Virgin Rail Group Limited

Directors' report and financial statements

28 February 1998
Registered number 3282548

Directors' report and financial statements

Contents

Directors' report

The directors present their report and the audited financial statements for the eleven months ended 28 February 1998. Virgin Rail Group Limited (the 'Company') and its two operating subsidiaries, CrossCountry Trains Limited and West Coast Trains Limited (together referred to as the 'Group') changed their accounting reference date to 28 February from 31 March on 19 March 1998.

Principal activities

The Group's principal activity during the period was the operation of passenger rail services in England, Scotland and Wales. The Group operates these services under the terms of two franchise agreements between Virgin Rail Group Limited and the Director of Passenger Rail Franchising. The Franchise Agreements expire on 20 February 2012 and 1 April 2012 for West Coast Trains Limited and CrossCountry Trains Limited respectively.

Results for the period and business review

The profit and loss account in the current period reflects the results of the Group for the eleven months ended 28 February 1998. In the prior period the profit and loss account reflected the results of CrossCountry Trains Limited and West Coast Trains Limited from their acquisitions on 5 January 1997 and 9 March 1997 respectively, together with the results of the Company from its incorporation on 18 November 1996.

The profit for the eleven months ended 28 February 1998 of £12,388,000 *(1997: loss of £10,159,000)* has been taken to reserves, which is after an exceptional charge of £12,899,000 *(1997:£12,383,000)*. The exceptional charge related to restructuring, property repair costs and new rolling stock costs.

The directors are satisfied with the financial performance of the Group during the eleven months ended 28 February 1998. Following the award of the franchises, the Group have introduced a number of new marketing initiatives and a more focused approach to customer service which the directors believe have already contributed to a growth in passenger volumes and an improvement in operating results before franchise receipts. Steps have also been taken to reduce staff costs through a programme of restructuring since the acquisition of the franchises.

Future prospects

The directors believe that there is significant potential to persuade passengers who would otherwise choose to travel by road or air to travel by rail, as the quality and convenience of the Group's services improve. The Group intends to provide this quality and convenience by offering higher standards of passenger comfort and service, shorter journey times, more frequent services and improved punctuality. Central to achieving these objectives will be investment in infrastructure improvements, refurbishment and then the replacement of almost all of the Group's existing rolling stock, and the application of Virgin's customer focus.

In addition, the directors expect that rail's competitiveness will be enhanced as road and air travel face increasing congestion and capacity constraints. HM Government's current policy is not to invest in significant increases in road capacity in Great Britain, but to promote a more integrated public transport network.

Significant developments have already been made by the Group with the appointment of GECA Alsthom Metro-Cammell Limited and Fiat Ferroviaria S.p.A as the preferred bidder to supply the new rolling stock for West Coast Trains Limited and Bombardier Inc. to supply the new rolling stock for CrossCountry Trains Limited. Financing arrangements are currently being negotiated for the new rolling stock for both franchises.

Additionally, an agreement with Railtrack Plc signed on 8 June 1998, will provide improvements in line speeds and significant additional capacity on the West Coast Main Line, scheduled for completion in May 2005.

A new product strategy was introduced in May 1998 on the London to Manchester route and the Company intends to introduce it progressively to other services if this trial is successful.

Directors' report *(continued)*

Proposed dividend

The directors do not recommend the payment of a dividend.

Directors and directors' interests

The directors who held office during the period or appointed subsequent to the period end were as follows:

Philip Cox (Chairman) [1]	(appointed 29 January 1998)
Brian Barrett	
Pierre Dupont [1]	
Jeremy Ferris [1]	
Stephen Murphy [1]	
William Whitehorn [1]	(resigned 6 May 1998)
Manjit Dale [1, 2]	(resigned 23 May 1997)
Randl Shure [1, 2]	(appointed 23 May 1997)
Alan Tomlin	(appointed 10 June 1997)
Chris Tibbits	(appointed 10 June 1997)
Ivor Warburton	(appointed 10 June 1997)
Geoffrey Thompson [1]	(appointed 29 January 1998)
Alan Jones[1]	(appointed 28 April 1998)

1 Non -executive director
2 Having resigned on 23 May 1997, Manjit Dale was appointed as an alternative director to Randl Shure.

