Highway Insurance

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The Insurer of Choice

Highway Insurance Holdings Plc

ANNUAL REPORT 2003

Highway Insurance

Financial Results 2003

	2003	2002 (restated)
Gross premiums written	£249.1 million	£134.0 million
Operating profit based on longer term investment return	£29.0 million	£3.5 million
Profit on ordinary activities before tax	£21.9 million	£1.0 million
Operating ratio	97.9%	96.7%
Expense ratio	20.4%	21.1%
Investment funds	£338.9 million	£283.9 million
Earnings per share	7.5p	(1.1p)
Final dividend	1.68p	1.68p
Full year dividend	2.48p	2.48p

Highlights

- Highway has again outperformed the UK motor insurance market
- Satisfactory financial performance, operating ratio 97.9% compared to market forecast of 103%
- Expense ratio reduced further to 20.4% (2002: 21.1%) compared with the latest published market expense ratio of 26.8%
- Highway's share of gross written premium increased by 86%
- Investment funds increased by 19.4%
- New investment mandates issued in November 2003 giving controlled exposure to hedge funds and equities
- FRS 17 fully adopted, pension deficit reduced by £12.1 million
- General trading conditions remain positive
- Proposed final dividend 1.68p per share (2002: 1.68p); full year 2.48p (2002: 2.48p)

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Financial Calendar

Ex-dividend date for 2003 final dividend	24 March 2004
Record date for 2003 final dividend	26 March 2004
Annual General Meeting	26 May 2004
Payment of final dividend	4 June 2004
Interim results announcement for the six months to 30 June 2004	September 2004

2003 was the year in which the reorganisation of the business undertaken in 2002, and many new initiatives, yielded significant results in terms of important savings in our operational and claims costs. While trading conditions were very competitive, Highway's highly developed focus and disciplined underwriting allowed it to achieve a respectable profit of £21.9 million. While our adoption of FRS 17 has had a positive effect on this result, this should not detract from the overall strength of the business' performance in conditions that have seen many competitors struggle.

Having now completed our exit from the Lloyd's of London insurance market and having engaged in a substantial restructuring and re-engineering of our business, we find ourselves in a considerably better position to the one in which the company stood 2 to 3 years ago. By applying sound management practices combined with innovative thinking, we have reshaped Highway into an insurance business with a much keener commercial focus, supported by a radically updated infrastructure.

But above all, insurance is a people business – and at Highway we have sought to develop a team of highly motivated, highly skilled individuals, all of whom share in our new corporate vision. That vision has put us firmly on course for success.

Insurance Operations

Our underwriting business encountered a challenging but productive year. Premium rates increased modestly while the most significant costs – the settlement of personal injury claims and our reinsurance programme – rose across the market by roughly 5 and 20 per cent respectively. Both are items substantially beyond our control. However, our commitment to processes designed to mitigate our exposure to claims inflation, and our philosophy to settle valid claims quickly while rejecting those that are fraudulent, minimised the impact of these factors.

With our numerous management initiatives, including the innovative use of Voice Stress Analysis, we have had much success. We have also reduced our operational costs following the reorganisation effected in 2002. These initiatives were constructed to make Highway the lowest cost producer for its position on the value chain. This much we have achieved given that our expense ratio is now 20.4%, one of the lowest in the industry. This is a commendable achievement.

Lastly, we have completed a wide-ranging reconfiguration of our book of business in order to focus on the most profitable risk classes. Instead of accepting risk on a "seat of the pants" basis, we now select our business on the basis of a series of algorithms based on industry statistics and our own experience. I am confident that as reserving patterns develop, we will justify our aim of achieving an average combined ratio of 98%, thus improving the quality of the Highway business and its prospective profitability.

Investment Operations

Highway has traditionally managed its investment fund in a highly conservative manner; exclusively in Sterling bonds and generally of very short maturity. Despite such caution, the approach left us hostage to fortune in two respects. As rates declined we received less income. At the time that the rate cycle moved upward we would be forced to guess the trajectory, as our bonds matured and required reinvesting. Frankly, what was clear was that if we really did possess these prophetic qualities we would probably not be writing motor insurance in Brentwood. It was also apparent that with an insurance fund in excess of £300 million we needed to partner with an investment professional.

In the early months of 2003, with the approval of the Board and the Investment Committee, we began our search for an investment partner to whom we could outsource the management of our fund. Our criteria were plain.

We wished to maintain a similar risk profile for the fund. We wanted an investment strategy that was substantially non-directional. We needed a manager to allocate our assets dynamically, rather than sit in prescribed asset classes over either finite or infinite time horizons. Predominantly the instruction was that ours was to be a stay-rich fund rather than a get-rich fund. We also expected a higher return than that available to us from our previous investment policy, and a return that was connected with our long-run expectation of 550 basis points.

Our problems and requirements were not that dissimilar to the issues faced by Japanese insurers when their domestic interest rates evaporated, or Swiss pension funds who faced minimal annual returns conferred by statute. We therefore employed Liability Solutions, a London-based consultancy, who advise on the allocation of funds to alternative managers. As a result, and after considerable due process, we awarded equal mandates to Union Bancaire Privée and to Banque Syz.

I believe that this is a significant step in improving the quality of Highway's business. Should Syz and UBP return something around 550 basis points across a fund of £300 million, which each considers reasonable, they will provide some kind of bedrock to our profitability. Both are required to produce this performance without adding to the risks faced by the Highway shareholders. After all, we already have a risk business in what is regarded as our predominant business: underwriting.

Pension Fund

As mentioned earlier in this statement, our 2003 reported profits and the 2002 comparatives have been modified by a change in accounting policy; our early adoption of FRS 17 concerning pensions. The effect has been to increase 2003 pre-tax profits by £12.1 million and reduce the 31 December 2003 consolidated net asset position by £4.7 million.

The adoption was part of the company's plan to illustrate its mitigation and restriction of its pension fund liability. As a result of these efforts we claimed back very fairly and reasonably a transfer of £12.1 million from potential pension liabilities to shareholders' funds. Should we have failed to address this issue, Highway would have been faced with a pension fund deficit of £10 million rather than a surplus of £850,000, based on the most recent triennial valuation completed in October 2003.

Outlook

I expect that the industry will remain competitive although I do not believe that the participants will chase prices down. Whilst the direct writers have established a significant position in the market place they compete largely on the basis that they must be the cheapest simply because they are direct. Some members of the public clearly accept such an implied contention; others do not. It is therefore also my belief that the role of broker or intermediary is far from extinct. Regulation could yet polarise the broking fraternity into larger groupings but here Highway is well represented. 65% of motor policies are still distributed through intermediaries and while the fade rate to direct may continue, I expect this to be at a lower rate than over the past ten years. Some evidence in support of such a contention possibly lies with the Direct Line acquisition of Churchill and Aviva's closure of Hill House Hammond.

The coming year will again afford opportunities to reduce both direct and indirect costs and if appropriate to write some additional business. It should also provide an improvement in our investment performance. All should contribute towards a more profitable year for our shareholders.

In summary, I would say that where we have been in control of our business, considerable achievements have been made. Where we have not been in control, we have been assiduous in mitigating our loss or liability. Efforts to regenerate shareholder value have been orchestrated by Andrew Gibson, his executive team and the entire staff of Highway Insurance. They have been aided by a non-executive contingent, probably bigger than for a company of our size, who have all contributed in their own area of expertise to take a measured chance in the improvement of the quality of the business. All are due my thanks on behalf of shareholders.

Ross Dunlop, *Executive Chairman*
15 March 2004

Chief Executive's Report

2003 has been a busy and productive year for Highway. Our main objectives were to build on the sound foundations we put in place in 2002, and move forward to be the Insurer of Choice for our business partners, our insureds and our people.

Key successes include:

- completing the development of the Highway Choice product range;
- developing a new corporate mission and vision;
- a significant reorganisation of our operational divisions;
- restructuring our investment portfolio.

Financial Performance

Overall, we are pleased with this year's financial result. Operating profit based on the longer term investment rate of return, before exceptional items and amortisation, was £29.0 million (2002: £16.6 million). The operating ratio was 97.9% (2002: 96.7%).

Profit before tax was £21.9 million (2002: £1.0 million).

Operational Review of 2003

In the paragraphs that follow, I describe the principal operational changes that were implemented during 2003 that have further strengthened our business.

In the final quarter of 2002, we initiated a restructuring of our underwriting teams to provide, on the one hand, a central team focused on business processing and service delivery, and on the other, teams responsible for managing the relationships with our differing business partners. This process was completed early in the year, and has proven to be highly successful.

At the same time, we have been successful in extending the implementation of our full-cycle EDI product, reaching and exceeding our target of 85% of all transactions being received electronically.

These two factors have allowed us to realise significant cost savings in underwriting operations, whilst achieving service levels higher than ever before.

2003 also saw the completion of the development of the Highway Choice product range, with the introduction of our new Commercial Vehicle and Motorcycle products. We now have, in all our key market areas, up-to-date products that have flexible rating schemes that allow a rapid and creative response to changing market conditions and new opportunities. To reinforce the completion of the product range, our marketing team has carried out a successful rebranding exercise.

In the middle of the year, following a strategic review, we developed a new vision for Highway as the Insurer of Choice for all our stakeholders. This vision is built on three fundamental, interacting elements:

- Firstly, we aim to have the lowest outgoings of any insurer in our markets, and we have set targets for the reduction of claims costs and operating expenses.
- Secondly, this will allow us to develop "smart" products; ones that are competitive, well serviced and appropriately distributed.
- Finally, underpinning all our initiatives, we recognise that our people are the key to our future. We are committed to recruiting, developing and retaining "smart" people and have developed a number of key values that will drive all that we do. We recognise that cultural change cannot be implemented overnight, but we are already seeing the benefits, not least in a number of initiatives to reduce claims costs.

Following on from this strategic review, we reorganised our operational divisions to provide a clearer focus to our teams.

This built on the restructuring of underwriting operations and has, for example, brought all customer-facing teams (in claims and underwriting) under a single management structure.

These changes have allowed us to continue streamlining the organisation. We achieved a reduction in headcount from 577 in December 2002 to 483 today.

Throughout 2003, we have leveraged the benefits of the new GIOS computer system. It has allowed us to implement full-cycle electronic trading rapidly and also provided the platform for a number of developments that assisted the streamlining of our business processes. During the year, we have transformed our IT support organisation, including changing our outsourcing partner, which has improved our infrastructure and now provides a more robust and responsive service.

Capital and Other Financial Matters

Lloyd's Exit

In November 2002 we agreed with Lloyd's of London that 2002 would be our last year in that market and in 2003 we would underwrite exclusively through Highway Insurance Company Limited ("HighCo"), our FSA-regulated insurance company. Highway has increasingly benefited from lower operating costs since HighCo was established for the 2000 underwriting year.

Plans to finalise the exit from Lloyd's with the closure of the 2002 and prior underwriting years are on target for completion towards the end of 2004. This will release funds that are currently on deposit with Lloyd's. In advance of the completion of this project we have renegotiated our banking facilities in early 2004, which has released some of these funds and improved our gearing position.

Pensions

At the end of 2002 Highway's defined benefits pension scheme had a deficit under FRS 17 of £11.5 million. Through 2003 we have worked to restructure the benefit provision and, as a result, have significantly reduced the funding deficit. At the end of 2003, this figure has reduced to a deficit of £4.7 million.

However, the figures above are based on standardised accounting formulae, which do not take into account specifics of individual schemes and beneficiaries.

The funding of our plan is based on a detailed actuarial review that takes into account the specifics of our scheme. On this basis, Highway's scheme was in deficit by £15.4 million at the end of 2002. At the time of the latest valuation (October 2003) this deficit had been eliminated and replaced by a surplus of £0.9 million.

Guernsey Captive

We have established a captive reinsurance vehicle in Guernsey, to which we will cede a proportion of the underwriting account. The captive will benefit from Guernsey's advantageous solvency rules and allow us to improve HighCo's solvency position.

Outlook

Although market conditions have become more difficult, we believe that the considerable changes we have made, and continue to make, to our products and organisation stand us in good stead for the challenging period ahead.

Underwriting

Our budget for income for 2004 is £220 million. Our strengthening solvency position means that we do not expect to require co-insurance or quota share arrangements with any third parties to underwrite this premium.

The projected premium income is driven strongly by higher targets for renewal of the new Choice products. We have a high level of confidence in achieving these targets, based on our experience of the Choice products as they reach their first anniversaries.

Throughout 2003, we have seen market conditions softening with only modest premium rate increases. We expect the "soft landing" to continue as a result of the greater underwriting discipline required in the low interest environment and greater regulatory attention on capital adequacy.

Distribution

The broker market faces regulation by the Financial Services Authority from the start of 2005. This fact is fuelling the drive towards consolidation already present in the market. Meanwhile, 2004 has already seen the loss of a major intermediary, with Aviva closing its Hill House Hammond subsidiary – with which Highway had only a modest commercial vehicle account.

Nonetheless, intermediaries continue to represent more than half of the UK motor insurance market, though the shape and nature of the market is changing.

We are undertaking a thorough review of our distribution model to respond to these changes and strengthen our overall business model.

Claims

Following the strategic review, described above, we have implemented a number of initiatives to reduce further claims costs. We have been assisted in this area by the increased detail in our statistical records provided by GIOS. This has allowed us to identify key areas of cost that we can tackle aggressively.

Claims cost inflation continues to be a significant issue for the market. Through our initiatives, we have maintained tight control over our personal injury, accidental damage and theft costs. We continue to attack this area aggressively and believe that 2004 will see further progress in this critical area.

Operating Expenses

In 2003 Highway had an expense ratio of 20.4% of premium income, compared to a figure of 21.1% in 2002. We are continuing to drive costs from our operation as part of our "lowest outgoings" initiative. A number of projects have been started, and will continue through 2004, which will reduce our expenses further, whilst maintaining and improving service standards.

