ARTHUR ANDERSEN

Malmaison Limited

and subsidiary undertakings

Financial statements 31 December 1997
together with directors' and auditors' reports

Registered number: 3141385

Directors' report

For the year ended 31 December 1997

The directors present their annual report on the affairs of Malmaison Limited ("the company") and its subsidiary undertakings ("the group"), together with the accounts and auditors' report, for the year ended 31 December 1997.

Principal activity and business review

The principal activity of the group was the ownership and operation of hotels. During 1998 the activities of the group changed as set out below.

On 8 April 1998 Patriot American Hospitality, Inc., through its wholly owned subsidiary, Arcadian International Limited ("Arcadian"), acquired all the outstanding share capital and loan stock in the company not already owned by Arcadian. Outstanding warrants and deferred shares were also acquired by Patriot together with all rights to the accrued interest on the loan stock. The management contract with the Malmaison Management Limited was terminated on the same day.

Patriot is a US Real Estate Investment Trust or 'REIT' whose shares are paired and trade as a single unit with those of Wyndham International, Inc. ('Wyndham'). Subsequent to the transaction, the trading stock and business of the group's hotels was sold to the Wyndham group for book value at the transaction dates. The group continues to own the freehold interests in the hotels which have been leased to a Wyndham's subsidiary, Malmaison Hotels Limited.

Details of this and other important events affecting the group which have taken place since the end of the current financial year are given in note 20 to the accounts.

Results and dividends

	1997	1996
	£'000	£'000
Group loss for the year after taxation	958	90

The directors do not recommend the payment of a dividend.

Directors' report (continued)

Directors and their interests

The directors who served during the year are as shown below.

The directors who held office at 31 December 1997 had no interests (including options) in the shares of group companies other than those shown below.

		Ordinary shares of 1p		Warrants	
		31 December 1997	31 December 1996	31 December 1997	31 December 1998
S.D. Bate	(resigned 8 April 1998)	-	-	-	-
R.K. Black	(resigned 8 April 1998)	211,745	211,745	86,273	-
R.R.A. Breare		-	-	-	-
A.G. Dodd	(resigned 8 April 1998)	937,500	937,500	148,168	-
A. Haining	(resigned 8 April 1998)	199,753	199,753	72,829	-
K.W. McCulloch		1,035,000	1,035,000	416,380	-
C.G. Upton		-	-	-	-
P.A. Nussbaum	(appointed 8 April 1998)	-	-	-	-
J. Bohlmann	(appointed 8 April 1998)	-	-	-	-
W.W. Evans III	(appointed 8 April 1998)	-	-	-	-

R.R.A. Breare and C.G. Upton are directors of, and at 31 December 1997, had interests in the share capital of, Arcadian International Limited, formerly Arcadian International Plc, which held 4,750,000 ordinary shares (1996 – 4,750,000) in the company and 4,246,925 warrants convertible into ordinary shares (1996 – 1,410,811). R.K. Black and A. Haining are directors of Botts Capital Nominees Limited which held as nominee 7,500,000 ordinary shares in the company, and 4,492,285 warrants convertible into ordinary shares (1996: nil) including their personal interests shown above.

Employee consultation

The group places considerable value on the involvement of its employees and keeps them informed on matters affecting them as employees and on the various factors affecting the performance of the group.

Auditors

The directors will place a resolution before the annual general meeting to reappoint Arthur Andersen as auditors for the ensuing year.

Directors' report (continued)

Statement of directors' responsibilities

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

(i) select suitable accounting policies and then apply them consistently;

(ii) make judgements and estimates that are reasonable and prudent;

(iii) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and

(iv) prepare the accounts 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 group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board,

Richard JM Bonella

R.J.M Bonella

Secretary

Gatton Place
St Matthew's Road
Redhill
Surrey RH1 1TA

17 July 1998

Auditors' report

London

To the Shareholders of Malmaison Limited:

We have audited the accounts on pages 5 to 24 which have been prepared under the historical cost convention as modified by the revaluation of hotels and the accounting polices set out on pages 8 to 10.

