancellable operating leases of plant and vehicles and land and buildings. The annual rentals payable under these leases are:

	Group		Company	
	1997 £'000	1996 £'000	1997 £'000	1996 £'000
Plant and vehicles				
Date of lease expiration:				
In second to fifth years inclusive	13	13	13	13
Land and buildings				
Date of lease expiration:				
After five years	1,333	651	1,333	651

## FIVE YEAR FINANCIAL SUMMARY

		1997	1996	1995	1994	1993
		£'000	£'000	£'000	£'000	£'000
Profit and loss	Turnover	16,398	12,612	11,503	10,680	11,111
	Operating profit before exceptional items	2,926	1,764	1,500	1,167	1,111
	Exceptional items	-	-	(17)	-	-
	Operating profit	2,926	1,764	1,483	1,167	1,111
	Interest payable	(635)	(579)	(670)	(780)	(1,051)
	Profit before taxation and minority interest	2,291	1,185	813	387	111
	Taxation	(138)	-	-	-	-
	Minority interest	-	-	34	29	-
	Profit after taxation	2,153	1,185	847	416	111
	Dividends	(382)	(240)	(182)	-	-
	Retained profits	1,771	945	665	416	111
Balance sheet	Tangible fixed assets	37,709	22,197	19,526	19,791	19,791
	<i>of which, new investment was</i>	15,999	3,333	1,181	360	38
	Other items	(694)	(41)	(326)	(463)	(36)
	Total capital employed	37,015	22,156	19,200	19,328	19,443
	Borrowings	11,454	9,729	8,205	9,498	10,000
Cash flow	Shareholders funds	25,561	12,427	10,995	9,830	9,443
	Cash flow from operations	3,413	2,127	1,834	1,498	1,500
Ratios	Earnings per share (in pence)	18.8	11.6	8.4	4.1	1.1
	Cash flow per share (in pence)	29.8	20.8	18.2	14.8	15.0
	Return on capital employed (ROCE)	11.7%	8.0%	7.8%	6.0%	6.0%
	Gearing	44.8%	78.3%	74.6%	96.6%	106.0%
	Interest cover (times)	4.6	3.0	2.2	1.5	1.1
	Dividend per share (in pence)	2.85	2.25	1.8	-	-
	Dividend cover (times)	5.6	4.9	4.7	-	-
	Value Added	98	(767)	-	-	-

## Notes

- Balance sheet figures have been restated for each year to reflect the change in accounting policy on revaluation of fixed assets made in 1997.
- Figures for 1993 have been adjusted to remove the effect of the change of financial year end from 31 March to 31 May during that year.
- Other items' comprise net current liabilities other than borrowings less provisions.
- Earnings per share represent the figures as reported under FRS3.
- Cash flow per share is calculated as cash flow from operations, divided by the number of shares used to calculate earnings per share.
- Return on capital employed is calculated as the ratio of operating profit to total capital employed. The 1997 figure has been adjusted to eliminate the financing of Richardsons Inns immediately prior to that year end.
- Gearing is calculated as the ratio of borrowings to shareholders funds.
- Interest cover is calculated as the number of times interest payable is covered by operating profits.
- Dividend cover is calculated as the number of times the dividends payable are covered by profit after taxation and minority interest.
- Value added is calculated as the excess percentage of ROCE over the company's weighted average cost of capital multiplied by the capital employed.

Financial calendar	Financial year end	31 May 1997
	Annual General Meeting	26 August 1997
	Ex-dividend date for final dividend	22 September 1996
	Closure of share register for final dividend	26 September 1997
	Payment of final dividend	29 November 1996
	Interim results period end	16 November 1996
	Announcement of interim results	15 January 1998*
	Ex-dividend date for interim dividend	16 February 1997*
	Closure of share register for interim dividend	20 February 1997*
	Payment of interim dividend	30 April 1997*
	Financial year end	31 May 1998
	Announcement of full year's results	27 August 1998*

*\* denotes provisional dates*

**Annual reports** Further copies of this annual report are available from the Company Secretary, at the Registered Office. Copies can also be obtained from the Financial Times' annual report service. For details see the London share service pages of the Financial Times.

**Share price information** The company's share price is quoted in both The Times and Financial Times each day. More regularly updated information is available from the Financial Times Cityline premium rate telephone service on 0336 435218.

**Payment of dividends** Shareholders can now elect to have dividends paid directly into a bank account. This payment method avoids the risk of dividend cheques being delayed or lost in the post. Tax vouchers are mailed at the time of the cash transfer.