Richard Branson is president of the Company.

At the end of the period the following directors held interests in options over non-voting ordinary shares of 10p each in the Company:

	28 February 1998	31 March 1997
Stephen Murphy	**303,945**	303,945
William Whitehorn	**303,945**	303,945
Brian Barrett	**303,945**	303,945
Alan Tomlin	**101,315**	101,315

All of the above options were granted for nil consideration on 20 March 1997 with an exercise price of £1.20 per share. Each individual has the opportunity to exercise options once in any year from three years since they were granted, or for certain directors on the date of a listing on the London Stock Exchange (see note 20) if earlier, until the options' expiry seven years after they were granted. No specific performance criteria apply to the exercising of options.

Other than as disclosed above none of the directors had any interest in the share capital of the Company either during the period or at the end of the period.

Directors' and officers' insurance

The Company has purchased liability insurance for its directors and officers.

Directors' report *(continued)*

Year 2000

Information technology systems and their supporting environment are critical to the operations of the Group. Some or all of the systems on which the Group depends are vulnerable to malfunction with the advent of the year 2000. Although the Group has established its own year 2000 compliance programme and expects to benefit from industry-wide initiatives (such as the Rail Millennium Programme Office) to identify and resolve year 2000 issues with respect to third-party systems on which it depends, there can be no assurance that all the information technology systems on which the Group relies will be modified on a timely basis. Any failure of material computer systems of the Group or third party systems on which it depends as a result of year 2000 issues, could have a material adverse affect on the operational and financial performance of the Group. Such system failures could, particularly if they affect the safe running of the network, lead to a shutdown of the Group's operations until those failures can be rectified.

The directors believe that substantially all of the Group's internal information technology systems will have been modified or replaced prior to 31 December 1999 and currently estimate that the cost to be borne by the Group for changes to its own and industry-wide systems in connection with year 2000 issues is £1.9 million. These costs and the timetable for resolving year 2000 issues are based on management's best estimates and include assumptions regarding third party modification plans. However, in particular due to the potential impact of third-party modification plans, there can be no assurance that these estimates will be achieved and it is possible that actual costs may ultimately differ materially from those presently anticipated.

Employees

The Group is a non-discriminatory employer operating an Equal Opportunities Policy which aims to eliminate unfair discrimination, harassment, victimisation and bullying. The Group is committed to ensuring that all individuals are treated fairly, with respect and are valued irrespective of disability, race, gender, health, social class, sexual preference, marital status, nationality, religion, employment status, age and membership or non-membership of a trade union.

The Group uses the consultative procedures agreed with its staff and elected representatives with a view to ensuring that its employees are aware of the financial and economic factors which affect the Group's performance and prospects.

The Group's policy, where possible, is to continue to employ those who may become disabled in service, together with some recruitment where circumstances permit. Training is adjusted to cater for an individual disability and the disabled share the same conditions of service as other staff in relation to career development and promotion.

Political and charitable contributions

The Group made no donations to charities or to political parties in the current period *(1997: £nil)*.

Auditors

In accordance with Section 385 of the Companies Act 1985, a resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

Diana Legge

Diana Legge
Company Secretary

19 June 1998

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year or period which give a true and fair view of the state of affairs 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 the Group 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.

The directors, having prepared the financial statements, note that the auditors are required by the Companies Act 1985 to take whatever steps and undertake whatever inspections they consider to be appropriate for the purposes of enabling them to give their audit report.

KPMG

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London EC4Y 8BB

Report of the auditors to the members of Virgin Rail Group Limited

We have audited the financial statements on pages 6 to 32.