Respective responsibilities of directors and auditors

As described on page 3 the company's directors are responsible for the preparation of the accounts. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

Basis of opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts 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 accounts.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the company and of the group as at 31 December 1997 and of the group's loss and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

Arthur Andersen
Chartered Accountants and Registered Auditors

1 Surrey Street
London
WC2R 2PS

17 July 1998

Consolidated profit and loss account

For the year ended 31 December 1997

	Notes	Year ended 31 December 1997 £'000	53 week period ended 31 December 1996 £'000
Turnover	2	2,687	168
Cost of sales		(1,245)	(81)
Gross profit		1,442	87
Administration expenses (net)		(1,098)	(71)
Operating profit	2	344	16
Investment income	3	69	8
Interest payable and similar charges	3	(1,371)	(114)
Loss on ordinary activities before taxation	4	(958)	(90)
Tax on loss on ordinary activities	6	-	-
Loss on ordinary activities after taxation		(958)	(90)
Retained loss for the period		(958)	(90)
Retained loss for the period			
The company		(22)	(30)
Group undertakings		(936)	(60)
		(958)	(90)

All operations of the group continued throughout both periods and no operations were acquired or discontinued.

Consolidated statement of total recognised gains and losses

For the year ended 31 December 1997

	Year ended 31 December 1997 £'000	53 week period ended 31 December 1996 £'000
Loss for the period	(958)	(90)
Unrealised surplus on revaluation of fixed assets	2,791	-
Total recognised gains and losses for the period	1,833	(90)

A statement of movements on reserves is given in note 15.

The accompanying notes are an integral part of these statements.

Balance sheets

31 December 1997

	Notes	Group 1997 £'000	Group 1996 £'000	Company 1997 £'000	Company 1996 £'000
Fixed assets					
Intangible assets	7	1,525	1,274	-	-
Tangible assets	8	33,253	8,851	141	-
Investments	9	-	-	4,904	4,960
		34,778	10,125	5,045	4,960
Current assets					
Stocks	10	67	13	-	-
Debtors	11	2,181	959	11,276	5,100
Cash at bank and in hand		908	1,068	3,237	961
		3,156	2,040	14,513	6,061
Creditors: Amounts falling due within one year	12	(7,032)	(1,405)	(3,160)	(201)
Net current (liabilities) assets	21	(3,876)	635	11,353	5,860
Total assets less current liabilities		30,902	10,760	16,398	10,820
Creditors: Amounts falling due after more than one year	13	(28,985)	(10,688)	(16,276)	(10,688)
Net assets		1,917	72	122	132
Capital and reserves					
Called-up share capital	14	174	162	174	162
Profit and loss account	15	(1,048)	(90)	(52)	(30)
Revaluation reserve	15	2,791	-	-	-
Total equity shareholders' funds	16	1,917	72	122	132

Signed on behalf of the Board

Director

17 July 1998

The accompanying notes are an integral part of these balance sheets.

Consolidated cash flow statement

For the year ended 31 December 1997

	Notes	Year ended 31 December 1997 £'000	53 weeks Period ended 31 December 1996 £'000
Net cash inflow (outflow) from operating activities	17a	1,205	(206)
Returns on investments and servicing of finance	17b	(1,231)	8
Capital expenditure and financial investment	17b	(18,052)	(2,978)
Acquisitions	17b	(247)	(757)
Cash outflow before financing		(18,325)	(3,933)
Financing			
- issue of shares	17b	-	103
- increase in debt	17b	18,165	4,898
(Decrease) increase in cash in the period	17c	(160)	1,068

Reconciliation of net cash flow to movement in net debt

For the year ended 31 December 1997

	Notes	Year ended 31 December 1997 £'000	53 weeks Period ended 31 December 1996 £'000
(Decrease) increase in cash in the period		(160)	1,068
Cash inflow from increase in debt	17c	(18,165)	(4,898)
Change in debt resulting from cash flows		(18,325)	(3,830)
Undistributed loan stock		-	(1,238)
Loan stock issued for non-cash consideration		-	(4,340)
New finance leases	17c	(238)	-
Movement in net debt in the period		(18,563)	(9,408)
Net debt at start of year		(9,408)	-
Net debt at end of year	17c	(27,971)	(9,408)

The accompanying notes are an integral part of these statements.

