Rolls Laval Heat Exchangers Limited

Directors' report and financial statements

Registered number 2902683

31 December 2002

Contents

Directors' report

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

Principal activities

The principal activity of the company was the design, development and manufacture of compact heat exchangers.

Business review and future developments

The results for the year are set out on page 4. The directors do not recommend the payment of a dividend.

The company announced on 2 July 2001 that it was to cease manufacturing on completion of its existing contract. The final heat exchanger was despatched on 15 January 2002.

The joint venture partners have agreed to continue to support the business.

The company recently entered into a 10 year contract with its major customer under which it will provide support services to heat exchangers previously delivered to the customer.

Directors and directors' interests

The directors serving during the year were:

BJ Finan (Chairman)
RD Buxton
SJ Garwood
UH Granstrand
HE Johansson
NM Patel
JD Widung

None of the directors had any beneficial interest in the share capital of the company.

Auditors

KPMG were re-appointed auditors during the year. However, subsequently their business was transferred to a limited liability partnership, KPMG LLP. Accordingly KPMG resigned as auditors on 13 August 2002 and the directors thereupon appointed KPMG LLP to fill the vacancy arising. A resolution for the reappointment of KPMG LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

JR Ashfield
Secretary

Moor Lane
Derby
Derbyshire
DE24 8BJ

18 June 2003

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

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

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

KPMG

2 Cornwall Street
Birmingham
B3 2DL

Independent auditors' report to the members of Rolls Laval Heat Exchangers Limited

We have audited the financial statements on pages 4 to 14.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 2, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

18 June 2003

Profit and loss account
for the year ended 31 December 2002

	Note	Discontinuing operations	
		2002	2001
		£000	£000
Turnover	*1*	**1,985**	6,915
Cost of sales		**(1,462)**	(5,531)
Gross profit		**523**	1,384
Administrative expenses		**(64)**	(577)
Operating profit		**459**	807
Loss on termination of business	*2*	**-**	(2,424)
Profit on sale of fixed assets		**58**	-
Profit/(loss) on ordinary activities before interest		**517**	(1,617)
Interest payable and similar charges	*3*	**(431)**	(1,394)
Profit/(loss) on ordinary activities before taxation	*4*	**86**	(3,011)
Tax on profit/(loss) on ordinary activities	*7*	**-**	2,579
Profit/(loss) for the financial year		**86**	(432)
Retained loss brought forward		**(20,105)**	(19,673)
Retained loss carried forward		**(20,019)**	(20,105)

The notes on pages 6 to 14 form part of these financial statements.

The reconciliation of movements in shareholders' funds is shown in note 16 to the financial statements.

The company has no recognised gains or losses in either the current or preceding year other than those disclosed in the profit and loss account.

There is no difference between the profit/(loss) on ordinary activities before taxation as disclosed in the profit and loss account and the profit/(loss) on an unmodified historical cost basis in either the current or preceding year.

Balance sheet
at 31 December 2002

	Note	2002 £000	2002 £000	2001 £000	2001 £000
Fixed assets					
Tangible assets	8		-		239
Current assets					
Stocks	9	-		127	
Debtors	10	689		739	
Cash at bank and in hand		92		4,052	
		781		4,918	
Creditors: amounts falling due within one year	12	(97)		(23,921)	
Net current assets/(liabilities)			684		(19,003)
Total assets less current liabilities			684		(18,764)
Creditors: amounts falling due after more than one year	13		(20,000)		-
Provisions for liabilities and charges	14		(693)		(1,331)
Net liabilities			(20,009)		(20,095)
Capital and reserves					
Called up share capital	15		10		10
Profit and loss account			(20,019)		(20,105)
Deficit in total equity shareholders' funds	16		(20,009)		(20,095)

These financial statements were approved by the board of directors on 18 June 2003 and were signed on its behalf by:

BJ Finan
Director

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements except as noted below. The company has adopted FRS 19'Deferred tax' in these financial statements. There is no financial impact resulting from this change of policy.