A mandate form for this purpose can be obtained from the Company Secretary at the Registered Office.

**Scrip dividend** Shareholders can also elect to receive shares in lieu of a cash dividend. Election forms enabling this together with an explanatory note can be similarly obtained.

**CREST** A new computerised system for settling sales and purchases of shares, (CREST), became operational for the company's shares during the year. It is a voluntary system which enables shareholders, if they choose, to hold and transfer shareholdings electronically rather than in paper form. Shareholders wishing to retain their paper certificates will continue to be able to do so.

**Company number** 1946949

## NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the 1997 Annual General Meeting of Surrey Free Inns plc (the Company) will be held at Minster Pavement Café Bar, Mincing Lane, London, EC3 at 11am on 26 August 1997 for the transaction of the following business

**As Ordinary Business**

1. To receive and adopt the Accounts for the period ended 31 May 1997 and the Directors' and Auditors' Reports.
2. To approve a final net dividend of 1.6p per ordinary £1 share.
3. To report the retirement of P W Townsend and A R Lamont as directors of the Company.
4. To re-elect R A Lo who retires by rotation as a director in accordance with Article 121 of the Company's Articles of Association.
5. To re-elect C Purtell who retires by rotation as a director in accordance with Article 121 of the Company's Articles of Association.
6. To reappoint Clark Whitehill, Chartered Accountants, as Auditors of the Company in accordance with Section 385 of the Companies Act 1985, to hold office from the conclusion of the 1997 Annual General Meeting until the conclusion of the next General Meeting at which accounts are laid before the members.
7. To authorise the directors to fix the remuneration of the Auditors.
8. To elect G B Richardson as a director who, having been appointed as a director by the Board during the year, retires in accordance with Article 128 of the Company's existing Articles of Association.

**As Special Business**

To consider and, if thought fit, pass the following resolutions as Ordinary and Special Resolutions respectively:

***Ordinary resolutions***

9. That the ordinary shares of £1 each in the capital of the Company be sub-divided into ordinary shares of 25p each, and the Directors be hereby authorised to cancel existing share certificate and to issue new certificates for four 25p ordinary shares for each £1 share held.
10. That the Directors be and are hereby generally and unconditionally authorised to exercise all powers of the Company to allot relevant securities (as defined for the purposes of Section 80 of the Companies Act 1985 (the "Act")) up to an aggregate nominal amount of £736,750 (this authority to be in substitution for all existing authorities pursuant to Section 80 of the Act), provided that this authority shall expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution (or, if earlier, on the date that is fifteen months following the date of such passing) save that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.
11. That the Company hereby approves and adopts the Rules of the 1997 Share Option Scheme (the main features of which are summarised in the Report of the Remuneration Committee) and that the directors be and are hereby authorised to do all such acts and things necessary to establish the 1997 Share Option Scheme and carry it into effect and to make such modifications and alterations to Section A of the Scheme as may be necessary to obtain approval of the Commissioners of the Inland Revenue pursuant to the provisions of Schedule 9 to the Income and Corporation Taxes Act 1988.

***Special resolutions***

12. That the 60 Deferred Shares of £1 each in the capital of the Company be and are hereby reclassified as 60 ordinary shares of £1 each in the capital of the Company, having the same rights and obligations as the existing issued ordinary shares of the Company, and that the rights and obligations of such Deferred Shares immediately prior to the time at which the conditions referred to in this resolution are satisfied be and are hereby cancelled and extinguished, and that the 60 ordinary shares of £1 each, upon conversion, be immediately sub-divided into ordinary shares of 25p each.