Notes to accounts

31 December 1997

1 Accounting policies

A summary of the principal accounting policies is set out below. All accounting policies have been applied consistently throughout the year and during the preceding period.

a) Accounting convention

The accounts are prepared under the historical cost convention, modified to include the revaluation of hotels, and in accordance with the provisions of the Companies Act 1985 and with applicable accounting standards except in relation to the absence of provision for the depreciation of freehold and long leasehold buildings, as set out in d) below.

b) Basis of consolidation

The group accounts consolidate the accounts of Malmaison Limited and all its subsidiary undertakings to 31 December 1997. The acquisition method of accounting has been adopted whereby the results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal. Goodwill arising on consolidation or on the acquisition of a business (representing the excess of the fair value of the consideration given over the fair view of the separable net assets acquired) is capitalised and amortised over a 20 year period. Any excess of the aggregate of the fair value of the separable net assets acquired over the fair value of the consideration given is credited directly to reserves.

No profit and loss account is presented for Malmaison Limited, as provided by section 230 of the Companies Act 1985. The company's loss for the year, determined in accordance with the Act, was £22,000 (1996 - £30,000)

In the company's accounts, investments in subsidiary undertakings are stated at cost less amounts written off. Only interest and dividends received or receivable are credited to the company's profit and loss account.

c) Intangible fixed assets

(i) The Malmaison brand is carried at cost less amounts written off. Provision is made for any permanent diminution in value. The directors having considered the residual value and useful economic life of the brand, believe any provision for amortisation would not be material.

(ii) Pre-opening and marketing expenses incurred up to the commencement of full trading by hotels are deferred and written off over three years.

d) Tangible fixed assets

Freehold hotel properties and hotel properties on leases with 25 years or more to run at the balance sheet date are revalued periodically and the resultant valuation is included in the balance sheet unless the surplus or deficit is immaterial. Where a material surplus or deficit arises, this is taken to the revaluation reserve to the extent available. Any permanent diminution in the value of such properties is charged to the profit and loss account.

Notes to accounts (continued)

1 Accounting policies (continued)

d) Tangible fixed assets (continued)

In accordance with normal practice within the hotel industry, no depreciation is provided on freehold hotel properties or on hotel properties on leases with 25 years or more to run at the balance sheet date. The group's properties are maintained at all times in sound condition and to a high standard. Accordingly, the directors are of the opinion that the length of lives and residual values (based on prices prevailing at the time of acquisition or subsequent valuation) of these properties are such that any provision for depreciation would not be material.

Work in progress comprises hotel development sites in the course of construction. It is stated at cost, which represents the cost of land, contractors' costs, professional fees, interest and an allocation of other direct and project overheads. Costs are capitalised from the date on which the group acquires an interest in a development site.

Interest on capital employed on land under development and on the cost of construction of hotels incurred until these projects are completed may, where appropriate, be capitalised as part of the costs of construction.

Depreciation is provided on a straight line basis over the following periods:

Office equipment	4 years
Furniture, fittings and equipment	5-10 years
Plant and machinery	10-15 years

e) Fixed asset investments

Investments are shown at cost less amounts written off. Provision is made for any permanent diminution in value.

f) Stocks

Stocks are valued at the lower of cost and net realisable value.

g) Taxation

Corporation tax payable is provided on taxable profits at the current rate.

The taxation liabilities of certain group companies are reduced wholly or in part by the surrender of losses by fellow group companies.

Deferred taxation has been calculated on the liability method. Deferred taxation is provided on timing differences which will probably reverse, at the rates of tax likely to be in force at the time of reversal. Deferred tax is not provided on timing differences which, in the opinion of the directors, will probably not reverse.

h) Turnover

Turnover comprises amounts receivable for goods and services provided, net of VAT and similar sales taxes.