Respective responsibilities of directors and auditors

As described on page 4 the Company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 28 February 1998 and of the profit of the Group for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG

KPMG
Chartered Accountants
Registered Auditors

19 June 1998

Consolidated profit and loss account

for the eleven month period to 28 February 1998

		11 month period to 28 February 1998			Period 18 November 1996 to 31 March 1997		
	Note	**Before exceptional items**	**Exceptional items (note 7)**	**Total**	Before exceptional items	Exceptional items (note 7)	Total
		£000	£000	**£000**	£000	£000	£000
Turnover	*2*	**397,198**	-	**397,198**	45,912	-	45,912
Franchise receipts	*22*	**176,316**	-	**176,316**	36,506	-	36,506
Other operating income		**1,484**	-	**1,484**	108	-	108
Train operating expenditure	*3*	**(435,873)**	**(972)**	**(436,845)**	(66,853)	-	(66,853)
Staff costs	*4*	**(79,363)**	**(6,636)**	**(85,999)**	(8,642)	(12,383)	(21,025)
Depreciation	*5*	**(128)**	-	**(128)**	(13)	-	(13)
Other operating charges		**(34,167)**	**(5,291)**	**(39,458)**	(5,022)	-	(5,022)
Operating profit/(loss)		**25,467**	**(12,899)**	**12,568**	1,996	(12,383)	(10,387)
Other interest receivable and similar income	*8*			**4,407**			467
Interest payable and similar charges	*9*			**(3,434)**			(239)
Profit/(loss) on ordinary activities before taxation	*5*			**13,541**			(10,159)
Tax on profit/(loss) on ordinary activities	*10*			**(1,153)**			-
Retained profit/(loss) on ordinary activities after taxation for the period	*21*			**12,388**			(10,159)

There were no gains or losses other than the retained profit for the period. The whole of the results presented above relate to continuing operations.

There were no material difference between profit and loss account shown above and those prepared on a historical cost basis.

Consolidated balance sheet

at 28 February 1998

	Note	28 February 1998 £000	31 March 1997 £000
Fixed assets			
Tangible assets	*11*	997	286
Intangible assets - negative goodwill	*12*	(12,079)	(14,089)
		(11,082)	(13,803)
Current assets			
Stocks	*14*	3,070	2,618
Debtors	*15*	78,912	74,748
Cash at bank and in hand	*16*	79,866	84,395
		161,848	161,761
Creditors: amounts falling due within one year	*17*	(77,675)	(75,076)
Net current assets			
Due within one year		49,304	55,885
Debtors due after more than one year	*15*	34,869	30,800
Total net current assets		84,173	86,685
Total assets less current liabilities		73,091	72,882
Creditors: amounts falling due after more than one year	*18*	(25,022)	(25,051)
Provisions for liabilities and charges	*19*	(10,790)	(22,940)
Net assets		37,279	24,891
Capital and reserves			
Called up share capital	*20*	3,500	3,500
Share premium account	*21*	31,550	31,550
Profit and loss account	*21*	2,229	(10,159)
Equity shareholders' funds		37,279	24,891

These financial statements were approved by the board of directors on 19TH JUNE 1998 and were signed on its behalf by:

Brian Barrett
Director

Alan Tomlin
Director

Company balance sheet
at 28 February 1998

	Note	28 February 1998 £000	31 March 1997 £000
Fixed assets			
Tangible assets	*11*	**103**	3
Investments	*13*	**5,261**	4,197
		5,364	4,200
Current assets			
Debtors	*15*	**32,604**	30,227
Cash at bank and in hand	*16*	**30,585**	30,062
		63,189	60,289
Creditors: amounts falling due within one year	*17*	**(8,094)**	(5,048)
Net current assets			
Due within one year		**25,095**	25,241
Debtors due after more than one year	*15*	**30,000**	30,000
Total net current assets		**55,095**	55,241
Total assets less current liabilities		**60,459**	59,441
Creditors: amounts falling due after more than one year	*18*	**(25,000)**	(25,000)
Net assets		**35,459**	34,441
Capital and reserves			
Called up share capital	*20*	**3,500**	3,500
Share premium reserve	*21*	**31,550**	31,550
Profit and loss account	*21*	**409**	(609)
Equity shareholders' funds		**35,459**	34,441