Investments

Highway's investment funds totalled £338.9 million at 31 December 2003 (2002: £283.9 million). These funds continue to grow as a result of the favourable trading conditions and our increasing premium income.

Historically, our investments have been held in low risk instruments, such as gilts. This has protected us over recent years from the capital losses suffered by some other insurers. Our investment managers worked within narrow constraints that have protected us from capital losses, but have limited the potential return.

A decision was taken in 2003 to move the investments to funds that are managed in a more active way. In November 2003 our investments were transferred to funds managed by Union Bancaire Privée and Banque Syz & Co. The new managers work within broad guidelines, which aim principally to preserve our capital, but which allow them to invest part of our funds in instruments that offer a higher return.

This strategy has already borne fruit, with our new managers producing a return of 150 basis points in November and December 2003, compared to a return for 2003 as a whole of some 350 basis points.

Non-Risk Income

We continue to develop our interests in businesses that extend our reach across the personal lines insurance value chain. These operations included: Crusader, Highway Premium Finance and Elite.

Crusader is an accident management business that provides services to those involved in non-fault accidents. Highway owns 60% of the share capital. Crusader continued to perform well in 2003 and made a contribution of £0.3m to Highway's pre-tax profits.

Highway Premium Finance is a wholly owned subsidiary that provides premium-financing facilities to brokers. Throughout 2003, Highway Premium Finance widened its scope, targeting some commercial as well as personal lines business, and increased its loan book by 50%.

In 2003, Highway increased its investment in Elite, a specialist motorcycle broker, to 75%. We have been working with Elite's management team to streamline the business and expand its markets. We expect Elite to continue to assist the Highway business with market information and by providing an additional income stream.

Summary

2003 was another constructive year for Highway. We have achieved a satisfactory financial result and, with an operating ratio of 97.9%, we expect that we will again outperform the UK motor market.

Moving forward from the capital raising in 2002, we have focused this year on restructuring our insurance operations to provide an even stronger foundation for the future. We believe that our broad range of initiatives will continue to strengthen the organisation, maximise our returns from the opportunities ahead and deliver value to shareholders.

Andrew Gibson, *Chief Executive Officer*
15 March 2004

Financial Review

The operating result based on the longer term investment rate of return was £29.0 million (2002: £16.6 million). Profit before tax was £21.9 million (2002: £1.0 million). This result equates to an after tax return on equity of 22.9% (2002: 16.1%) excluding the exceptional items.

The results can be analysed as follows:

£ millions	2003	2002
Net earned premiums	168.0	154.8
Underwriting result	4.6	5.3
Long term investment return	17.2	15.8
Reported technical result	21.8	21.1
Other income	2.4	4.2
Pension scheme past service credit	12.1	-
Other charges	(5.9)	(8.5)
Non-underwriting investment return	(1.4)	(0.2)
Operating profit based on longer term rate of return	29.0	16.6
Exceptional items	-	(13.2)
Short term investment fluctuation	(7.1)	(2.4)
Reported profit before tax	21.9	1.0
Tax	(6.9)	(2.9)
Reported profit/(loss) after tax	15.0	(1.9)
Earnings per share	7.5p	(1.1p)

The technical result for Highway Insurance for the year was a profit of £21.8 million compared to £21.1 million in 2002. This result equates to an operating ratio of 97.9% against 96.7% in 2002.

£ millions	2003	2002
Gross premiums written	250.2	129.8
Net premiums written	209.4	120.2
Net earned premiums	177.6	152.9
Net claims incurred	(137.6)	(115.5)
Loss ratio	77.5%	75.6%
Net operating expenses	(36.3)	(32.3)
Expense ratio	20.4%	21.1%
Long term investment return	17.0	14.8
Other technical income	1.1	1.2
Published technical result	21.8	21.1
Operating ratio	97.9%	96.7%

Written Premiums

Highway's share of written premiums rose significantly in the year as business written in 2002 by our co-insurer was written in 2003 by Highway Insurance Company Limited ("HighCo"). Business ceded to the co-insurer does not appear as part of the Group's written premiums.

On a like-for-like basis business written rose by 9% to £256 million.

Expense Ratio

Highway trades with one of the lowest expense ratios in the UK personal lines insurance market. 2003 saw the completion of Highway's transfer of business out of Lloyd's into HighCo, where we save up to 3% of premium income per annum on regulatory costs.

Investment Income

Net investment income received this year was £8.7 million (2002: £13.2 million). Funds under management increased during the period from £283.9 million at the end of December 2002 to £338.9 million at the end of December 2003.

2003 was a very poor year for fixed income investment, with low yields at the start of the year further impacted by capital losses as yields rose from July onwards. The Group maintained a defensive strategy of short durations to minimise exposure to upward yield movements.

The Group made an initial small allocation to alternative investments in the form of hedge funds in August. This proved very successful yielding 2.68% between August and October through a period when fixed interest lost money.

On 1 November the Group moved its entire portfolio to an absolute return strategy managed by Union Bancaire Privée and Banque Syz of Geneva. Their mandate is to produce steady, positive absolute returns with a low level of volatility. They are seeking to achieve these objectives via a global portfolio of investments diversified amongst several asset classes including fixed income bonds, cash, alternative investments, and to a lesser extent equities.

In the two months since its introduction this strategy has proved beneficial, generating 1.51% against the previous Merrill Lynch 1 to 3 year benchmark return of 1.25%.

Investment income received is analysed below:

£ millions	**2003**	**2002**
Long-term return on insurance funds	17.2	15.8
Adjustment for actual yield received	(7.2)	(2.4)
Actual return on investment funds	10.0	13.4
Net loan interest payable	(1.3)	(0.2)
Total investment return achieved	8.7	13.2

Highway has utilised greater amounts of debt in 2003, the costs of which offset any investment income earned on non-insurance funds.

Non-Risk Income

Crusader is our uninsured loss recovery business that provides accident management services to those involved in non-fault road traffic accidents. Crusader is 60% owned by Highway with the remainder held by staff and one of Highway's principal producing brokers.

2003 saw the continued development of our instalment plan business, Highway Premium Finance. Its remit expanded to cover some commercial, in addition to personal motor business.

Early in 2003, we increased our investment in Elite, a specialist motorcycle broker, to a 75% holding.

Together, our non-risk ventures contributed £0.6 million to the Group's profits.

Pension Commitments

The Group has adopted FRS 17 'Retirement Benefits' in full. This has the effect of reducing net assets by the shortfall on pension assets as calculated using the FRS 17 methodology of £4.7 million net of tax. A credit to past service costs arising from the change to the terms of the pension scheme is shown separately in the profit and loss account.

Central Costs

Highway's central costs include the Group's central administrative and support functions and the costs of the central management team. The costs are those retained by Highway net of expenditure allocated to managing agencies and names.

During 2002 the former head office in Bishopsgate was closed and the management team was reorganised. 2003 saw the benefit of these actions with central costs reduced from £3.9 million to £1.9 million.

The detailed figures are set out below:

£ 000s	2003	2002
Property and other costs	220	709
Irrecoverable VAT	172	161
Central management costs	881	2,380
Professional and consultancy cost	360	545
Other central costs	295	112
	1,928	3,907

Dividends

The directors have proposed a final dividend of 1.68p per share (2002: 1.68p) payable on 4 June 2004 to shareholders on the register on 26 March 2004. Taken together with the interim dividend of 0.8p per share (2002: 0.8p), total dividends for the year are 2.48p per share (2002: 2.48p).

Balance Sheet

The Balance Sheet presented within the financial statements consolidates the assets and liabilities of Highway Insurance Company Limited, Syndicate 2037 and the NLC syndicates with other directly held corporate assets. For clarity the Balance Sheet is replicated below summarising the main headings and including Syndicate 2037 and Highway Insurance Company Limited as single separate lines.

As discussed above the Group has adopted the provisions of FRS 17. The Group has also adopted the provisions of UITF 38 'Accounting for ESOPs' the effect of which is to net investments in own shares against reserves. All companies will be required to adopt UITF 38 and FRS 17 by 22 June 2004 and 1 January 2005 respectively. Had these changes of accounting policy not been adopted net assets would have been £76.7 million.

£ millions	2003	2002
Intangibles	3.2	3.5
Tangible fixed assets	1.6	1.2
Group assets used as funds at Lloyd's	21.5	19.7
Other financial investments and cash balances	3.4	9.4
Net other assets	(3.5)	5.3
Term debt	(50.0)	(35.0)
Interest in Highway Insurance Company	102.9	71.2
Interest in managed syndicate	(5.0)	(2.3)
Pension fund	(4.7)	(11.5)
	69.4	61.5

Net assets were equivalent to 35.1p per share at 31 December 2003 (2002: 31.1p).

Following the year end the Group agreed a new £40 million term debt facility and £10 million Letter of Credit facility with Lloyds TSB and Credit Lyonnais to replace the existing £50 million term debt facility. On 11 February 2004, £10 million of the existing facility was repaid reducing the Group's outstanding term debt to £40 million.

International Accounting Standards

From 1 January 2005, it will be a requirement for all UK listed entities to report their results under International Financial Reporting Standards (IFRS) rather than the present UK GAAP.

The Group has started a project to assess the financial, systems and reporting impacts of IFRS on the business. A steering group has been established, and work is in progress, to assess the technical impacts arising from the new standards. At the time of this report, certain key standards, in particular Exposure Draft 5 governing accounting for insurance contracts, have yet to be finalised by the International Accounting Standards Board.

Following the final issue of the reporting requirements, expected in the first half of 2004, further work will be undertaken to permit the reporting of IFRS-compliant results, including the modification of systems necessary.

Ian Patrick, *Finance Director*
15 March 2004

Directors' Report

Directors and Advisers

Directors

Ross George Dunlop
Executive Chairman

David Frank Barker*

David Ean Coleridge*

Stuart Robert Davies
Operations Director

Richard Arthur Gamble*

Andrew James Gibson
Chief Executive Officer

Christopher Derek Hill
Underwriting Director

Judy Ann Kellie*

Ian William James Patrick
Finance Director

John Mayfield Stoker*

Allen Lloyd Thomas*

*Non-executive

Secretary

Philip John Lampshire

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Stockbrokers

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Bankers

Lloyds TSB Bank Plc
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EC3X 4AX

Directors' Report

The directors submit their report and the audited financial statements of the Group and Company for the year ended 31 December 2003.

Principal Activities, Business Review and Future Developments

The Company is a holding company and provides services to its subsidiaries, which are in the main an insurance company, Lloyd's underwriting agencies, associated broker product providers and corporate members of Lloyd's. A review of the Group's activities and its future prospects is set out in the Chief Executive's Report and the Financial Review.

Group Results and Dividends

The profit for the year to 31 December 2003 attributable to shareholders amounted to £15,039,000 after taxation before minority interest (2002: loss of £1,889,000). An interim dividend of 0.8p per share (2002: 0.8p) was paid in November 2003 amounting to £1,587,000. The directors are recommending a final dividend of 1.68p per share net amounting to £3,330,000 payable on 4 June 2004 to shareholders on the register at the close of business on 26 March 2004. This will make a total dividend for the year of 2.48p per share net (2002: 2.48p per share). The retained profit for the year of £9,981,000 will be transferred to reserves (2002: loss of £6,938,000 transferred from reserves).

Directors

The interests of the directors who held office at 31 December 2003, in the share capital of the Company, are set out on page 25 in the Directors' Remuneration Report.

There were a number of changes to the Board during the year:

Retirements

Keith Bradley*	5 February 2003
Graham Kennedy*	5 February 2003

Appointments

Judy Kellie*	5 February 2003
John Stoker*	5 February 2003
David Barker*	12 March 2003
Stuart Davies	12 March 2003
Richard Gamble*	12 March 2003

*Non-executive

Mr Coleridge, Mr Dunlop and Mr Thomas retire by rotation and, being eligible, offer themselves for reappointment at the Annual General Meeting.

Board of Directors

Executive Directors

Ross Dunlop, *Executive Chairman*
Ross Dunlop, aged 49, was appointed Executive Chairman in July 2002. Previously he was a non-executive director and Deputy Chairman of Highway. He was with National Car Parks for four years prior to its sale in 1998 for £801 million. There he fulfilled a number of roles, including acting as the group's finance director, and was on the board of Green Flag's insurance subsidiary, U.K. Insurance. He worked previously at Robert Fleming, Hoare Govett and at KPMG.

Andrew Gibson, *Chief Executive Officer*
Andrew Gibson, aged 47, was appointed Chief Executive Officer in July 2002. He spent seven years with Touche Ross as an auditor and management consultant in the financial services division, latterly managing the insurance IT consultancy group. He joined Sturge Group in 1991 working first in IT and operations before becoming finance director of the group's aviation and non-marine subsidiaries. On the sale of those businesses, he joined Highway's management team in October 1995, was appointed to the Board in July 1996 and became Finance Director in October 1996.

Ian Patrick, *Finance Director*
Ian Patrick, aged 36, trained and qualified with Chartered Accountants BDO Binder Hamlyn in their Edinburgh office. He moved into industry with Croft Oil & Gas Plc in 1991 becoming company secretary in 1992 and finance director in 1994. After the sale of the group in 1997 he joined Mitsui Bussan Commodities, a global metal derivatives trading business, as financial controller. Ian joined Highway as Group Financial Controller in July 1999 and was appointed to the Board in July 2002.

Chris Hill, *Underwriting Director*
Chris Hill, aged 48, joined Highway in October 2001 and was appointed to the Board in July 2002. He spent 12 years at Sun Alliance and two years at Direct Line before joining ITT London & Edinburgh as motor underwriting manager in 1988. From 1997 to 2001, he was director of underwriting for motor, household and travel at Fortis.