Notes to accounts (continued)

1 Accounting policies (continued)

i) Leases

Assets held under finance leases are initially reported at the fair value of the asset, with an equivalent liability categorised under creditors due within or after one year as appropriate. The asset is depreciated over the shorter of the lease term or its useful economic life. Finance charges are allocated to accounting periods over the period of the lease to produce a constant rate of return on the outstanding balance. Rentals are apportioned between finance charges and reduction of the liability. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful economic lives.

Rentals under operating leases are charged on a straight-line basis over the lease term and commitments are provided for in the balance sheet at the time the rental payments fall due.

j) Government grants

Government grants relating to tangible fixed assets are treated as deferred income and credited to the profit and loss account by equal instalments over the period to which the grant relates. Where any grant repayments are required under the terms of the grant, such repayments are recorded in the profit and loss account in the period to which they relate.

k) Capital instruments

Capital instruments are classified as liabilities if they contain an obligation to transfer economic benefit and if they are not included in shareholders' funds. Capital instruments are initially stated at the amount of the net proceeds after the deduction of issue costs. The finance cost recognised in the profit and loss account in respect of capital instruments other than equity shares is calculated so as to give a constant rate of return on the outstanding balance.

2 Segment information

All of the group's turnover and operating profit arise from the operation of hotels, all of which are in the UK.

3 Investment income and interest payable

	Year ended 31 December 1997 £'000	53 week period to 31 December 1996 £'000
Investment income comprises:		
- interest on cash at bank	69	8
Interest payable comprises		
- subordinated loan stock	2,275	212
- senior debt	326	-
- mezzanine debt	409	-
	3,010	212
Less interest capitalised	(1,639)	(98)
	1,371	114

Notes to accounts (continued)

4 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging/(crediting):

	Year ended 31 December 1997 £'000	53 week period to 31 December 1996 £'000
Staff costs (note 5)	723	41
Amortisation and amounts written off		
- goodwill	22	4
- pre-opening expenses	65	5
Depreciation of tangible fixed assets		
- owned	81	6
- held under hire purchase contracts and finance leases	26	-
Amortisation of grants	(10)	-
Auditors remuneration		
- audit services	35	16

5 Staff costs

Particulars of employees (including executive directors) are shown below:

	Year ended 31 December 1997 £'000	53 week period to 31 December 1996 £'000
Employee costs during the period amounted to:		
Wages and salaries	673	37
Social security costs	50	4
	723	41

The average monthly number of persons employed by the group for the periods were as follows:

	1997 Number	1996 Number
Hotel operations	65	38
Administration	2	2
	67	40

Directors' remuneration:

No director received any remuneration for their services to any group company during the year.

6 Tax on loss on ordinary activities

There is no taxable profit in the current year, and accordingly, no charge to tax arises.

A potential liability on deferred chargeable gains of £1,300,000 (1996 - £450,000) exists following the revaluation of property. In addition a further £240,000 (1996 - £63,000) of deferred tax liabilities is present within the group. These amounts are unprovided for due to the existence of brought forward tax losses. Such losses may be relieved only against future trading profits.

Notes to accounts (continued)

7 Intangible fixed assets

The movement in the year was as follows:

Group	Brand £'000	Goodwill £'000	Pre-opening expenses £'000	Total £'000
Cost				
Beginning of year	800	436	47	1,283
Additions	-	-	394	394
Adjustment of goodwill (see note 9)	-	(56)	-	(56)
End of year	800	380	441	1,621
Amounts written off				
Beginning of year	-	4	5	9
Amortisation	-	22	65	87
End of year	-	26	70	96
Net book value				
Beginning of year	800	432	42	1,274
End of year	800	354	371	1,525

8 Tangible fixed assets

The movement in the year was as follows:

	Freehold land and buildings £'000	Work in progress £'000	Furniture, fixtures & equipment £'000	Total £'000
Group				
Cost or valuation				
Beginning of year	3,058	5,410	389	8,857
Additions	8,799	10,958	1,961	21,718
Reclassification	3,055	(3,055)	-	-
Revaluations	2,791	-	-	2,791
End of year	17,703	13,313	2,350	33,366
At valuation	17,703	-	-	17,703
At cost	-	13,313	2,350	15,663
Depreciation				
Beginning of year	-	-	6	6
Charge	-	-	107	107
End of year	-	-	113	113
Net book value				
Beginning of year	3,058	5,410	383	8,851
End of year	17,703	13,313	2,237	33,253

Leased assets and assets held on finance leases included in the above:

Net book value				
Beginning of year	-	-	-	-
End of year	-	-	212	212

Additions to work in progress include interest capitalised of £1,639,000 (1996 -£98,000). Cumulative interest capitalised included in the cost of tangible fixed assets amounts to £1,737,000 (1996 - £98,000).

Freehold properties are included at valuation. The valuations were carried out by Edward Symmons (Hotel & Leisure) Limited, Chartered Surveyors, on an open market value at 31 December 1997 for existing use basis, inclusive of fittings and equipment and with the benefit of licences where applicable during the year. The valuations are recorded after deducting the net book value of fittings and equipment is recorded against freehold land and buildings. Additions made subsequent to the valuations are recorded at cost.

On a historical cost basis, the net book amount of tangible fixed assets at 31 December 1997 would be £30,462,000, and the depreciation charge would not be materially different.

Notes to accounts (continued)

8 Tangible fixed assets (continued)

Company	Work in progress £'000
Cost	
Beginning of year	-
Additions	141
End of year	141

9 Fixed asset investments

	Company	
	1997 £'000	1996 £'000
Subsidiary undertakings	4,904	4,960

The movement in the year relates to actual professional fees being less than estimated on the subsidiaries acquired in 1996. In the group accounts, goodwill has been reduced accordingly (see note 7).

a) Principal group investments

The principal subsidiary undertakings are shown below:

Subsidiary undertakings	Country of incorporation and operation	Principal Activity	Proportion of ordinary share capital and voting rights held by the group
The Malmaison Hotel (Glasgow) Limited	Scotland	Hotel operations	100%
The Malmaison Hotel (Newcastle) Limited	England	Hotel operations	100%
The Malmaison Hotel (Manchester) Limited	England	Hotel operations	100%
The Malmaison Hotel (Leeds) Limited	England	Hotel operations	100%
Malmaison Brand Limited	Scotland	Brand ownership	100%

b) Acquisition of subsidiary undertakings

On 15 April 1997 the company formed The Malmaison Hotel (Leeds) Limited.

10 Stocks

	Group 1997 £'000	Group 1996 £'000
Hotel operating stocks	67	13

11 Debtors

	Group		Company	
	1997 £'000	1996 £'000	1997 £'000	1996 £'000
Amounts falling due within one year:				
Trade debtors	287	34	-	-
Amounts owed by subsidiary undertakings	-	-	10,646	4,743
VAT	507	590	273	357
Other debtors	1,251	27	256	-
Prepayments and accrued income	136	14	101	-
Prepaid facility fees	-	294	-	-
	2,181	959	11,276	5,100

Included in other debtors above is £247,500 relating to a deposit made by the company on the acquisition of the Malmaison hotel in Edinburgh (see note 20).

12 Creditors: Amounts falling due within one year

	Group		Company	
	1997 £'000	1996 £'000	1997 £'000	1996 £'000
Bank loans and Senior debt	550	-	-	-
Trade creditors	1,447	448	202	49
Accrued interest	2,677	-	2,677	-
Other creditors	197	19	-	12
VAT	34	-	-	-
Grants	564	-	-	-
Accruals and deferred income	1,563	938	281	140
	7,032	1,405	3,160	201

Notes to accounts (continued)

13 Creditors: Amounts falling due after more than one year

	Group		Company	
	1997 £'000	1996 £'000	1997 £'000	1996 £'000
Senior debt	10,602	-	-	-
Mezzanine debt	3,000	-	3,000	-
Subordinated debt	13,276	10,476	13,276	10,476
Grants	1,974	-	-	-
Other	133	212	-	212
	28,985	10,688	16,276	10,688

During the year the group was awarded a £2,400,000 grant in relation to the Malmaison Manchester property and a £148,000 grant in relation to the Malmaison Glasgow property.