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards on the basis of continuing support from the joint venture parties. The company is dependent on continuing finance being made available to enable it to continue operating and to meet its liabilities as they fall due. Since the year end the company has closed its manufacturing operation in Wolverhampton, but has retained an aftermarket support capability.

Loan facilities from the shareholders at 31 December 2002 were approved up to a level of £20,000,000 and were fully drawn down. The shareholders have confirmed their willingness to continue to provide support to the company for it to be able to pay its debts as they fall due.

Cash flow statement

The company is exempt from the requirement of Financial Reporting Standard No 1 (revised 1996) to prepare a cash flow statement as it is entitled to the filing exemptions as a small company under section 246 of the Companies Act 1985 when filing accounts with the Registrar of Companies.

Turnover

Turnover represents the value of sales and services to customers and is stated after deducting value added tax. Turnover is recognised only upon completion of a discrete segment of an individual contract, usually the completion of an entire heat exchanger.

Pensions

The company is part of two defined benefit pension schemes operated by the Rolls-Royce plc group. The assets of the schemes are held separately from those of the group in independently administered funds. The company is unable to identify its share of the schemes' assets and liabilities. The pension cost represents contributions payable by the company to the schemes. Details of the schemes are set out in the Rolls-Royce plc group financial statements.

Tangible fixed assets

All tangible fixed assets are depreciated on a straight line basis so as to write off the original cost, less the estimated residual value, of each asset over its expected useful life, as follows:

Leasehold improvement	10 years
Fixtures and fittings	10 years
Plant and machinery	3-10 years

Stocks

Stocks are stated at the lower of cost incurred in bringing each product to its present location and condition and net realisable value. Work in progress is valued based upon the cost of direct materials and labour plus attributable overheads on a normal level of activity.

Notes *(continued)*

1 Accounting policies *(continued)*

Long term contracts

Profit on long term contracts is taken as the work is carried out if the final outcome can be assessed with reasonable certainty. The profit included is calculated on a prudent basis to reflect the proportion of the work carried out at the year end, by recording turnover and related costs (as defined in "Stocks" above) as contract activity progresses. Turnover recognition is detailed on page 6 of the financial statements. Revenues derived from variations on contracts are recognised only when they have been accepted by the customer. Full provision is made for losses on all contracts in the year in which they are first foreseen.

Payments on account in excess of work in progress net of foreseeable losses are included in creditors.

Taxation

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

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction or at the contracted rate if the transaction is covered by a forward exchange contract. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date or, if appropriate, at the forward contract rate, and the gains and losses on translation are included in the profit and loss account.

Operating leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the life of the lease.

Government grants

Capital based government grants are included within accruals and deferred income in the balance sheet and credited to operating profit over the estimated useful economic lives of the assets to which they relate.

Revenue based government grants are credited to the profit and loss account so as to match them with the expenditure towards which they are intended to contribute.

Where a grant includes both capital and revenue components, the grant is credited to the profit and loss account over an appropriate period, to reflect the relative weightings of those components.

Research and development

Expenditure on research and development is written off in the year in which it is incurred.

Notes *(continued)*

2 Loss on termination of the business

On 2 July 2001, the company announced that it was to cease manufacturing on completion of its existing contract. At 31 December 2001, the final heat exchanger was virtually complete and was subsequently despatched on 15 January 2002. An amount of £2,424,000 relating to termination costs, including asset write downs, was included in the financial statements for 2001.