Stuart Davies, *Operations Director*
Stuart Davies, aged 36, was appointed to the Board on 12 March 2003. He is a qualified chartered accountant having trained at Ernst & Young. Stuart has spent over ten years with Highway in a variety of roles, including Finance Director of Highway Insurance Company Limited.

Non-Executive Directors

Allen Thomas
Allen Thomas, aged 64, joined the Board in 1995, was Chairman from 1996 to 2002 and is the senior independent director. He moved to London in 1992 to become general counsel to a private investment group following his retirement as a partner of the New York law firm Paul, Weiss, Rifkind, Wharton & Garrison where he practised commercial law for 28 years. He is a non-executive director of Penna Holdings Plc and Eidos Plc.

David Barker
David Barker, aged 62, joined the Board on 12 March 2003. An actuary by profession, he spent 27 years with Norwich Union, latterly as Chief Investment Manager, before becoming managing director of Hill Samuel Investment Management in 1986. In 1990 he joined Royal Insurance Asset Management as managing director and was a director of Royal Insurance Holdings Plc and subsequently a group director of Royal & Sun Alliance Insurance Group Plc from 1996 to 1998.

David Coleridge
David Coleridge, aged 71, joined the Group in 1957 and was its Chairman from 1978 to 1995. He was Chairman of Lloyd's in 1991 and 1992.

Richard Gamble
Richard Gamble, aged 64, joined the Board on 12 March 2003 and is Chairman of the Audit Committee. He is a chartered accountant and was group chief executive of Royal Insurance Plc (1992–96) and Royal & Sun Alliance Insurance Group Plc (1996–97). He has also held senior positions at British Airways and Lowndes Lambert and is a non-executive director of Excel Airways Group Plc.

Judy Kellie

Judy Kellie, aged 56, joined the Board on 5 February 2003. She worked for Orion Insurance from 1968 to 1986 in a number of agency management and marketing functions, finally as agency manager. In 1986 she joined London & Edinburgh Insurance Company Limited and was group marketing & corporate relations director from 1992 to 1998. In 1999 she joined Intelligent Marketing Partnership – a business development, marketing, communications and PR consultancy to the general insurance industry. Judy Kellie has served on a number of ABI and CII national committees.

John Stoker

John Stoker, aged 69, joined the Board on 5 February 2003. He worked for Sedgwick Group for 32 years and was a director of a number of Sedgwick companies both in the UK and overseas. In 1989 he joined the management consultants and actuaries, Tillinghast, where he was engaged in a variety of insurance-related projects. Since 1993 he has been an independent consultant and his clients have included government agencies, Lloyd's, the ILU and a range of insurers and purchasers of insurance products.

Substantial Interests

Other than the holding of David Coleridge, as disclosed on page 25 of the Directors' Remuneration Report, so far as the directors are aware, or have been notified pursuant to section 198 of the Companies Act 1985, the following shareholders have interests in 3% or more of the ordinary share capital of the Company at 15 March 2004.

	Number of Shares	%
J O Hambro Capital Management Limited	35,525,274	17.62
Laxey Partners Limited	17,072,604	8.47
Artemis Investment Management	15,060,054	7.47
Fidelity Investments	14,878,421	7.38
UBS Global Asset Management	13,811,269	6.85
Aberforth Partners' Clients	10,500,000	5.21
Legal & General Investment Management Limited	7,216,195	3.58
Henderson Global Investors	6,460,132	3.20

Share Capital

Details of the current share capital of the Company are given in note 20 to the financial statements.

Permission was obtained from shareholders at the Annual General Meeting in May 2003 to purchase up to 10% of the Company's ordinary share capital. A resolution to grant the Board power to buy back up to 10% of the issued capital for a further year will be put to shareholders at the Annual General Meeting to be held on 26 May 2004.

3,372,906 shares are held on behalf of the Employee Benefit Trust and, except in respect of 0.001 pence per share, the right to receive any dividend has been waived.

Creditor Payment Policy

It is the Group's policy to follow "The Better Payment Practice Code" published by the Department of Trade and Industry. A copy of the Code can be obtained from the DTI Publications Orderline on 0870 1502500, quoting reference URN 01/621.

As the Company owed no amounts to trade creditors at 31 December 2003, the number of days required to be shown in this report to comply with the provisions of the Companies Act 1985 is nil. The number of creditor days for the Highway Group, based on creditors at the year end and purchases during the year, was 25 days (2002: 34 days).

Employment Policies

The Group is committed to employment policies which follow best practice, based on equal opportunities for all employees irrespective of sex, sexual orientation, race, colour, religion, disability, marital status or age.

The Board pursues policies designed to encourage employees to identify with the Group and to use their knowledge and skills actively towards its success. It encourages and funds appropriate training and studying for relevant professional qualifications.

The Group has an Executive Share Option Plan and intends to introduce an all-employee Share Incentive Plan in 2004.

Full and fair consideration is given to employment applications from disabled persons who have the necessary aptitude and abilities. Where an employee becomes disabled whilst employed, arrangements are made whenever practicable to maintain employment and offer appropriate training.

Charitable and Political Contributions

During the year the Group did not make any charitable donations and no contributions were made for political purposes.

Corporate Responsibility, Safety and the Environment

The Group is committed to the highest standards of business conduct in its dealings with customers, business partners and suppliers. Policies and procedures are in place to facilitate reporting of suspected business malpractice or fraudulent activities.

The Group's Health and Safety policy aims to ensure the health and safety of all employees, contractors and others who may be affected by the Group's operations. Training is provided and all staff have access to health and safety information via the Group's Intranet.

The Group is mindful of its responsibilities towards the environment and the community in general and seeks to exert a positive influence on environmental issues both internally and externally. However, as the Group operates within the insurance sector of the financial services market, environmental issues have relatively little impact on the Group's business. The introduction of electronic data exchange, together with the widespread use of e-mail and the Group's Intranet, have helped to reduce paper consumption and the Group has paper recycling arrangements in place.

Auditors

Ernst & Young LLP resigned as auditors on 13 August 2003. KPMG Audit Plc were appointed as auditors to fill the casual vacancy. Special notice having been given to the Company pursuant to section 388(3) of the Companies Act 1985, a resolution will be proposed at the Annual General Meeting to re-appoint KPMG Audit Plc as auditors and authorise the directors to determine their remuneration.

By order of the Board
Philip Lampshire, *Secretary*
15 March 2004

Directors' Remuneration Report

Remuneration Committee

The Remuneration Committee, comprising Allen Thomas (Chairman), David Coleridge, Judy Kellie and John Stoker makes recommendations to the Board on the framework of executive directors' remuneration and determines, on the Board's behalf, specific remuneration packages for the Chairman and the executive directors. The Committee meets at least twice a year.

The Committee gives consideration to pay and employment policies throughout the Group especially when determining annual salary increases.

From time to time, although this did not occur in 2003, the Remuneration Committee takes advice from external consultants regarding the Group's remuneration policy to maximise comparability with the marketplace.

Directors' Remuneration Policy

The Group's policy on remuneration for 2003 and subsequent financial years is that the overall remuneration package should be sufficiently competitive to attract, retain and motivate high quality executives capable of achieving the Group's objectives and thereby enhancing shareholder value. The package consists of basic salary, benefits, share options, performance related bonuses and pensions. It is performance led and market based, rewarding above average performance through incentives, and integrated with the budgetary process.

The fees of the non-executive directors are agreed by the Board and are designed to attract individuals with the necessary experience and ability. The fees, which are neither performance related nor pensionable, are comparable with those paid by other companies.

Basic Salary and Benefits

Salary and benefits are reviewed annually in the context of individual and business performance. The strategy for executive directors' pay is for basic salaries to reflect the market median and for benefits such as a company car, pension and medical insurance to reflect market practice.

Variable Compensation

The executive directors and other key executives participate in performance related remuneration schemes which are designed to reflect specific targets linked to the performance of the business.

Performance Related Bonuses

These are designed to reflect specific goals linked to business performance. In 2003, Mr Dunlop, Mr Gibson, Mr Hill, Mr Patrick and Mr Davies had a maximum bonus opportunity of 100% of salary. The awards were based on Group and individual performance and the attainment of predetermined targets relating to the Company's combined ratio and return on equity.

In 2004, Mr Hill will again have a maximum bonus opportunity equal to 100% of his salary. The other executive directors will be considered for a discretionary bonus, the details of which have not yet been put in place.

Executive Share Option Plan

In September 2002, following shareholder approval, the Highway Executive Share Option Plan was established. The performance conditions are aimed to align directors' performance to shareholder value and were selected by the Remuneration Committee following discussions with a number of the Company's leading institutional investors. The Plan provides for the grant of unapproved share options to eligible executives. "Unapproved" in this context means that any gains eventually realised on the exercise of options will be liable to both income tax and National Insurance Contributions. The Plan participants are also required to meet the Company's National Insurance Contributions. The exercise price of an option is determined by the Remuneration

Committee not later than the date when the option is granted and may not be less than 34.5 pence per share. Details of options granted to executive directors under the Highway Executive Share Option Plan, together with the performance conditions relating thereto, are set out under "Directors' interests" on page 25.

Ockham Long Term Incentive Plan

In September 1999 the Ockham Long Term Incentive Plan ("the LTIP") was established. The LTIP has been replaced by the new Highway Executive Share Option Plan. No awards have vested under the LTIP. The final performance period for outstanding awards ended in December 2003 and the LTIP has now been closed.

Service Contracts

Mr Dunlop, Mr Gibson and Mr Hill have service contracts that the Company may terminate by giving one year's notice. Mr Davies and Mr Patrick do not have service contracts but have employment contracts that the Company may terminate by giving six months' notice.

None of the non-executive directors has a service contract. Their appointment may be terminated on not more than three months' notice.

There are no predetermined special provisions for executive or non-executive directors with regard to compensation in the event of loss of office. The Remuneration Committee considers the circumstances of individual cases of early termination and determines compensation payments accordingly.

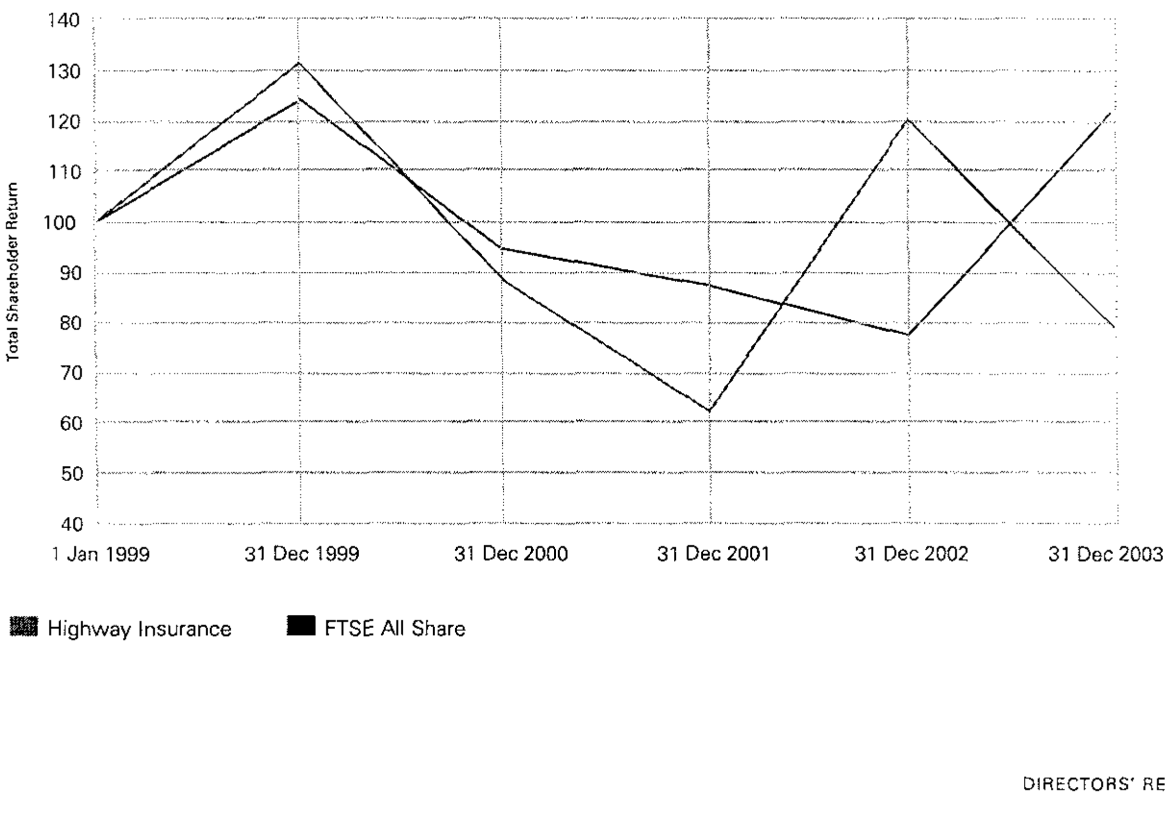
Performance Graph

The graph below shows the percentage change in the total shareholder return (with dividends reinvested) for each of the last five financial years of a holding of the Company's shares against the corresponding change in the FTSE All Share Index.

The FTSE All Share Index was selected as it represents a broad equity market index in which the Company is a constituent member.

Total Shareholder Return

Highway Insurance Holdings vs FTSE All Share Index Annual Changes



Directors' Remuneration in 2003

This section of the Report (which has been subject to audit) sets out the directors' emoluments for the year ended 31 December 2003 and comparison at 31 December 2002.