Senior debt

At 31 December 1997 the group had senior borrowing facilities of £22,300,000 (1996 - £9,500,000) of which £12,389,000 (1996 - £nil) was drawn down. Borrowings are repayable on a quarterly basis from 31 March 1998, incur interest at 2.5% p.a. above LIBOR, are secured by a first fixed and floating charge on the group's hotels and other assets, and are subject to financial covenants.

Amounts shown for senior debt are net of facility fees £1,237,000 (1996 - £nil).

Mezzanine debt

The company has entered into a mezzanine loan facility agreement of £5,750,000 and a working capital facility of £500,000 with Arcadian International Limited. The loan facility incurs interest at 10% and is repayable on 31 December 2006 and the working capital facility incurs interest at 3% above The Royal Bank of Scotland Plc base rate and is repayable on 31 December 1999. These facilities are secured by second charges on the group's hotel properties. Drawings under these facilities at 31 December 1997 were £3,000,000 and £nil respectively (1996 £nil and £nil).

Subordinated debt

The loan stock is unsecured, bears interest at 20% per annum, and is repayable in instalments between 2003 and 2005 (see note 19). At 31 December 1997 issued loan stock was as follows:

	1997 £'000	1996 £'000
'A' loan stock	5,873	5,873
'B' loan stock	4,603	4,603
'C' loan stock	2,800	-
	13,276	10,476

13 Creditors: Amounts falling due after more than one year (continued)

On 15 April 1997 the company issued £1,700,000 of 'C' loan stock in connection with interalia the purchase of a development site in Leeds.

On 10 December 1997 the company issued a further £1,100,000 of 'C' loan stock in connection with interalia the part repayment of the mezzanine loan with Arcadian International Limited, a related party.

The A, B and C loan stock rank pari passu in all respects with the exception of the winding up of the company. In this case the C loan stock is subordinated to the A and B loan stock. The B loan stock is subordinated to the A loan stock and all classes of loan stock are subordinated to the claims of all other creditors.

Analysis of borrowings

Borrowings are repayable as follows:

		Group		Company	
		1997 £'000	1996 £'000	1997 £'000	1996 £'000
Due within five years					
- within 1 year	- finance leases	78	-	-	-
	- bank loans	600	-	-	-
- within 1-2 years	- finance leases	78	-	-	-
	- bank loans	1,400	-	-	-
- within 2-5 years	- finance leases	56	-	-	-
	- bank loans	6,300	-	-	-
More than 5 years	- bank loans	4,089	-	-	-
	- mezzanine loan	3,000	-	3,000	-
	- subordinated loan stock	13,276	10,476	13,276	10,476
		28,877	10,476	16,276	10,476

14 Called-up share capital

	1997 £'000	1996 £'000
Authorised		
25,100,000 (1996 – 19,100,000) ordinary shares of 1p each	251	191
1,900,000 (1996 – 1,900,000) 'B' deferred convertible shares of 1p each	19	19
	270	210
Allotted, called-up and fully-paid		
17,400,000 (1996 – 16,150,000) ordinary shares of 1p each	174	162

Notes to accounts (continued)

14 Called-up share capital (continued)

During the year the company issued 1,250,000 shares as part consideration for the acquisition of The Malmaison Hotel (Manchester) Limited in 1996.

Arcadian International Limited and K.W. McCulloch have the right before 31 December 2005, to subscribe for a number of deferred shares, which are convertible into ordinary shares at par upon the sale of a substantial part of the assets of the group, the admission of the ordinary shares of the company to the London Stock Exchange or control of the company passing to one shareholder. The number of deferred shares subject to this right is determined by the value attributable to the group in the transaction. Upon the acquisition of the share capital of the company by Patriot American Hospitality, Inc. ("Patriot"), K.W. McCulloch transferred the right to 1,390,581 deferred shares to Patriot (see note 20).