3 Interest payable and similar charges

	2002	2001
	£000	£000
Amounts payable on bank loans and overdrafts	**225**	692
Amounts payable on other loans	**206**	702
	431	1,394

4 Profit/(loss) on ordinary activities before taxation

The profit/(loss) on ordinary activities before taxation is stated after charging/(crediting) the following:

	2002	2001
	£000	£000
Development costs (current year expenditure)	-	1
Depreciation of owned tangible assets	-	314
Auditors' remuneration - audit work	**10**	19
Payments under operating leases:		
Other assets	-	84
Government grants	-	(96)

5 Staff numbers and costs

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

	2002	2001
	Number	Number
Technical/production	-	24
Administration	**2**	17
	2	41

Notes *(continued)*

5 Staff numbers and costs *(continued)*

The aggregate payroll costs of these persons were as follows:

	2002	2001
	£000	£000
Wages and salaries	**275**	1,404
Social security costs	**28**	94
Other pension costs	**10**	67
	313	1,565

Amounts of £237,000 paid to employees in respect of redundancy costs are included in the payroll costs above.

6 Directors' remuneration

	2002	2001
	£000	£000
Aggregate directors' emoluments	**22**	144

7 Tax on profit/(loss) on ordinary activities

	2002	2001
	£000	£000
Current tax:		
Consortium Relief receivable at 30%	**13**	584
Adjustments in respect of previous periods	**-**	1,890
Total current tax	**13**	2,474
Deferred tax – origination and reversal of timing differences	**(13)**	105
Total tax charge	**-**	2,579

	2002	2001
	£000	£000
Reconciliation of tax charge		
Profit/(loss) on ordinary activities before tax	**86**	(3,011)
Nominal (charge)/credit at UK Corporation tax rate of 30% *(2001: 30%)*	**(26)**	903
Expenses not deductible for tax purposes	**-**	(1)
Capital allowances in excess of depreciation for the year	**39**	(347)
Other timing differences for year	**-**	29
Adjustments in respect of prior years	**-**	1,890
Total current tax	**13**	2,474

Notes *(continued)*

8 Tangible fixed assets

	Computers £000	Leasehold improvements £000	Fixtures and fittings £000	Plant and machinery £000	Total £000
Cost					
At beginning of year	30	343	189	2,616	3,178
Disposal	(30)	(343)	(189)	(2,616)	(3,178)
At end of year	-	-	-	-	-
Depreciation					
At beginning of year	30	343	189	2,377	2,939
Disposal	(30)	(343)	(189)	(2,377)	(2,939)
At end of year	-	-	-	-	-
Net book value					
At 31 December 2002	-	-	-	-	-
At 31 December 2001	-	-	-	239	239

9 Stocks and long term contracts

	2002 £000	2001 £000
Raw materials and consumables	-	74
Long term contracts	-	53
	-	127

Long term contract balances comprise:

	2002 £000	2001 £000
Costs incurred to date	-	1,443
Applicable payments on account	-	(1,390)
	-	53

Notes *(continued)*

10 Debtors

	2002 **£000**	2001 £000
Amounts owed by joint venture parties	-	15
Consortium relief recoverable	**597**	584
Deferred taxation (note 11)	**92**	105
Other debtors and prepayments	-	35
	689	739

11 Deferred taxation

The full potential asset for deferred taxation which represents the debtor made is:

	2002 **£000**	2001 £000
Accelerated capital allowances	**92**	105
Full potential asset and debtor (at 30%)	**92**	105

In addition, the company has unutilised corporation tax losses available for offset against future profits of approximately £Nil *(2001: £Nil)*.

The movement on the deferred taxation debtor is as follows:

	£000
At beginning of year	105
Amount credited to profit and loss account	(13)
At end of year	92

Notes *(continued)*

12 Creditors: amounts falling due within one year

	2002 £000	2001 £000
Bank loans and overdrafts	-	11,500
Trade creditors	-	214
Amounts owed to joint venture parties	**26**	11,669
Other taxation and social security	-	330
Accruals and deferred income	**71**	208
	97	23,921

The bank loan of £11,500,000 was repaid on 31 May 2002.

Interest on each bank advance consists of the aggregate of:

- the bank's margin at a rate of 0.45% per annum; and
- the cost of sterling deposits to the bank which is the rate per cent per annum at which sterling deposits are offered to the bank in the London Inter-Bank Market on the first day of an interest period in an amount equal or substantially similar to the amount being drawn down for a period equal or similar to such Interest Period; and
- other associated costs.