Directors' emoluments

	Salaries/Fees £000	Other benefits* £000	Performance related remuneration and bonus £000	Pension contributions £000	2003 Total £000	2002 Total £000
Executive						
S R Davies	109	10	130	13	**262**	–
R G Dunlop	165	1	165	–	**331**	215
A J Gibson	212	18	212	46	**488**	381
C D Hill	180	16	180	51	**427**	177
I W J Patrick	130	13	130	20	**293**	112
Non-executive						
D F Barker	24	–	–	–	**24**	–
K N G Bradley	3	–	–	–	**3**	30
D E Coleridge	30	1	–	–	**31**	31
R A Gamble	24	–	–	–	**24**	–
J A Kellie	29	–	–	–	**29**	–
G N Kennedy	3	–	–	–	**3**	30
J M Stoker	34	–	–	–	**34**	–
A L Thomas	30	–	–	–	**30**	53
Overall total	**973**	**59**	**817**	**130**	**1,979**	1,029

* "Other benefits" includes a company car allowance, life insurance cover and private medical insurance.

Ms Kellie and Mr Stoker were appointed to the Board on 5 February 2003. Mr Barker, Mr Davies and Mr Gamble were appointed to the Board on 12 March 2003. Their emoluments reflect their dates of appointment.

Mr Patrick had personal pension arrangements during the year to which the Company made contributions of £20,439 (2002: £8,051).

The Group operates a defined benefit pension scheme (which was closed to new members in 2001) and a defined contribution pension scheme.
Mr Gibson, Mr Hill and Mr Davies all participated in the defined contribution pension scheme during the year. The pension contributions made by the Company during the year were £45,799 (2002: £39,922) for Mr Gibson, £50,776 (2002: £12,650) for Mr Hill and £13,308 (2002: not applicable) for Mr Davies.

Directors' Interests

The interests of the directors who held office at any time during the year and their immediate families in the ordinary shares of 20p each in the Company at 31 December 2003 (or their date of ceasing to hold office if earlier), with comparative figures as at 1 January 2003 (or their date of appointment if later) according to the register of directors' interests, were:

Shares	At 31 December 2003 (or date of ceasing to hold office if earlier)	At 1 January 2003 (or date of appointment if later)	At 31 December 2003	At 1 January 2003
	Beneficial		As Trustee	
D F Barker	–	–	–	–
K N G Bradley	–	–	–	–
D E Coleridge	**6,806,250**	6,806,250	**673,525**	673,525
S R Davies	**2,566**	2,566	–	–
R G Dunlop	**200,000**	130,000	–	–
R A Gamble	**50,000**	–	–	–
A J Gibson	**350,802**	350,802	–	–
C D Hill	–	–	–	–
J A Kellie	–	–	–	–
G N Kennedy	**30,000**	30,000	–	–
I W J Patrick	**9,748**	9,748	–	–
J M Stoker	**120,946**	120,946	–	–
A L Thomas	**214,824**	214,824	–	–

Options to acquire shares	At 1 January 2003 (or date of appointment if later)	Granted during the year	Exercised/lapsed during the year	At 31 December 2003	Exercise price of options granted, exercised or lapsed
S R Davies	1,500,000	–	–	**1,500,000**	**34.5p**
R G Dunlop	2,000,000	–	–	**2,000,000**	**34.5p**
A J Gibson	2,000,000	–	–	**2,000,000**	**34.5p**
C D Hill	1,500,000	–	–	**1,500,000**	**34.5p**
I W J Patrick	1,500,000	–	–	**1,500,000**	**34.5p**

Under the terms of the Highway Executive Share Option Plan, the Remuneration Committee of the Board of the Company may from time to time at its discretion grant options to eligible executives to subscribe for or acquire fully paid ordinary shares of the Company. Performance conditions are set when the grant of options is made and the options cannot normally be exercised unless the conditions have been met.

Options to acquire ordinary shares in the Company were granted to executive directors and senior executives on 6 September 2002. The exercise price of the options is 34.5 pence per share which is the price at which the Company's shares were issued under the Placing and Open Offer in April 2002. The closing mid-market price of the Company's shares on the date of the grant was 35.5 pence per share. The options are exercisable between 6 September 2006 and 5 September 2012. The Rules of the Plan provide, inter alia, that in order to vest 100%, the average middle market value of a Highway share, calculated over any three consecutive calendar months expiring no earlier than two years after the grant of the option, should be at least 65 pence. If the average middle market value is equal to 55 pence then only 50% of the options granted will be exercisable. Between 55 pence and 65 pence the options becoming exercisable would increase from 50% to 100% on a straight-line basis.

The market price of the Company's shares on 31 December 2003 was 35.25 pence per share. The highest and lowest market prices during the year were 48.25 pence and 35.25 pence respectively.

The interests of the directors in the Company's ordinary shares have not changed since the year end.

During the year to 31 December 2003 and at that date, no contracts of significance existed in which a director of the Company was materially interested, other than as disclosed in note 33 to the financial statements.

Allen Thomas, *Chairman, Remuneration Committee*
15 March 2004

Corporate Governance Statement

The Group is committed to high standards of corporate governance. This statement describes how the Company has applied the principles set out in The Combined Code on Corporate Governance appended to the Listing Rules of the UK Listing Authority.

The Board

At 31 December 2003 the Board comprised five executive directors (including the Chairman) and six non–executive directors. The Board considers this structure to be an effective size and balance for the Company. The directors' biographies appear on pages 18 and 20. The non-executive directors bring a wide range of experience and skills to the Board and all are considered by the Board to be independent. Although Mr Coleridge is a former executive director of the Company, his executive responsibilities ceased in 1995 and the Board considers him to be independent of management. Mr Thomas is the senior independent non-executive director. Under the Company's Articles of Association directors must retire by rotation, and may stand for re-election by shareholders, at least every three years.

The roles of the Chairman and Chief Executive are separate. The Chairman leads the Board and facilitates the effective contribution of each director, particularly the non-executive directors. He monitors, with assistance from the Company Secretary, the information distributed to the Board to ensure it is sufficient, accurate, timely and clear. The Chief Executive has day-to-day management responsibility for the Company's operations, implementing the strategies and policies agreed by the Board.

The Board has a formal schedule of matters that it reserves to itself. These matters include strategic and policy issues, approval of accounts and dividends, significant changes to accounting policies or practices, changes to the membership of the Board and its committees, internal control and risk management strategy.

The Board meets six times a year. The Chairman meets twice a year with the non-executive directors without the executive management present. All directors have access to the advice and services of the Company Secretary. Where necessary in the discharge of their duties, directors may seek independent professional advice at the Company's expense, although this did not occur during the year under review. All new directors receive induction training and refresher training is provided where appropriate.

The Company maintains directors' and officers' liability insurance with a limit of cover of £10 million for each and every claim and in the aggregate.

Board Committees

There are five Board committees to which the Board has delegated specific responsibilities as described below.

Audit Committee

Members: Richard Gamble (Chairman), David Coleridge, Judy Kellie, Allen Thomas.

The Audit Committee meets four times a year. Its terms of reference include review of the Group's financial statements prior to publication; reviewing the programme and effectiveness of the internal audit function; reviewing and monitoring the relationship with the external auditors, including review of non-audit services to ensure that the external auditors' independence and objectivity is not compromised. Time is set aside at two of these meetings for the committee to meet with the internal and external auditors without executive management present.

Nomination Committee

Members: Ross Dunlop (Chairman), Andrew Gibson, Judy Kellie, John Stoker, Allen Thomas.

The Nomination Committee makes recommendations to the Board on all new Board appointments. The Committee meets as required.

Remuneration Committee

Members: Allen Thomas (Chairman), David Coleridge, Judy Kellie, John Stoker.

The Remuneration Committee meets at least twice a year. The Committee makes recommendations to the Board on the Company's executive remuneration policy and determines the specific remuneration packages for each of the executive directors. The Directors' Remuneration Report is set out on pages 22 to 26.

Investment Committee

Members: David Barker (Chairman), Andrew Gibson, Marcus Johnson (Meridian Consulting), Roger Nightingale (Independent Consultant), David Osbourne (Meridian Consulting), Ian Patrick.

The Investment Committee oversees the management of the Company's investment and pension funds and meets approximately eight times a year. Review meetings are held each quarter to review performance with the fund managers selected to manage the funds.

Reinsurance Committee

Members: Chris Hill (Chairman), Peter Gallagher (Catastrophic Injury Claims Manager), Andrew Gibson, Ian Patrick, John Stoker.

The Reinsurance Committee reviews and monitors all aspects of the Group's reinsurance programmes. The Committee meets as necessary.

Risk Management and Internal Controls

The Board is ultimately responsible for the Group's systems of risk management and internal control and for reviewing their effectiveness.

Risk Management

A risk management policy and strategy have been implemented and are designed to ensure that factors, which may impede the achievement of the Group's strategic and operational objectives, are managed by strong controls. A Risk Review Committee, comprising the senior executives responsible for each business area, has been established. Its purpose is to define the Group's risk appetite, agree policy and oversee the day-to-day risk management process. The Committee has developed a list of prioritised key risks together with actions to monitor and mitigate these risks. Quarterly progress reports are provided to the Board. The Group regards risk management as key to the achievement of its business objectives and will continue to embed the management of risk into its systems and processes.

Internal Controls

The Board has delegated to executive management the establishment and implementation of a system of internal controls appropriate to the business of the Group. These controls include, but are not limited to: the safeguarding of assets; the maintenance of proper accounting records; the reliability of financial information; the monitoring of outsourcing arrangements; compliance with appropriate legislation, regulation and best practice; the monitoring of, and reaction to, external / market events and the identification and control of business risks.

The internal control system is monitored and supported by a dedicated internal audit function that reports its findings to executive management and the Audit Committee. The internal audit programme is focused on the areas of greatest risk to the Company based on the results of the Group's risk management process.

The Board believes that the Group's system of risk management and internal controls provides reasonable but not absolute assurance against material misstatement or loss. Having reviewed its effectiveness, the Board is not aware of any significant weakness or deficiency in the Group's system of internal controls.

Going Concern

Having reviewed the financial and cash flow positions of the Company and the Group, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operation for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

Communicating with Shareholders

The Company is committed to effective dialogue with shareholders and meets regularly with institutional shareholders, fund managers and analysts. In particular, meetings are held after the release of the Group's interim and final results. Summaries of these discussions and meetings are provided to the Board.

Copies of the interim and annual report are sent to all shareholders and to other potential investors on request. The Company's website (www.highway-insurance.co.uk) keeps existing and potential investors informed of corporate developments. This website contains share price information, an events calendar, recent annual reports and other information about the Group's activities.

Statement of Compliance

The Board has applied the principles set out in The Combined Code on Corporate Governance appended to the Listing Rules of the UK Listing Authority and has complied throughout the year with the exception that the Board did not have a formal schedule of matters specifically reserved to it for decisions (Code Provision A.1.2). This is because it has been the Board's view that this has not been appropriate given the size and structure of the Company. However, in view of the structural and business changes that have occurred during 2003, as referred to in the Chief Executive Officer's report, the Board has adopted a formal schedule of matters specifically reserved for its decision with effect from 2004.

Although the new Combined Code on Corporate Governance is only effective for reporting years beginning on or after 1 November 2003, the Company is already well advanced towards compliance with the new Code.

Financial Statements

Independent Auditors' Report

to the Members of Highway Insurance Holdings Plc

We have audited the financial statements on pages 34 to 71. We have also audited the information in the directors' remuneration report that is described as having been audited.

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 auditors' 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 Annual Report and the directors' remuneration report. As described on page 33, this includes responsibility for preparing 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, the Listing Rules of the Financial Services Authority, 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 whether the financial statements and the part of the directors' remuneration report to be audited have been 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 Group is not disclosed.

We review whether the statement on page 29 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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 and the part of the directors' remuneration report to be audited. 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 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 and the part of the directors' remuneration report to be audited 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 and the part of the directors' remuneration report to be audited.

Opinion

In our opinion:

the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2003 and of the profit of the Group for the year then ended; and

the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants & Registered Auditor
8 Salisbury Square
London
EC4Y 8BB
15 March 2004

Statement of Directors' Responsibilities

Financial Statements

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 Group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Accounting Policies

Basis of Consolidation

The consolidated financial statements comprise the accounts of Highway Insurance Holdings Plc ("the Company") and its subsidiary undertakings for the year to 31 December 2003.

Highway Insurance Company Limited, Highway Corporate Capital Limited and Ockham Corporate Limited participate in the Highway Insurance business managed by the Group. The accounts have been prepared on an annual accounting basis for these participations.

The New London Capital corporate members participate on syndicates managed by other agents. These participations are accounted for on a three year funded basis, under which the excess of premiums written and attributable net investment return over claims and expenses paid in respect of contracts incepting in an accounting period ("the underwriting year") is carried forward as a technical provision until the end of the third year from the inception of the underwriting year. Consequently no profit is recognised in respect of an underwriting year until that time. Where any syndicate underwriting year is expected to make a loss, the loss is recognised as soon as it is foreseen.

In accordance with Lloyd's practice, the underwriting year is normally recognised as closed after three years of development, at which time any profits are distributed. Each underwriting year of account is considered separately for the purpose of determining any aggregate net profit or loss.

In preparing the financial statements for the current year, the Group has fully implemented Financial Reporting Standard 17, ' Retirement Benefits' (FRS 17). The comparative figures have been restated accordingly and the impact is explained further in notes 23 and 28.

The Group has also fully implemented UITF Abstract 38, 'Accounting for ESOPs'. Again the comparative figures have been restated accordingly and the impact is explained further in notes 21 and 23.

Accounting Convention

The financial statements have been prepared in accordance with Section 255A of, and Schedule 9A to, the Companies Act 1985 ("the Act") as reflected in the ICAEW Technical Release 1/99 "Accounting by Lloyd's Corporate Capital Vehicles", and in accordance with applicable accounting standards. The recommendations of the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998 have been adopted.