As at 31 December 1996 the company had in issue warrants to subscribe for 1,410,811 ordinary shares exercisable at par. On 15 April 1997 the company issued warrants to subscribe for 4,949,026 ordinary shares exercisable at par. On 10 December 1997 the company issued warrants to subscribe for 3,202,311 ordinary shares exercisable at par. All the warrants in issue were acquired by Patriot on the 8 April 1998 (see note 20).

15 Reserves

Of total reserves shown in the group and company's balance sheets, the following amounts are regarded as distributable or otherwise:

	Group		Company	
	1997	1996	1997	1996
	£'000	£'000	£'000	£'000
Distributable				
- profit and loss account	(1,048)	(90)	(52)	(30)
Non distributable				
- revaluation reserve	2,791	-	-	-
Total reserves	1,743	(90)	(52)	(30)

Notes to accounts (continued)

15 Reserves (continued)

	Revaluation reserve £'000	Profit and loss account £'000	Total £'000
Group			
Beginning of the year	-	(90)	(90)
Accumulated loss for the year	-	(958)	(958)
Revaluation of operating hotels	2,791	-	2,791
End of year	2,791	(1,048)	1,743
Company			
Beginning of the year	-	(30)	(30)
Accumulated loss for the year	-	(22)	(22)
End of year	-	(52)	(52)

16 Reconciliation of movements in shareholders' funds

	Group		Company	
	1997 £'000	1996 £'000	1997 £'000	1996 £'000
Loss for the financial year	(958)	(90)	(22)	(30)
Other recognised gains and losses relating to the year	2,791	-	-	-
New share capital subscribed	12	162	12	162
Net addition to (reduction in) shareholders' funds	1,845	72	(10)	132
Opening shareholders' funds	72	-	132	-
Closing shareholders' funds	1,917	72	122	132

Notes to accounts (continued)

17 Cash flow information

a) Reconciliation of operating profit to operating cash flows

	Year ended 31 December 1997 £'000	53 week period to 31 December 1996 £'000
Operating profit	344	16
Depreciation and amortisation charges	194	15
Increase in stocks	(54)	(1)
Increase in debtors	(343)	(748)
Increase in creditors	1,073	512
Amortisation of grant income	(10)	-
Net cash inflow (outflow) from operating activities	1,205	(206)

b) Analysis of cash flows for headings netted in the cash flow statement

	Year ended 31 December 1997	53 week period to 31 December 1996
Returns on investments and servicing of finance	£'000	£'000
Interest received	69	8
Interest and facility fees paid	(1,300)	-
	(1,231)	8
Capital expenditure and financial investment		
Expenditure on tangible fixed assets	(19,270)	(2,978)
Expenditure on intangible fixed assets	(394)	-
Grants received	1,612	-
	(18,052)	(2,978)
Acquisitions		
Purchase of subsidiary undertakings	-	(410)
Deposits to purchase subsidiary undertaking	(247)	-
Cash acquired	-	53
Purchase of brand name	-	(400)
Net cash outflow for acquisitions	(247)	(757)
Financing		
Issue of ordinary share capital	-	103
Repayment of finance leases	(24)	-
Debt due within one year	600	-
Debt due greater than one year	17,589	4,898
Cash inflow from financing	18,165	5,001

17 Cash flow information (continued)

c) Analysis of net debt

	Beginning of year £'000	Cash flow £'000	Other (non-cash) £'000	End of year £'000
Cash on hand and at bank	1,068	(160)	-	908
Finance leases	-	24	(238)	(214)
Debt due within one year	-	(600)	-	(600)
Debt due after 1 year	(10,476)	(17,589)	-	(28,065)
	(9,408)	(18,325)	(238)	(27,971)

d) Major non-cash

During the year the group entered into finance lease arrangements in respect of assets with a total capital value at the inception on the leases of £238,000 (1996 - £nil).