As Special Business  
(continued)*Special resolutions (continued)*

13. That the Directors be and are hereby empowered to allot equity securities (as defined for the purposes of Section 95 of the Act) for cash pursuant to the authority conferred by resolution 10 as if Section 89(1) of the Act did not apply to any such allotment, this power to be in substitution for all existing powers pursuant to Section 95 of the Act, provided that this power shall be limited to:
- (a) the allotment of equity securities in connection with issues to holders of ordinary shares on a pro rata basis, notwithstanding that by reason of such exclusions of other arrangements as the Directors may deem necessary or appropriate in connection with fractional entitlements or legal or practical problems arising under the laws or requirements of any recognized regulatory body or any stock exchange or otherwise in any overseas territory, the equity securities to be issued are not offered to all such holders in proportion to the number of ordinary shares held by each of them; and
- (b) the allotment (otherwise than pursuant to sub-paragraph (a) of this resolution) of equity securities up to an aggregate nominal amount of £734,234 and shall expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution (or, if earlier, on the date that is fifteen months following the date of such passing), save that the Company may before such expiry make an offer or agreement which would or might require securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such an offer or agreement as if the power conferred hereby had not expired.
14. That the name of the Company be changed to "SFI Group plc".
15. That new Articles of Association (in the form produced to the meeting and initialled by the Chairman for the purposes of identification only), a copy of which has been available for inspection at the registered office of the Company from the date of the Notice of the 1997 Annual General Meeting to the conclusion of the 1997 Annual General Meeting, be adopted in substitution for the existing Articles of Association.
16. That the Directors be and are hereby authorised to offer holders of ordinary shares of the Company the right to elect to receive ordinary shares, credited as fully paid, instead of cash in respect of the whole of any dividend declared or paid during the period from the date of passing this resolution to the beginning of the next Annual General Meeting.

C R Eplett  
SECRETARY  
30 July 1997

Registered office: Headley House  
Headley Road  
Grayscott  
Hindhead  
Surrey  
GU26 6TU

*Note*

*A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him/her. A proxy need not be a member of the Company. A form of proxy follows. The Register of Directors' shareholdings will be available for inspection at the registered office of the Company during usual business hours on any weekday (Saturday and public holidays excluded) from the date of this notice until the date of the meeting. Such items will also be available for inspection at and for 30 minutes prior to the meeting.*



## NEW ARTICLES OF ASSOCIATION SUMMARY

It is proposed that new Articles of Association of the Company be adopted at the Annual General meeting, notice of which is set out on page 34. Your directors consider that the intended transfer of the Company to the Official List provides an opportunity to adopt new Articles of the Company which are in the form commonly adopted by companies whose shares are listed on the Official List. **THE PROPOSED NEW ARTICLES OF ASSOCIATION DO NOT ALTER ANY RIGHTS ATTACHING TO THE EXISTING ORDINARY SHARES OF THE COMPANY.** The principle changes in the new Articles of Association are to reflect the fact that the ordinary shares of the Company may be held and transferred by means of an uncertificated system (including the CREST settlement system) and to comply with the requirements of the London Stock Exchange. The material changes to the existing Articles of Association are summarised below and copies of the new Articles of Association are available for inspection at the registered office of the Company from the date of the Notice of the Annual General Meeting until the close of that meeting. References below to the Articles are to the existing Articles of Association.

- Article 3a which sets out the rights attaching to the preference shares has been deleted as there are no longer any such shares in the capital of the Company.
- Two new provisions have been added to the provisions relating to the share certificates of the Company. The first enables the Company to convert certificated shares into uncertificated shares in such manner as the directors may determine. The second provision requires the Company to enter on its register of members how many shares each member holds in uncertificated form and certificated form respectively.
- The provisions relating to the ability of directors to sell shares over which the Company has a lien and the provisions relating to the sale by the Company of shares which have been forfeited have been amended to provide that the directors may require a member to convert an uncertificated share into certificated form and to keep it held in such form.
- The provisions relating to the allotment of shares at Articles 9-11 inclusive and to the allotment of new shares at Article 55-56 inclusive have been deleted as the powers of the directors to allot shares are granted by the Company in general meeting.
- The provisions relating to the transfer of shares have been amended so the shares may be transferred on an uncertificated settlement system, such as CREST.
- The provisions relating to the directors' discretion to refuse to register any transfer of shares in the Company that are not fully paid shares have been amended so that the discretion is now subject to the proviso that the refusal must not prevent dealings in the shares from taking place on an open and proper basis.
- The provisions relating to the notice period required to propose the appointment of a new director at any general meeting set out in Article 126 have been amended so that the notice period is now not less than 7 nor more than 42 clear days before the meeting rather than the existing notice period of not less than 6 nor more than 48 clear days before meeting.
- The provisions relating to the payment of dividends have been amended to allow payment through an uncertificated settlement system, such as CREST.
- The provisions relating to notices to be given by advertisement by the Company set out in Article 175 have been amended so that such advertisement must appear in at least one leading national daily newspaper published in the United Kingdom as opposed to two leading daily newspapers published in London.
- The provisions at Article 184 relating to the rights attaching to the deferred shares have been deleted as it is proposed that the deferred shares, none of which are issued, be reclassified as ordinary shares in the Company and a resolution to this effect to be put to shareholders of the Company at the Annual General Meeting is set out in the Notice.