- No profit and loss account is presented for the Company as permitted by Section 230 of the Act.
- The balance sheet of the Company has been prepared in accordance with Section 226 of, and Schedule 4 to, the Act.

Premiums

Managed participations

Gross written premiums represent premiums on business incepting during the period together with adjustments to premiums written in previous periods. The provision for unearned premiums represents that part of gross premiums written which is estimated to be earned after the balance sheet date. Outward reinsurance premiums are accounted for in the same accounting period as the gross premiums to which they relate.

Non-managed participations

Gross written premiums represent premiums on business incepting during the period together with adjustments to premiums written in previous periods. Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the direct and inward reinsurance business to which they relate.

Claims

Managed participations

Claims incurred include all losses occurring during the year, whether reported or not, related handling costs and any adjustments to claims outstanding from previous years.

Outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling expenses.

Non-managed participations

Paid claims represent all claims paid during the year and include claims handling expenses.

Normally each Lloyd's syndicate year of account is kept open for three years at which time it closes into the next year of account of the syndicate based on a reinsurance to close premium estimated by the managing agent. The process of calculating the reinsurance to close will vary from managing agent to managing agent but it is likely to include the use of statistical projections based on previous claims history, case-by-case reviews of notified losses and the use of security ratings to help assess the financial ability of reinsurers to pay the reinsurance recoveries anticipated of them.

The payment of a reinsurance to close premium does not eliminate totally the liability of the closed year for outstanding claims. If the reinsuring syndicate were unable to meet its obligations and the other elements of the Lloyd's chain of security were to fail, then the members of the closed underwriting year would have to settle outstanding claims. The directors consider that the likelihood of such failure of the reinsurance to close is extremely remote and, therefore, the reinsurance to close has been deemed to settle liabilities outstanding at the closure of the underwriting account and no further provision is made for any potential variation in the ultimate liability of that year of account.

Technical Provisions

Claims outstanding

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, such as the Chain Ladder and Bornhuetter-Ferguson methods. Such methods extrapolate the development of paid and incurred claims, average cost per claim and ultimate claim numbers for each underwriting year, based upon the observed development of earlier years and expected loss ratios. Although the estimate of net outstanding claims is considered to be fair and reasonable, it is implicit in the estimation procedure that ultimate liabilities will be at variance from the amount provided. Any difference between provisions at the balance sheet date and settlements and provisions in the following year is included in the underwriting result for that year.

The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. Judgement is used to assess the extent to which past trends may not apply in future, for example, to reflect public attitudes to claiming or varying levels of claims inflation. The approach adopted takes into account, inter alia, the nature and materiality of the business and the type of data available.

Skilled claims technicians applying their experience and knowledge to the circumstances of individual claims generally set case estimates. Additional qualitative input, such as allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix, is used in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, from a range of possible outcomes, taking account of all the uncertainties involved.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share, having regard to collectability.

Unexpired risk provision

A provision for unexpired risks is made when it is anticipated that unearned premiums will be insufficient to meet future claims and claims settlement expenses of business in force at the end of the period. The provision for unexpired risks is calculated after taking into account the relevant investment return.

Acquisition Costs

Managed participations

Acquisition costs, comprising commission and other costs related to the acquisition of new insurance contracts, are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

Non-managed participations

Acquisition costs comprise all direct costs arising from the conclusion of insurance contracts. These costs are charged to the profit and loss account as incurred.

Investment Return

Net investment return comprises investment income, including realised gains and losses, unrealised gains and losses on investments, investment expenses and interest payable.

Realised gains and losses on investments represent the difference between net sales proceeds and purchase price.

Unrealised gains and losses on investments represent the difference between the current value of investments at the balance sheet date and their purchase price, adjusted for previously recognised unrealised gains and losses on investments disposed of in the accounting period.

The longer term return on investments owned by the underlying syndicates, together with the longer term return generated by the Funds at Lloyd's which support the underwriting activities, initially allocated to the non-technical account, is transferred from that account to the technical account. The actual net investment return from other activities is included within the non-technical account as part of operating profit. The difference between the longer term return allocated to the technical account and the actual return achieved on the underlying assets is recorded in the non-technical account as 'Short term fluctuations in investment return'.

Foreign Exchange

Syndicate assets, liabilities, income and expenditure expressed in US dollars and Canadian dollars are translated at the rates of exchange ruling at 31 December. Underwriting transactions in other foreign currencies are included in the financial statements at the rate ruling at the date of the transaction. All differences on the translation of foreign currency amounts in the syndicates are dealt with in the technical account; other differences are dealt with in the non-technical account.

The Group's assets expressed in foreign currency relate to monetary assets, which are translated at the rates ruling at the balance sheet date. Exchange differences arising from transactions are taken to the profit and loss account.

Underwriting Agency Fees

These represent net fee income receivable from capital providers, which are accounted for on an accruals basis.

Profit Commission

Profit commission from managed syndicates is recognised as earned on an annual basis to match the related underwriting profits. Profit commission is receivable when the syndicate's underwriting year of account is closed; this is normally at the end of the three calendar years.

Other Commissions and Fees

Other commissions and fees are made up of invoiced sales of services, excluding VAT, which are accounted for on an accruals basis.

Operating Expenses

The Group's operations include the control and payment of expenses, some of which relate to and are recharged to managed syndicates. The residual costs are charged to the profit and loss account as incurred.

Depreciation

Depreciation is calculated to write off the cost of tangible fixed assets on a straight-line basis over their estimated useful economic lives as follows:

Leasehold property	15 years
Leasehold improvements	5 years
Computer hardware	3 to 5 years
Computer software	3 to 10 years
Motor vehicles	3 years

Goodwill Arising on Consolidation

Goodwill, being the cost of acquisition less the fair value of net assets acquired, incurred prior to 1 January 1998 was offset against reserves. On disposal of a business acquired prior to 1998, the profit or loss is determined after taking into account goodwill previously offset against reserves. Goodwill incurred with effect from 1998 is capitalised as an intangible asset and amortised on a straight-line basis over a period of ten years, which the directors consider to be a reasonable estimate of the economic life of such an asset. The value of goodwill and the economic life of the asset is reviewed and amended as necessary, any impairment is recognised in the profit and loss account.

Intangible Assets

The costs of acquisition of syndicate capacity are capitalised as an intangible asset and amortised on a straight-line basis over a period of ten years, which the directors consider to be a reasonable estimate of the economic life of the Group's interest in the Highway Insurance operations, commencing in the first year in which underwriting income is recognised from that capacity. The value and economic life of the asset is reviewed and amended as necessary, any impairment is recognised in the profit and loss account.

Investments

Other financial investments are stated at their current value at the balance sheet date. Listed investments are stated at mid-market price at close of business on the balance sheet date or the last Stock Exchange dealing day before the balance sheet date.

Other investments in the Company balance sheet are stated at cost less amounts written off in respect of a permanent diminution in value.

Retirement Benefits

The Group operates a defined contribution pension scheme. The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

The Group also operates a pension scheme providing benefits based on final pensionable pay. As set out above, the Group fully adopted FRS 17 in the year, further details are set out in notes 23 and 28.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

Any pension scheme surplus (to the extent that it is recoverable) or deficit and the associated deferred tax balances are recognised in full and shown in the balance sheet. The movement in the surplus or deficit is split between operating charges, finance items and, in the statement of total recognised gains and losses, actuarial gains and losses.

Taxation

Current tax, including UK corporation tax is provided on taxable profits at the rate applicable at the balance sheet date.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exceptions:

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on the tax rates and laws enacted or substantively enacted at the balance sheet date.

Leases

Operating lease costs are charged to the profit and loss account in equal annual instalments over the life of the lease.

Assets held under finance leases and hire purchase contracts are capitalised at their fair value on inception of the leases and depreciated over their estimated useful lives. The finance charges are allocated over the period of the lease on a straight-line basis.

Investment in Own Shares

The cost of own shares held by the Group's ESOP trust is deducted in arriving at shareholders' funds.

Group Profit and Loss Account

For the year ended 31 December 2003

Technical Account – General Business

	Note	2003 £000	2002 £000
Gross premiums written	1	249,148	133,965
Outward reinsurance premiums		(49,419)	(11,862)
Net premiums written		199,729	122,103
Change in the gross provision for unearned premiums		(46,353)	37,827
Change in the provision for unearned premiums, reinsurers' share		14,610	(5,169)
Change in net unearned premiums		(31,743)	32,658
Net earned premiums		167,986	154,761
Allocated investment return transferred from the non-technical account		17,213	15,784
Other technical income		1,076	1,218
Total technical income		186,275	171,763
Gross claims paid		(157,414)	(167,889)
Reinsurers' share		29,965	26,858
Net paid claims		(127,449)	(141,031)
Change in claims provision		2,503	(18,661)
Reinsurers' share		(1,968)	45,090
Change in the provision for claims		535	26,429
Net claims incurred	2	(126,914)	(114,602)
Net operating expenses	1,3	(37,580)	(36,045)
Total technical charges		(164,494)	(150,647)
Balance on the technical account – general business		21,781	21,116

Group Profit and Loss Account

For the year ended 31 December 2003

Non – Technical Account

	Note	2003 £000	2002 (restated) £000
Balance on the general business technical account		21,781	21,116
Investment income	6	14,958	15,230
Unrealised gains on investments	6	4,267	923
Investment expenses and charges	6	(9,207)	(1,885)
Unrealised losses on investments	6	(1,325)	(1,037)
Allocated investment return transferred to the general business technical account	6	(17,213)	(15,784)
Other income		2,403	4,200
Pension scheme past service credit		12,100	–
Total other income		14,503	4,200
Other charges including value adjustments		(5,901)	(8,459)
Operating profit before exceptional items		21,863	14,304
Loss arising from investment in NMT		–	(12,071)
Restructuring costs		–	(1,178)
		21,863	1,055
Operating profit based on longer term investment return		29,030	3,478
Short term fluctuations in investment return	6	(7,167)	(2,423)
Profit on ordinary activities before taxation		21,863	1,055
Taxation on profit on ordinary activities	7	(6,824)	(2,944)
Profit/(loss) on ordinary activities after taxation		15,039	(1,889)
Minority interest		(141)	(138)
Profit/(loss) for the financial year		14,898	(2,027)
Dividends	9	(4,917)	(4,911)
Retained profit/(loss) for financial year	22	9,981	(6,938)
Earnings per share			
Basic	10	7.5p	(1.1p)
Diluted	10	7.5p	(1.1p)

Group Balance Sheet

As at 31 December 2003

Assets	Note	2003 £000	2002 (restated) £000
Intangible assets	12	3,150	3,498
Investments			
Other financial investments	13	292,812	278,117
Deposits with ceding undertakings		–	1
Reinsurers' share of technical provisions			
Provision for unearned premiums		19,522	4,912
Claims outstanding		101,416	105,331
		120,938	110,243
Debtors			
Debtors arising out of direct insurance operations – intermediaries		47,335	43,506
Debtors arising out of reinsurance operations		23,125	11,645
Other debtors – amounts falling due within one year	15	9,781	20,242
Other debtors – amounts falling due after more than one year	16	3,289	6,161
		83,530	81,554
Other assets			
Tangible assets	11	7,948	6,420
Cash at bank and in hand	14	49,394	30,275
		57,342	36,695
Prepayments and accrued income			
Deferred acquisition costs		21,191	13,582
Other prepayments and accrued income		17,308	6,606
		38,499	20,188
Total assets		596,271	530,296

Group Balance Sheet

As at 31 December 2003 (continued)

Liabilities	Note	2003 £000	2002 (restated) £000
Capital and reserves			
Called up share capital	20	40,323	40,323
Share premium account	21	16,277	16,277
Investment in own shares	21	(2,557)	(2,557)
Merger reserve	21	39,221	39,221
Other reserves	21	1,640	1,640
Profit and loss account	21	(25,863)	(33,668)
Total shareholders' funds – equity	22	69,041	61,236
Minority interest – equity		355	254
Total capital and reserves		69,396	61,490
Technical provisions			
Provision for unearned premiums		124,863	78,510
Claims outstanding		305,091	307,934
		429,954	386,444
Creditors			
Creditors arising out of direct insurance operations		9,999	15,509
Creditors arising out of reinsurance operations		5,664	5,879
Other creditors – amounts falling due within one year	18	32,177	9,994
Other creditors – amounts falling due after more than one year	19	38,000	35,845
		85,840	67,227
Accruals and deferred income		6,370	3,663
Total liabilities excluding net pension liability		591,560	518,824
Net pension liability	28	4,711	11,472
Total liabilities including net pension liability		596,271	530,296

Approved by the board of directors and signed on its behalf on 15 March 2004 by:

Ross Dunlop, *Executive Chairman*

Ian Patrick, *Finance Director*

Company Balance Sheet

As at 31 December 2003

	Note	2003 £000	2002 (restated) £000
Fixed assets			
Tangible assets	11	35	79
Other investments	13	54,321	53,733
		54,356	53,812
Current assets			
Debtors – amounts falling due within one year	15	147,249	129,550
Debtors – amounts falling due after more than one year	16	6,698	1,530
Cash at bank and in hand	14	29	6,392
		153,976	137,472
Creditors – amounts falling due within one year	18	(104,270)	(83,117)
Net current assets		49,706	54,355
Total assets less current liabilities		104,062	108,167
Creditors – amounts falling due after more than one year	19	(37,500)	(35,000)
Net assets		66,562	73,167
Capital and reserves			
Called up share capital	20	40,323	40,323
Share premium account	21	16,277	16,277
Investment in own shares	21	(2,557)	(2,557)
Other reserves	21	1,640	1,640
Profit and loss account	21	10,879	17,484
Total shareholders' funds – equity	22	66,562	73,167