18 Guarantees and other financial commitments

a) Capital commitments

At the end of the year capital commitments were:

	Group		Company	
	1997 £000	1996 £000	1997 £000	1996 £000
Contracted for but not provided for	3,614	13,441	-	-

b) Contingent liabilities

The company has guaranteed and secured by a floating charge on its own assets overdrafts and other liabilities of certain subsidiary undertakings, the amount outstanding at 31 December 1997 being £12,389,000 (1996 - £ nil).

Notes to accounts (continued)

19 Related party transactions

a) A. Haining and R.K. Black, both shareholders in the company during the year, are directors of Botts & Company Limited and financial advisers to the company. During the year Botts & Company Limited received fees of £160,000 (1996 - £119,000). In addition, as at 31 December 1997, Botts & Company Limited held 4,439,955 (1996 - £2,925,000) subordinated loan stock (see note 14).

b) R.R.A. Breare and C.G. Upton are both directors of Arcadian International Limited ("Arcadian"), a shareholder of the company. During the year Arcadian received fees of £500,000 (1996 - £500,000).

In addition, as at 31 December 1997, Arcadian held 5,061,972 (1996 - £4,102,500) subordinated, loan stock (see note 14).

c) K.W. McCulloch a shareholder of the company during the year, is also a director of and the majority shareholder in MHM Limited. Arcadian and MHM Limited have a joint venture, Malmaison Management Limited, which has a ten year management contract for the group's hotels. Management fees payable for the year ended 31 December 1997 under this contract were £143,000 (1996 - £9,000).

In addition, as at 31 December 1997, K.W. McCulloch held 1,090,081 (1996 - £1,024,650) subordinated loan stock (see note 14).

In 1996 Malmaison Management Limited entered into project co-ordination agreements with the group to assist with the development of its hotels. Amounts payable in the year ended 31 December 1997 under these agreements were £471,000 (1996 - £240,000).

d) Arcadian and K.W. McCulloch, as shareholders in Malmaison Management Limited, have the right to subscribe for deferred shares in the company in the event of a realisation of the assets of the group before 31 December 2005. Further details are given in note 14.

e) In 1996 Arcadian entered into two forms of guarantee on behalf of a syndicate of banks, led by Coutts & Company, in favour of the banks. The first relates to the overrun of construction costs of the hotels and is limited to the amount of the group's senior debt of £9.5 million plus accrued interest thereon. The second relates to the repayments of £1.5 million of principal of the senior debt in the period to 31 December 1999 and the payment of any interest on the senior debt in that period. Should any payments be made by Arcadian under the terms of either guarantee, Arcadian would receive additional A loan stock in the company to the value of any such payment.

Notes to accounts (continued)

20 Subsequent events

On 18 March 1998 the company acquired the trade and assets of the Malmaison Hotel in Edinburgh for a cash consideration of £4,949,000 for which the company had paid a deposit of £247,500 before year end. MHM Limited, a related company (see note 19c), held a management contract with this hotel.

On 8 April 1998 Arcadian International Limited ("Arcadian"), acquired all the outstanding share capital and loan stock in the company not already owned by Arcadian. Outstanding warrants and deferred shares were also acquired together with all rights to the accrued interest on the loan stock. The management contract with the Malmaison Management Limited was terminated on the same day.

Patriot is a US Real Estate Investment Trust or 'REIT' whose shares are paired and trade as a single unit with those of Wyndham International, Inc. ('Wyndham'). Subsequent to the transaction, the trading stock and business of the group's hotels was sold to the Wyndham group for book value at the transaction dates. The group continues to own the freehold interests in the hotels which have been leased to Wyndham's subsidiary, Malmaison Hotels Limited.

21 Net current liability position

The net current liabilities of the group at 31 December 1997 are £3,876,000 (1996 - net assets £635,000). Arcadian International Limited has confirmed its intention of providing continued financial support to the group to enable it to meet its liabilities as they fall due, for a period of at least twelve months from the date of signing these accounts.