13 Creditors: amounts falling due after more than one year

	2002 £000	2001 £000
Amounts owed to joint venture parties	**20,000**	-

14 Provisions for liabilities and charges

	Closure provision £000	Warranty £000	Liquidated damages £000	Total £000
At beginning of year	798	296	237	1,331
Charge for the year	-	366	-	366
Utilised in the year	(572)	(132)	-	(704)
Released	(63)	-	(237)	(300)
At end of year	163	530	-	693

Notes *(continued)*

15 Share capital

	2002 £000	2001 £000
Authorised, allotted, called up and fully paid:		
5,000 "A" ordinary shares of £1 each	5	5
5,000 "B" ordinary shares of £1 each	5	5
	10	10

The voting and other rights of the 'A' and 'B' ordinary shares are the same.

16 Reconciliation of movements in shareholders' funds

	2002 £000	2001 £000
Profit/(loss) for the financial year	**86**	(432)
Deficit of shareholders' funds at beginning of year	**(20,095)**	(19,663)
Deficit of shareholders' funds at end of year	**(20,009)**	(20,095)

17 Commitments under operating leases

At 31 December 2002 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings	
	2002 £000	2001 £000
Expiring within 2 – 5 years	-	84

18 Capital commitments

There are no amounts contracted for, but not provided.

19 Joint venture parties

The company is a joint venture undertaking between Rolls-Royce plc and Alfa Laval Limited, each shareholder holding 50% of the issued share capital. Neither party to the joint venture has overall control. Both of the joint venture parties are registered in England and Wales. Copies of the financial statements of each shareholder can be obtained from Rolls-Royce plc, 65 Buckingham Gate, London, SW1E 6AT and Alfa Laval Limited, 7 Doman Road, Camberley, Surrey, GU15 3DN respectively.

Notes *(continued)*

20 Related party transactions

Transactions with related parties during the year to 31 December 2002 and balances with related parties at that date are given below. All transactions are made at arm's length.

	Country	Sales to related party £000	Purchases / Interest to related party £000	Amounts owed to related party £000	Group tax relief receivable from related party £000
Rolls-Royce plc	UK	276	120	10,000	292
Rolls-Royce Power Engineering	UK	-	193	-	-
Rolls-Royce Nuclear Engineering Services Limited	UK	-	-	73	-
Alfa Laval Limited	UK	-	125	10,026	292

Rolls-Royce plc

The company has a 50% interest in the share capital of Rolls Laval Heat Exchangers Limited and provides a loan, which is non-interest bearing from 31 May 2002.

Rolls-Royce Power Engineering Ltd
Rolls-Royce Nuclear Engineering Services Limited

Members of Rolls-Royce Group, providing technical and personnel support services to Rolls Laval Heat Exchangers Limited.

Alfa Laval Limited

The company has a 50% interest in the share capital of Rolls Laval Heat Exchangers Limited and provides a loan, which is non-interest bearing from 31 May 2002.

21 Pension funding

The company is a participating employer of The Rolls-Royce Pension Fund and Rolls-Royce Group Pension Scheme, which are multi-employer defined benefit schemes. The assets of the schemes are held in separate funds administered by trustees and invested in them independently of the finances of the company and the Rolls-Royce group. The schemes are funded by annual contributions from:

a) Rolls-Royce plc, its subsidiary undertakings and other participating employers; and

b) scheme members.

The company is unable to identify its share of the underlying assets and liabilities of the schemes and in accordance with FRS 17 Retirement Benefits, has accounted for contributions as if the schemes were defined contribution schemes.

On this basis, the amount of employer contributions for 2002 were £10,000 *(2001: £67,000)* (contributions excluding SSAP 24 adjustment).

The FRS 17 disclosure relating to the schemes is given in the group financial statements of Rolls-Royce plc.