Approved by the board of directors and signed on its behalf on 15 March 2004 by:

Ross Dunlop, *Executive Chairman*

Ian Patrick, *Finance Director*

Group Cash Flow Statement

For the year ended 31 December 2003

	Note	2003 £000	2002 £000
Net cash inflow from operating activities	24	28,456	273
Interest paid			
Dividends paid to minorities		(40)	(120)
Interest paid		(2,673)	(2,200)
Interest element of finance lease payments		(38)	(38)
		(2,751)	(2,358)
Taxation			
Corporation tax paid		–	(948)
Capital expenditure			
Purchase of tangible fixed assets	11	(3,538)	(5,938)
Sale of tangible fixed assets		29	126
Purchase of goodwill	12	(194)	–
Purchase of syndicate capacity		–	(642)
		(3,703)	(6,454)
Equity dividends paid		(4,917)	(3,124)
Financing			
Issue of ordinary share capital	22	–	25,000
Expenses of issue	22	–	(1,638)
Capital element of finance leases and hire purchase contracts		(307)	(322)
Drawdown of bank loan	26	15,000	2,000
		14,693	25,040
Net cash flows		31,778	12,429
Cash flows were invested as follows:			
Increase in cash holdings	26	19,119	5,975
Net portfolio investments			
Financial investments	27	12,659	6,454
Net investment of cash flows		31,778	12,429

Group Statement of Total Recognised Gains and Losses

For the year ended 31 December 2003

	Note	2003 £000	2002 (restated) £000
Profit/(loss) for the financial year		14,898	(2,027)
Pension scheme actuarial losses		(3,108)	(17,380)
Deferred tax on pension scheme actuarial losses		932	5,214
Total recognised gains and losses relating to the year		12,722	(14,193)
Prior year adjustment	23	(11,472)	
Total gains and losses recognised since the last annual report		1,250	

Notes to the financial statements

For the year ended 31 December 2003

1. Segmental information

Segmental information in the format required by SSAP 25 – 'Segmental Reporting', so far as available, is as follows, and relates entirely to external customers:

(a) Analysis of insurance underwriting

	Gross premiums written		Gross premiums earned		Gross claims incurred	
	2003	**2002**	**2003**	**2002**	**2003**	**2002**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Motor – third party liability	113,348	75,607	88,514	99,129	78,729	121,720
Motor – other classes	136,859	53,658	115,340	64,268	95,495	63,710
Property	12	542	12	4,237	(1,856)	6,399
Non-managed participations	(1,071)	4,158	(1,071)	4,158	(17,457)	(5,279)
Total	249,148	133,965	202,795	171,792	154,911	186,550

	Net operating expenses		Reinsurance balance	
	2003	**2002**	**2003**	**2002**
	£000	**£000**	**£000**	**£000**
Motor – third party liability	15,562	19,064	4,925	44,489
Motor – other classes	20,775	12,406	3,685	16,790
Property	–	836	(75)	337
Non-managed participations	1,243	3,739	(15,347)	(6,699)
Total	37,580	36,045	(6,812)	54,917

Notes to the financial statements

For the year ended 31 December 2003 (continued)

1. Segmental information (continued)

(b) Profit on ordinary activities before taxation and net assets by business division

	Underwriting £000	Distribution £000	Corporate £000	Pension fund £000	2003 Total £000
Balance on the general business technical account	21,781	–	–	–	21,781
Other investment return	25	(70)	(1,211)	(97)	(1,353)
Other income	–	2,524	(121)	12,800	15,203
Other expenses	(18)	(1,896)	(4,750)	63	(6,601)
Operating profit based on longer term investment return	21,788	558	(6,082)	12,766	29,030
Short term fluctuations in investment return	(7,167)	–	–	–	(7,167)
Profit on ordinary activities before taxation	14,621	558	(6,082)	12,766	21,863
Net assets	67,750	2,508	3,494	(4,711)	69,041

	Underwriting £000	Distribution £000	Corporate £000	Pension fund £000	2002 Total (restated) £000
Balance on the general business technical account	21,116	–	–	–	21,116
Other investment return	–	(81)	(830)	781	(130)
Other income	–	1,850	2,350	–	4,200
Other expenses	(1,623)	(1,365)	(5,482)	11	(8,459)
Operating profit based on longer term investment return	19,493	404	(3,962)	792	16,727
Exceptional items	–	–	(13,249)	–	(13,249)
Short term fluctuations in investment return	(2,423)	–	–	–	(2,423)
Profit on ordinary activities before taxation	17,070	404	(17,211)	792	1,055
Net assets	39,186	5,225	28,297	(11,472)	61,236

2. Movement in prior years provisions for claims outstanding

Included within claims incurred in the technical account is an amount of £9,417,000 (2002: £4,704,000) being the difference between the provision for claims outstanding at the beginning of the year less payments made during the year on account of claims incurred in previous years and the provision for claims outstanding at the end of the year for such claims.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

3. Net operating expenses – technical account

	2003 £000	2002 £000
Acquisition costs	34,419	26,027
Movement in deferred acquisition costs	(7,609)	620
Administrative expenses	10,770	9,398
Total	37,580	36,045

4. Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging the following items (stated gross before recharges to syndicates):

	2003 £000	2002 £000
Depreciation of tangible fixed assets	2,005	1,465
Amortisation of goodwill	109	94
Amortisation of syndicate capacity	433	381
Operating leases rentals (see note 32):		
Land and buildings	968	1,125
Auditors' remuneration:		
Audit fees, including Company £75,000 (2002: £50,000)	185	125
Other services	–	248

In 2002 £164,000 was paid to Ernst & Young (the prior year auditors) for the provision of actuarial services.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

5. Employees

(a) Staff costs (including directors)

	2003 £000	2002 (restated) £000
Salaries, bonus and commission	13,490	13,564
Social security	1,351	1,188
Other pension costs	1,032	1,026
Other staff costs	373	776
Total	16,246	16,554

(b) Number of staff (including directors)

	Average for the year		At 31 December	
	2003	2002	2003	2002
Continuing operations:				
Insurance activities	527	591	509	577
Centre	–	10	–	–
Total	527	601	509	577

(c) Directors' emoluments

Full details of directors' emoluments and their interests in the ordinary share capital of the Company are included in the Directors' Remuneration Report on pages 22 to 26.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

6. Investment return

	2003 £000	2002 (restated) £000
Investment income	14,814	9,673
Realised gains on investments	144	4,776
Unrealised gains on investments	4,267	923
	19,225	15,372
Net pension scheme (expense)/income	(97)	781
Investment expenses and charges	(7,762)	(1,052)
Loan interest payable	(2,673)	(1,870)
Net investment return	8,693	13,231

Analysed as:

	2003 £000	2002 (restated) £000
Allocated investment return transferred to the general business technical account	17,213	15,784
Non-underwriting investment income	1,320	1,740
Loan interest payable	(2,673)	(1,870)
Net investment return	15,860	15,654
Short term fluctuations in investment return	(7,167)	(2,423)
Net investment return	8,693	13,231

Included within investment expenses and charges are realised losses of £5,667,000 (2002: £1,037,000).

Notes to the financial statements

For the year ended 31 December 2003 (continued)

6. Investment return (continued)

The transfer to the technical account represents the estimated long-term rate of return of 5.5% (2002: 5.5%) applied to the investment assets and solvency capital held by the Group's insurance businesses.

The longer-term rate of return is based on a combination of historical experience and current expectations for each category of investment.

The longer-term rates of return used were:

	2003 %	2002 %
Debt securities and other fixed income securities	5.5	5.5
Deposits with credit institutions	5.5	5.5

Comparison of the long-term investment return credited to the general business technical account with the actual return included in the non-technical account:

	1999 – 2003	1998 – 2002
Long-term investment return credited to the general business technical account	80,539	72,087
Actual return included in the non-technical account	69,142	67,857
Excess of the long-term investment return over the actual return	11,397	4,230

Notes to the financial statements

For the year ended 31 December 2003 (continued)

7. Taxation on profit on ordinary activities

(a) Analysis of charge for the year

	2003 £000	2002 (restated) £000
UK corporation tax		
Current tax on profits for the year	(124)	(153)
Adjustments in respect of prior years	1	(61)
Current tax charge	(123)	(214)
Deferred tax		
Current year	(6,559)	(4,583)
Adjustments in respect of prior years	(142)	1,853
Deferred tax charge	(6,701)	(2,730)
Total tax charge	(6,824)	(2,944)

The charge for tax on profit for the year is based on a UK corporation tax rate of 30% (2002: 30%).

(b) Factors affecting tax charge for the period

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the current tax charge for the year is given below:

	2003 £000	2002 (restated) £000
Profit on ordinary activities before tax	21,863	1,055
Tax charge thereon at UK corporation tax rate of 30%	(6,559)	(317)
Factors affecting charge:		
Expenses not deductible for tax purposes (including goodwill amortisation)	(471)	(640)
Decrease in accelerated capital allowances	(598)	(210)
Expenses not deductible in relation to the loss on New Millennium Technologies	–	(3,492)
Expenses not deductible in relation to Group restructuring	–	(78)
Deferred tax on accrued underwriting result	996	2,045
Deferred tax on FRS 17 pension adjustment	3,830	238
Losses arising in the year relievable against current tax	2,622	1,945
Other	56	356
Tax over provided/(under provided) in previous years	1	(61)
Current tax charge	(123)	(214)

(c) Factors that may affect future tax charges

The Group has capital losses carried forward of £47,946,862 (2002: £47,946,862). It is not anticipated that the Group will make any capital gains in the near future.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

8. Loss for the financial year

	2003 £000	2002 £000
Loss before dividend for the financial year attributable to the shareholders dealt within the accounts of the Company	(1,688)	(5,630)

9. Dividends

	2003 £000	2002 £000
Interim paid of 0.8p per share (2002: 0.8p per share)	1,587	1,581
Final proposed of 1.68p per share (2002: 1.68p per share)	3,330	3,330
Total	4,917	4,911

10. Earnings per share

	2003 £000	2002 (restated) £000
Profit/(loss) for the financial year	14,898	(2,027)
	Number of shares	Number of shares
Weighted number of shares in issue excluding LTIP shares	198,242,410	177,990,624
Basic profit/(loss) per share	7.5p	(1.1p)
Diluted profit/(loss) per share	7.5p	(1.1p)

Notes to the financial statements

For the year ended 31 December 2003 (continued)

11. Tangible assets

Group	Leasehold property £000	Leasehold improvements £000	Computer and other equipment £000	Motor vehicles owned £000	Total £000
Cost					
At 1 January 2003	268	1,251	11,299	433	13,251
Additions	–	–	3,456	82	3,538
Disposals	–	–	–	(123)	(123)
At 31 December 2003	268	1,251	14,755	392	16,666
Accumulated depreciation					
At 1 January 2003	97	1,181	5,234	319	6,831
Charge for the year	16	30	1,856	103	2,005
Disposals	–	–	–	(118)	(118)
At 31 December 2003	113	1,211	7,090	304	8,718
Net book value					
At 31 December 2003	155	40	7,665	88	7,948
At 31 December 2002	171	70	6,065	114	6,420

Leasehold property has a life of 15 years.

Leasehold improvements are in respect of leases with a life of under 50 years.

With the exception of leasehold property, which is shown separately, there is £345,832 (2002: £678,571) of computer and other equipment held under finance leases and hire purchase contracts, included in the table above.

Company	Leasehold property £000	Computer and other equipment £000	Total £000
Cost			
At 1 January 2003 and at 31 December 2003	351	269	620
Accumulated depreciation			
At 1 January 2003	291	250	541
Charge for the year	30	14	44
At 31 December 2003	321	264	585
Net book value			
At 31 December 2003	30	5	35
At 31 December 2002	60	19	79

Notes to the financial statements

For the year ended 31 December 2003 (continued)

12. Intangible assets

Group	Goodwill arising on consolidation £000	Syndicate capacity acquisition £000	Total £000
Cost			
At 1 January 2003	941	4,411	5,352
Addition	194	–	194
At 31 December 2003	1,135	4,411	5,546
Amortisation			
At 1 January 2003	470	1,384	1,854
Charge for the year	109	433	542
At 31 December 2003	579	1,817	2,396
Net book value			
At 31 December 2003	556	2,594	3,150
At 31 December 2002	471	3,027	3,498

The addition in the value of goodwill during the year arose from the acquisition on the 12 March 2003 of a 75% equity shareholding in Elite Underwriting Limited.

13. Investments

Group	2003 £000	2002 £000
Other financial investments:		
Interest-bearing deposits held as security by the Corporation of Lloyd's	21,486	19,721
Shares and other variable-yield securities and units in unit trusts	64,368	584
Debt securities and other fixed income securities	94,660	117,296
Deposits with credit institutions	109,825	140,016
Other	2,473	500
Total	292,812	278,117

Notes to the financial statements

For the year ended 31 December 2003 (continued)

13. Investments (continued)

Company	2003 £000	2002 £000
Investments in Group undertakings and participating interests:		
Shares in subsidiary undertakings	54,321	53,733

Group	2003 £000	2002 £000
Listed investments at market value	77,946	61,631

The interest-bearing deposits are secured by Lloyd's premium trust deed to the Society of Lloyd's.

The Company's investments in Highway Group Services Plc and SLA Holdings Limited of £38,220,000 (2002: £38,132,000) are secured by a first legal charge to Lloyds TSB Bank Plc.

Further details of subsidiary undertakings are given on page 68.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

14. Cash at bank and in hand

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Cash at bank and in hand	46,768	30,196	29	6,392
Cash held in Premium Trust Funds	2,626	79	–	–
Total	49,394	30,275	29	6,392

15. Other debtors – amounts falling due within one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Subsidiary undertakings	–	–	146,666	129,078
Other syndicate debtors	8,380	18,647	–	–
Other debtors	1,401	1,595	583	122
Taxation recoverable	–	–	–	350
Total	9,781	20,242	147,249	129,550

16. Other debtors – amounts falling due after more than one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Subsidiary undertakings	–	–	6,650	1,400
Deferred tax	3,289	6,161	48	130
Total	3,289	6,161	6,698	1,530

Notes to the financial statements

For the year ended 31 December 2003 (continued)

17. Deferred tax

The amounts provided for deferred tax are as set out below:

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Accelerated capital allowances	835	523	48	130
Trading losses available for carry forward	2,848	6,373	–	–
Other timing differences	(394)	(735)	–	–
Total	3,289	6,161	48	130

Deferred tax asset	Group £000	Company £000
At 1 January 2003	6,161	130
Origination and reversal of timing differences	(2,730)	(82)
Adjustments in respect of prior periods	(142)	–
At 31 December 2003	3,289	48

The Group has no unprovided deferred tax liabilities. (See also note 7c)

18. Other creditors – amounts falling due within one year

	Group 2003 £000	Group 2002 (restated) £000	Company 2003 £000	Company 2002 (restated) £000
Subsidiary undertakings	–	–	85,163	78,914
Other syndicate creditors	9,811	2,841	–	–
Other creditors	6,191	2,961	769	789
Bank loan	12,500	–	12,500	–
Corporation tax	–	154	2,508	–
Social security costs	–	360	–	84
Proposed dividend	3,330	3,330	3,330	3,330
Finance leases	345	348	–	–
Total	32,177	9,994	104,270	83,117

Following the year end the terms of the Group's bank facilities were varied. The effects of the variation is set out in note 19.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

19. Other creditors – amounts falling due after more than one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Bank loan	37,500	35,000	37,500	35,000
Other loan	500	500	–	–
Finance leases	–	345	–	–
Total	38,000	35,845	37,500	35,000

At 31 December 2003 the Group had fully drawn its £50 million term loan facility. On 29 January 2004 the Group entered into an agreement to vary the terms of the facility principally to reduce the term loan facility to £40 million and to provide a £10 million letter of credit facility. On 11 February 2004 the Group repaid £10 million to reduce the term loan to £40 million and had issued on its behalf a £10 million Letter of Credit.

£3.75 million of the term loan facility is repayable during 2004. The balance is repayable in full between 2 and 5 years. Interest is payable at 1.75% over LIBOR.

20. Called up share capital

Company	Number of shares	2003 £000	Number of shares	2002 £000
Ordinary 20p shares:				
Authorised	274,999,998	55,000	274,999,998	55,000
Allotted, issued and fully paid	201,615,316	40,323	201,615,316	40,323

Under the Sale and Purchase Agreement of 1 December 1997, Warrants to subscribe for 5 million Ordinary 20p shares in Highway Insurance Holdings Plc were issued to the US Investors from whom the Company acquired 42% of the issued share capital of Highway Group Services Plc. These Warrants, which were valued in aggregate at £150,000, can be exercised at 125p per share at any time between the second and eighth anniversary of completion of the Agreement.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

21. Reserves

Group	Share premium account £000	Investment in own shares £000	Merger reserve £000	Other reserves £000	Profit and loss account £000
At 1 January 2003 as previously reported	16,277	–	39,221	1,640	(22,196)
Prior year adjustment	–	(2,557)	–	–	(11,472)
At 1 January 2003 as restated	16,277	(2,557)	39,221	1,640	(33,668)
Retained profit for the financial year	–	–	–	–	9,981
Pension scheme actuarial losses	–	–	–	–	(3,108)
Deferred tax on pension scheme actuarial losses	–	–	–	–	932
At 31 December 2003	16,277	(2,557)	39,221	1,640	(25,863)

Company	Share premium account £000	Investment in own shares £000	Other reserves £000	Profit and loss account £000
At 1 January 2003 as previously reported	16,277	–	1,640	17,484
Prior year adjustment	–	(2,557)	–	–
At 1 January 2003 as restated	16,277	(2,557)	1,640	17,484
Retained loss for the financial year	–	–	–	(6,605)
At 31 December 2003	16,277	(2,557)	1,640	10,879

Notes to the financial statements

For the year ended 31 December 2003 (continued)

22. Reconciliation of movements in shareholders' funds – equity

	Group 2003 £000	Group 2002 (restated) £000	Company 2003 £000	Company 2002 (restated) £000
Profit/(loss) for the financial year	15,039	(1,889)	(1,688)	(5,630)
Minority interest	(141)	(138)	–	–
Dividends	(4,917)	(4,911)	(4,917)	(4,911)
Retained profit/(loss) for the financial year	9,981	(6,938)	(6,605)	(10,541)
Pension scheme actuarial losses	(3,108)	(17,380)	–	–
Deferred tax on pension scheme actuarial losses	932	5,214	–	–
Placing and open offer	–	25,000	–	25,000
Placing expenses	–	(1,638)	–	(1,638)
Scrip issue final dividend 2001	–	214	–	214
Scrip issue interim dividend 2002	–	236	–	236
Net increase/(decrease) in shareholders' funds	7,805	4,708	(6,605)	13,271
Shareholders' funds – equity at 1 January as previously reported	75,265	58,945	75,724	62,453
Prior year adjustment	(14,029)	(2,417)	(2,557)	(2,557)
Shareholders' funds – equity at 1 January as restated	61,236	56,528	73,167	59,896
Shareholders' funds – equity at 31 December	69,041	61,236	66,562	73,167

23. Prior year adjustments

The prior year adjustments relate to the full implementation of FRS 17 – 'Retirement Benefits' and UITF Abstract 38 'Accounting for ESOPs'.

The adoption of FRS 17 has resulted in an increase in the reported profit before taxation for 2002 of £792,000. In addition, the profit before taxation for 2003 is £12,766,000 higher than would have been the case had FRS 17 not been adopted during the year.

The adoption of FRS 17 has resulted in a net pension liability line and reduction in the profit and loss reserve in the balance sheet of £4,711,000 (2002: £11,472,000) in respect of the Group deficit on the pension fund.

The adoption of UITF Abstract 38 'Accounting for ESOPs' has resulted in a decrease in the cost of investment in own shares of £2,557,000, and a corresponding decrease in shareholders' funds of £2,557,000. In addition, the shareholders' funds for 2003 have decreased by £2,557,000. This has had no material effect on the profit for either the current or the comparative year.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

24. Reconciliation of operating profit to net cash inflow from operating activities

	2003 £000	2002 (restated) £000
Operating profit	21,863	1,055
Depreciation	2,005	1,465
Amortisation	542	475
Interest on borrowings	2,847	1,886
Changes in market value – increase	(2,035)	(924)
(Profit)/loss on sale of tangible fixed assets	(24)	53
Amortisation of investment in own shares	(65)	65
Additional contributions in excess of service cost	(12,863)	(11)
Expected return on net assets of pension scheme	97	(781)
Write-off of debtor in New Millennium Technologies	–	6,663
Debtors – (increase)/decrease	(34,014)	16,355
Creditors – increase/(decrease)	50,103	(26,028)
Net cash inflow from operating activities	28,456	273

25. Movement in opening and closing portfolio investments net of financing

	2003 £000	2002 £000
Increase in cash holdings	19,119	5,975
Cash flow – bank loan	(15,000)	(2,000)
Cash flow – portfolio investments	12,659	6,454
Cash flow – finance lease	(345)	(360)
Net movement arising from cashflows	16,433	10,069
Changes in market value	2,035	924
Non cash changes	–	223
Total movement in portfolio investments net of financing	18,468	11,216
Portfolio net of financing at 1 January	273,586	262,370
Portfolio net of financing at 31 December	292,054	273,586

Notes to the financial statements

For the year ended 31 December 2003 (continued)

26. Movement in cash and portfolio investments

	1 January 2003 £000	Cash flow £000	Changes to market value £000	31 December 2003 £000
Net cash:				
Cash	30,196	16,572	–	46,768
Cash held in Premium Trust Funds	79	2,547	–	2,626
	30,275	19,119	–	49,394
Other financial investments	278,117	12,660	2,035	292,812
Deposits with ceding undertakings	1	(1)	–	–
Bank loan	(35,000)	(15,000)	–	(50,000)
Other loan	(500)	–	–	(500)
Finance lease	693	(345)	–	348
Total	273,586	16,433	2,035	292,054

27. Net cash inflow on portfolio investments

	2003 £000	2002 £000
Interest-bearing deposits held as security by the Corporation of Lloyd's	1,765	1,471
Shares and other variable-yield securities and units in unit trusts	62,226	(949)
Debt securities and other fixed income securities	(23,112)	(126,550)
Deposits with credit institutions	(31,378)	136,412
Deposits with ceding undertakings	(1)	(59)
Other	3,159	(3,871)
Total	12,659	6,454

Notes to the financial statements

For the year ended 31 December 2003 (continued)

28. Retirement benefits

The Group has two pension schemes – a defined contribution scheme and a defined benefit scheme.

The defined contribution scheme covers the majority of the Group's employees and directors.

The defined benefit scheme is closed to all employees other than those who were aged over 50 years of age as at September 2000. The funds of the scheme are controlled by trustees and are administered externally. Since the defined benefit scheme is now closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as the members of the scheme approach retirement.

An independent qualified actuary carried out the latest actuarial valuation of this scheme as at 31 December 2002 using the projected unit method to value the liabilities. The market value of the scheme's assets was £52,600,000 and the level of funding at that date was some 102%. The actuary recommended that the next actuarial valuation of the scheme be conducted no later than 31 December 2004.

The Company has agreed with the actuary to maintain contributions into the Ockham Pension Scheme at the rate of 25.7% of pensionable salary.

FRS 17 Retirement Benefits

The valuation used for FRS 17 disclosures has been based on the most recent actuarial valuations, updated to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 December 2003.

The main financial assumptions used to calculate scheme liabilities under FRS 17 are:

	Percentage per annum 2003	Percentage per annum 2002	Percentage per annum 2001
Discount rate	5.40	5.50	5.75
Rate of increase of pensions in payment and deferred pensions	2.50	5.00	5.00
Increase in earnings	2.50	2.35	2.50
Inflation assumption in course of payments and deferred pensions	2.50	2.35	2.50

Notes to the financial statements

For the year ended 31 December 2003 (continued)

28. Retirement benefits (continued)

The assets and liabilities of the scheme, attributable to defined benefit members, and the expected rate of return were:

	Long-term rate of return at 31 December 2003	Fair value at 31 December 2003 £000	Long-term rate of return at 31 December 2002	Fair value at 31 December 2002 £000	Long-term rate of return at 31 December 2001	Fair value at 31 December 2001 £000
Equities	7.25%	46,204	7.0%	39,546	7.5%	53,000
Bonds	4.75%	10,206	4.5%	11,599	5.0%	10,500
Cash	3.75%	1,490	4.0%	1,338	3.25%	2,700
Total market value of assets		57,900		52,483		66,200
Actuarial value of liability		(64,630)		(68,871)		(66,000)
Recoverable (deficit)/surplus in the scheme		(6,730)		(16,388)		200
Related deferred tax asset/(liability)		2,019		4,916		(60)
Net pension (liability)/asset		(4,711)		(11,472)		140

Analysis of the amount (credited)/charged to operating profit:

	2003 £000	2002 £000
Current service cost	174	253
Past service cost	(12,800)	–
Total	(12,626)	253

Analysis of the amount (charged)/credited to investment income:

	2003 £000	2002 £000
Expected return on pension scheme assets	3,296	4,512
Interest on pension scheme liabilities	(3,393)	(3,731)
Total	(97)	781

Notes to the financial statements

For the year ended 31 December 2003 (continued)

28. Retirement benefits (continued)

Analysis of the amount recognised in the statement of total recognised gains and losses:

	2003 £000	2002 £000
Actual return less expected return on scheme assets	3,605	(16,029)
Experience gains and losses arising on scheme liabilities	(4,526)	1,158
Changes in assumptions underlying the present value of the scheme liabilities	(2,187)	(2,509)
Actual losses recognised	(3,108)	(17,380)

Movement in deficit in the scheme during the year is as follows:

	2003 £000
Deficit as at 1 January 2003	(16,388)
Movement in year:	
Current service cost	(174)
Contributions	238
Past service credit – restriction of pension increase to retail price index	12,800
Other finance income	(97)
Actuarial loss	(3,108)
Deficit as at 31 December 2003	(6,729)

History of experience gains and losses:

	Year to 31 December 2003 £000	Year to 31 December 2002 £000
Actual return less expected return on scheme assets:		
Amount	3,605	(16,029)
Percentage of scheme assets at balance sheet date	6%	(31%)
Experience gains and losses on scheme liabilities:		
Amount	(4,526)	1,158
Percentage of scheme liabilities at balance sheet date	(7%)	2%
Total amount recognised in statement of total recognised gains and losses:		
Amount	(3,108)	(17,380)
Percentage of scheme liabilities at balance sheet date	(5%)	(25%)

Notes to the financial statements

For the year ended 31 December 2003 (continued)

29. Guarantees

Group	2003 £000	2002 £000
Bank guarantees with respect to employees' and former employees' membership of Lloyd's	177	187
Guarantee required by the Corporation of Lloyd's with regard to the financial recourses of subsidiary undertakings which are managing and members' agencies	2,000	2,000

30. Litigation

The majority of actions against the Group's managing and members' agency subsidiary undertakings in respect of the Lloyd's market litigation have now been either discontinued or dismissed.

There remain a small number of actions outstanding where there has been no activity but where writs have not been formally dismissed. There also remains a possibility that a small minority of Names who did not accept the Lloyd's Settlement Offer might decide to pursue litigation against the Group. Nonetheless the Directors consider that the likelihood of any residual litigation having a material adverse effect on the financial position of the Group is minimal.

31. Capital commitments

No expenditure has been authorised and not provided for.

Notes to the financial statements

For the year ended 31 December 2003 (continued)

32. Lease commitments

Amounts due under finance leases and hire purchase contracts:

	2003 £000	2002 £000
Commitments expiring:		
Within one year	345	348
Two to five years	–	345
	345	693
Less finance charges allocated to future periods	(41)	(78)
Total	304	615

The Group has annual operating lease commitments, a portion of which will either be paid directly by managed syndicates or recharged to them as incurred, as follows:

	Land and Buildings	
	2003 £000	2002 £000
Commitments expiring:		
Within one year	–	18
Two to five years	267	169
Over five years	701	938
Total	968	1,125

33. Related party transactions

The following information regarding related party transactions is given in accordance with FRS 8 "Related Party Disclosures" for the year to 31 December 2003:

(a) Managed syndicates

Expenses incurred by the Group and recharged to Highway Motor Syndicate 37 amounted to £1,978,000 (2002: £2,165,000). Amounts owed by Highway Motor Syndicate 37 to the Group were £174,691 (2002: £159,378).

Directors supported the Highway Motor Syndicate 37 for capacity of £nil during the 2003 year of account (2002: £335,782). The Group received managing agency fees of £nil (2002: £3,358) with respect to this underwriting and received profit commission of £nil with respect to the 2000 year of account (2002: £nil with respect to the 1999 year of account).

b) Other transactions with key management

Motor insurance has been purchased from Highway Insurance Company, an FSA-regulated entity. The value of these transactions are not material to the Group, the Syndicates or the key management concerned.

Subsidiary Undertakings

As at 31 December 2003

Motor and Personal Lines Insurance Operations	
Highway Group Services Plc*	Intermediate holding company
Ockham Corporate Limited	Corporate member of Lloyd's
Highway Corporate Capital Limited*	Corporate member of Lloyd's
Highway Insurance Company Limited	FSA-regulated insurance company
Highway Insurance (Guernsey) Limited*	Guernsey regulated insurance company
Highway Premium Finance Limited	Premium financing company
Highway Direct Limited	Intermediate holding company
Highway Insurance Agency Limited	Lloyd's managing agency
Crusader Uninsured Loss Recovery Limited**	Claims management company
Elite Underwriting Limited***	Insurance broker
New London Capital	
New London Capital Plc*	Investment company
New London Capital Holdings Limited	Intermediate holding company and manager of underwriting capacity at Lloyd's on behalf of third parties
NLC Name No. 1 Limited	Corporate member of Lloyd's
NLC Name No. 2 Limited	Corporate member of Lloyd's
NLC Name No. 3 Limited	Corporate member of Lloyd's
NLC Name No. 4 Limited	Corporate member of Lloyd's
NLC Name No. 5 Limited	Corporate member of Lloyd's
NLC Name No. 7 Limited****	Corporate member of Lloyd's
Discontinued Operations	
Ockham.com Limited*	Technology investment company
SLA Holdings Limited*	Intermediate holding company
SMSM Limited	Lloyd's managing agency
SNSM Limited	Lloyd's managing agency
RWS Agency Limited	Lloyd's managing agency
Stafford Run-Off Agency Limited	Lloyd's managing agency

Notes:

Unless otherwise stated, the Group owns 100% of the equity share capital and voting rights of the undertakings which operate in the United Kingdom and are registered in England and Wales.

During the year a number of Group subsidiary undertakings have been liquidated.

Undertakings, which in the opinion of the directors did not materially affect the results or assets of the Group, are not shown.

* Indicates held directly by Highway Insurance Holdings Plc.

** The Group owns 60% of the equity share capital and voting rights.

*** The Group owns 75% of the equity share capital and voting rights.

**** NLC Name No.7 Limited is excluded from consolidation in accordance with Section 229 of the Act and FRS 2, on the grounds that this investment is immaterial and confers no economic interest to the Group.

Consolidated Five – Year Summary

Profit and Loss Account

	2003	2002 (restated)	2001	2000	1999
	£000	£000	£000	£000	£000
Technical account for general business					
Net premiums earned	167,986	154,761	115,612	202,869	159,840
Allocated investment return	17,213	15,784	21,624	17,804	8,114
Other technical income	1,076	1,218	–	–	–
Claims incurred, net of reinsurance	(126,914)	(114,602)	(74,722)	(189,060)	(133,914)
Net operating expenses	(37,577)	(36,033)	(47,579)	(41,434)	(41,927)
Personal expenses	(3)	(12)	(311)	853	(3,013)
Balance on the technical account for general business	21,781	21,116	14,624	(8,968)	(10,900)
Non technical account					
Balance on the technical account for general business	21,781	21,116	14,624	(8,968)	(10,900)
Other income – including investment income	5,983	1,647	3,314	5,655	9,360
Total income	27,764	22,763	17,938	(3,313)	(1,540)
Other charges	(5,901)	(8,459)	(7,461)	(5,535)	(10,234)
Operating profit/(loss) before exceptional items	21,863	14,304	10,477	(8,848)	(11,774)
Exceptional items	–	(13,249)	–	–	1,326
Profit/(loss) on ordinary activities before taxation	21,863	1,055	10,477	(8,848)	(10,448)
Operating profit based on longer term investment return	29,030	3,478	12,608	(10,196)	(9,424)
Short term fluctuations in investment return	(7,167)	(2,423)	(2,131)	1,348	(1,024)
Profit/(loss) on ordinary activities before taxation	21,863	1,055	10,477	(8,848)	(10,448)
Taxation on profit/(loss) on ordinary activities	(6,824)	(2,944)	(3,300)	6,732	5,226
Profit/(loss) after taxation	15,039	(1,889)	7,177	(2,116)	(5,222)
Minority interests	(141)	(138)	(396)	–	–
Profit/(loss) for the financial period	14,898	(2,027)	6,781	(2,116)	(5,222)
Dividends	(4,917)	(4,911)	(2,986)	(6,028)	(5,966)
Retained profit/(loss) for the financial period	9,981	(6,938)	3,795	(8,144)	(11,188)
Earnings/(loss) per share	7.5p	(1.1p)	5.4p	(1.7p)	(4.2p)
Highway dividends per share	2.48p	2.48p	2.4p	4.9p	4.9p

Consolidated Five – Year Summary (continued)

Balance Sheet

	2003 £000	2002 (restated) £000	2001 (restated) £000	2000 £000	1999 £000
Assets					
Fixed assets	303,910	288,036	278,532	216,757	180,809
Current assets	292,361	242,260	261,811	395,541	365,597
Total assets	596,271	530,296	540,343	612,298	546,406
Liabilities					
Called up share capital	40,323	40,323	25,578	25,286	25,286
Share premium account	16,277	16,277	7,210	7,587	7,587
Investment in own shares	(2,557)	(2,557)	–	–	–
Merger reserve	39,221	39,221	39,221	38,520	38,520
Other reserve	1,640	1,640	1,640	1,640	1,640
Profit and loss account	(25,863)	(33,668)	(14,564)	(18,499)	(10,355)
Minority interests	355	254	236	–	–
	69,396	61,490	59,321	54,534	62,678
Creditors due within one year	54,210	35,045	31,399	20,254	22,378
Creditors due after one year	38,000	35,845	34,137	22,500	500
Provisions	429,954	386,444	415,626	515,010	460,850
Total liabilities excluding net pension liability	591,560	518,824	540,483	612,298	546,406
Net pension liability/(asset)	4,711	11,472	(140)	–	–
Total liabilities including net pension liability	596,271	530,296	540,343	612,298	546,406

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of Highway Insurance Holdings Plc will be held at Highway House, 171 Kings Road, Brentwood, Essex CM14 4EJ on Wednesday 26 May 2004 at 11.00 am to transact the following business:

Ordinary Business

Resolution 1

To receive the directors' report and the accounts of the Company for the year ended 31 December 2003 together with the auditors' report thereon.

Resolution 2

To declare a final dividend of 1.68 pence per Ordinary Share.

Resolution 3

By separate resolutions, to re-appoint as directors, the following who retire by rotation under Article 89.1 of the Company's Articles of Association:

(a) Mr R G Dunlop

(b) Mr A L Thomas

Resolution 4

To re-appoint KPMG Audit Plc as the Company's auditors (having previously been appointed by the board to fill the casual vacancy arising by reason of the retirement of Ernst & Young LLP) from the conclusion of this meeting until the conclusion of the next general meeting at which accounts are laid and to authorise the directors to determine their remuneration.

Special Business (see explanation on page 75)

To consider and, if thought fit, pass the following resolutions of which number 5 will be proposed as a special resolution and numbers 6 and 7 as ordinary resolutions.

Resolution 5 – To be proposed as a special resolution

That the Company be and is hereby granted general and unconditional authority to make market purchases (as defined in section 163 of the Companies Act 1985) of any of its ordinary shares on such terms and in such manner as the directors of the Company may from time to time determine provided that the general authority conferred by this resolution shall:

(i) be limited to 20,161,531 ordinary 20p shares;

(ii) not permit the payment per share of more than 5% above the average of the middle market quotations of an ordinary 20p share of the Company on the London Stock Exchange Daily Official List for the five business days immediately prior to the date of purchase or less than 20p (in each case exclusive of advance corporation tax payable (if any) and expenses); and

(iii) expire at the conclusion of the Annual General Meeting of the Company held in 2005 (except in relation to the purchase of shares the contract for which was concluded before the expiry of the said period and which might be executed wholly or partly after such date).

Resolution 6

To re-appoint as a director pursuant to and in accordance with the provisions of section 293(5) of the Companies Act 1985 Mr D E Coleridge who retires by rotation under Article 89.1 of the Company's Articles of Association.

Resolution 7

To approve the Directors' Remuneration Report for the financial year ended on 31 December 2003.

By order of the Board

Philip Lampshire, *Secretary*
31 March 2004

Notes:

(i) You may appoint one or more proxies of your own choice if you are unable to attend the meeting but would like to vote on a poll. A proxy need not be a member of the Company. If no name is entered on the form of proxy, the return of the form of proxy duly signed will appoint the Chairman of the meeting to act as your proxy. The completion and return of a form of proxy will not, however, preclude shareholders from attending and voting in person at the meeting or at any adjournment thereof, should they wish to do so.

(ii) In the case of a corporation, the form of proxy must be executed under its common seal or under the hand of a duly authorised officer or attorney.

(iii) The form of proxy (together with any power of attorney or other authority under which it is signed, or a certified copy of that power or authority) must be received by Lloyds TSB Registrars not later than 11.00 am on Monday 24 May 2004 (or, if the Meeting is adjourned, not less than 48 hours before the time for holding the adjourned meeting).

(iv) If two or more persons are jointly entitled to a share conferring the right to vote, any one of them may vote at the meeting either in person or by proxy, but if more than one joint holder is present at the meeting either in person or by proxy, the one whose name stands first in the register of members in respect of the joint holding shall alone be entitled to vote in respect thereof. In any event, the names of all joint holders should be stated on the form of proxy.

(v) If the form of proxy is returned without any indication as to how the person(s) appointed shall vote on the resolution, such person(s) will exercise his/her/their discretion as to how to vote or whether to abstain from voting.

(vi) Unless instructed otherwise, the proxy may also vote or abstain from voting as he or she thinks fit on any other business which may properly come from the meeting (including amendments to the resolutions).

(vii) Only those shareholders registered in the Register of Members of the Company as at 6.00 pm on 24 May 2004 shall be entitled to attend or vote at the above mentioned meeting in respect of the number of Ordinary Shares registered in their name at that time. Changes to entries on the Register of Members after 6.00 pm on 24 May 2004 shall be disregarded in determining the rights of any person to attend or vote at the meeting.

Explanation of Resolution 5 proposed under Special Business

The directors consider that it would be appropriate and in the best interests of the Company to seek to renew the authority previously granted to the Company to make market purchases of its Ordinary Shares on the London Stock Exchange. There may be occasions when, for a variety of reasons, the directors consider that it would be desirable to reduce the issued share capital by purchases in the market. The Board proposes to exercise the powers of purchase only when satisfied that any purchase will have a beneficial impact on the earnings per share and that it is in the interests of Shareholders so to do. The authority being sought is for up to 20,161,531 Ordinary Shares (representing 10% of the present issued share capital) at a price which is not more than 5% above the average of the middle market quotations of Ordinary Shares in the Company on the London Stock Exchange on the five business days prior to the date of purchase and, in any event, not lower than the nominal value of each share (in each case exclusive of any advance corporation tax and expenses). Any shares purchased under this authority will be cancelled. At the close of business on 31 March 2004, the latest practicable date before printing this document, the middle market quotation for Ordinary Shares of the Company as derived from the Stock Exchange Daily Official List was 38.5 pence per share. The authority proposed in the resolution will expire at the next Annual General Meeting of the Company. The Board intend to seek renewal of the authority at the next Annual General Meeting. Any purchase of the Company's shares would take place within the limits of available reserves.

Explanation of Resolution 6 proposed under Special Business

This resolution is to seek the re-appointment of Mr D E Coleridge as a director of the Company, pursuant to section 293(5) of the Companies Act 1985, as Mr Coleridge has attained the age of 71 years. Mr Coleridge is highly valued by the Board because of his knowledge and experience of the insurance industry.

Explanation of Resolution 7 proposed under Special Business

This resolution is to approve the Directors' Remuneration Report for the financial year ended 31 December 2003. You can find the report on pages 22 to 26. This resolution is included to comply with the provisions of the Directors' Remuneration Report Regulations 2002 which require the Report to be presented for a non-binding vote at the Annual General Meeting.