These financial statements were approved by the board of directors on 19th June 1998 and were signed on its behalf by:

Brian Barrett
Director

Alan Tomlin
Director

Reconciliations of movements in shareholders' funds
for the eleven month period to 28 February 1998

	11 month period to 28 February 1998		Period 18 November 1996 to 31 March 1997	
	Group	Company	Group	Company
	£000	£000	£000	£000
Profit/(loss) for the financial period	**12,388**	**1,018**	(10,159)	(609)
New share capital subscribed	-	-	3,500	3,500
Share premium arising on new share capital	-	-	31,550	31,550
Net addition to shareholders' funds	**12,388**	**1,018**	24,891	34,441
Opening shareholders' funds	**24,891**	**34,441**	-	-
Closing shareholders' funds	**37,279**	**35,459**	24,891	34,441

Consolidated cash flow statement

for the eleven month period to 28 February 1998

	Note	**11 month period ended 28 February 1998 £000**	Period 18 November 1996 to 31 March 1997 £000
Net cash (outflow)/inflow from operating activities	*25*	**(708)**	25,606
Return on investments and servicing of finance	*26*	**1,205**	119
Capital expenditure and financial investment	*26*	**(797)**	27
Acquisitions and disposals	*26*	**(4,197)**	(1,407)
Management of liquid resources	*26*	**-**	(30,000)
Net cash outflow before financing		**(4,497)**	(5,655)
Financing	*26*	**(32)**	60,050
(Decrease)/increase in cash	*27*	**(4,529)**	54,395

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements.

Basis of preparation

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

Basis of consolidation

The Group financial statements consolidate the financial statements of Virgin Rail Group Limited and all of its subsidiary undertakings, all of which are coterminous with those of the parent company.

The acquisition method of accounting has been adopted. Under this method, the results of subsidiaries acquired are included in the consolidated profit and loss account from the date of acquisition. Goodwill has been determined by subtracting the fair value of net assets acquired from the cash consideration and associated costs of acquisition in respect of each acquisition. The resulting negative goodwill is reduced by the extent of any impairment of the fair values of net assets acquired.

Amortisation of negative goodwill is credited to the profit and loss account over the franchise period.

The amount of the profit for the financial period dealt with in the financial statements of Virgin Rail Group Limited is disclosed in note 21 to these financial statements. The Company has taken advantage of Section 230 of the Companies Act 1985 and has not presented its own profit and loss account.

Turnover

Turnover represents amounts receivable, excluding VAT, supplied to external customers, primarily in respect of passenger transportation.

Passenger transportation revenue represents principally amounts attributed to the Group by the Railway Settlement Plan. Income is attributed based on models of certain aspects of passenger behaviour and to a lesser extent from allocations agreed for specific revenue flows. The attributed share of season ticket income is deferred within creditors and released to the profit and loss account over the life of the relevant season ticket.

Other trading income consists principally of the provision of station facilities to other train operators and the hire of train crew and rolling stock.

Fixed assets and depreciation

Depreciation is provided to write off the cost less estimated residual value on a straight line basis over the estimated useful economic lives of the assets and commences from the date on which the assets are brought into use. The lives used for the major categories of assets are:

Plant and equipment	-	3-20 years
Fixture and fittings	-	3-10 years

Notes *(continued)*

1 **Accounting policies** *(continued)*

Track access costs

Track access costs are charged to the profit and loss account in the period to which they relate.

Railtrack Plc is undertaking a programme of infrastructure works to upgrade the West Coast Main Line to enable trains to run at speeds of up to 200 kph and at higher frequencies. This is referred to as Phase I of the Upgrade. These works are due to be completed by May 2002. As part of these arrangements West Coast Trains Limited is incurring additional track access charges with effect from 1 April 1997. To the extent that these charges relate solely to Phase I of the Upgrade, these are being carried forward within prepayments and are to be written off to the profit and loss account from May 2002, the date from which West Coast Trains Limited will benefit from these infrastructure improvements.

Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease'. The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

All other leases are accounted for as 'operating leases' and the rental charges are charged to the profit and loss account on a straight line basis over the life of the lease.

Maintenance

Charges for major maintenance expenditure in respect of rolling stock is typically included within operating lease charges and are accounted for accordingly over the period of the operating lease. Other rolling stock maintenance costs are written off as incurred.

Franchise receipts

Franchise receipts or amounts payable in respect of the operation of the rail franchises are taken to the profit and loss account in the year to which they relate.

Stocks

Stocks are stated at the lower of cost and net realisable value. Raw materials include amounts incurred in respect of the rights to utilise stocks of replaceable spares.

Pensions and other post-retirement benefits

West Coast Trains Limited and CrossCountry Trains Limited participate in a pension scheme which provides benefits on a defined benefit basis. The assets of the scheme are held separately from those of the Group in an independently administered fund. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives within the Group.

Certain directors and senior employees of the Company are members of money purchase pension schemes.

Details of the pension schemes are provided in note 24.

Deferred taxation

Deferred tax is accounted for, using the liability method, on all material timing differences to the extent that it is probable that a liability or an asset will crystallise in the foreseeable future.

Notes *(continued)*

2 Turnover

Turnover originates wholly in the United Kingdom. The directors consider that the whole of the activities of the Group constitute a single class of business, that of operating passenger rail services.

Turnover comprises:

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Passenger revenue	**356,090**	41,132
Catering income	**16,748**	1,831
Maintenance revenue	**10,483**	819
Other trading income	**13,877**	2,130
	397,198	45,912

Other trading income consists primarily of the provision of station facilities to other train operators, and the hire of train crew and rolling stock.

3 Train operating expenditure

Train operating expenditure comprises:

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Rolling stock costs	**123,908**	21,945
Track access costs	**206,111**	30,376
Station and depot access costs	**33,054**	4,359
Power costs	**17,160**	2,862
Other operating expenditure	**56,612**	7,311
	436,845	66,853

Other operating expenditure consists primarily of commissions payable, catering supplies and the National Rail Enquiry Scheme charges.

Notes *(continued)*

4 Staff numbers and costs

Staff numbers and costs comprise:

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Wages and salaries	**68,306**	7,495
Social security costs	**5,343**	619
Other pension costs	**2,421**	196
Other staff costs	**9,929**	12,715
	85,999	21,025

The average number of persons employed by the Group during the period were:

Average number of employees during the period

	11 month period to 28 February 1998	Period 18 November 1996 to 31 March 1997
Management	**381**	507
Other staff	**3,286**	3,672
	3,667	4,179

Notes *(continued)*

5 Profit/(loss) on ordinary activities before taxation

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Profit/(loss) on ordinary activities before taxation is stated after charging/(crediting)		
Auditors' remuneration:		
Audit - group	**120**	100
- parent	**20**	25
Other services	**654**	50
Depreciation	**128**	13
Operating lease rentals:		
- hire of plant and machinery	**85,467**	14,078
- other operating leases	**12,082**	731
Hire of plant and machinery - finance charges under finance leases	**-**	2
Rental income received on properties	**(1,484)**	(108)
Amortisation of negative goodwill	**(946)**	(98)

Additional fees of £nil *(1997: £375,000)* were paid to the auditors, in respect of other services, and were included in the cost of the investment in subsidiaries.

Notes *(continued)*

6 Remuneration of directors

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Aggregate emoluments of directors	500	2
Company contributions to money purchase pension scheme	21	-
Amount paid to third parties in respect of non-executive directors' services	57	5
	578	7

	Number of directors 28 February 1998	Number of directors 31 March 1997
The number of directors eligible for shares under a long term incentive scheme	**4**	3
Retirements benefits are accruing to the following number of directors under:		
Money purchase schemes	**2**	1
Defined benefit schemes	**2**	-

The aggregate emoluments of the highest paid director were £158,000, and company pension contributions of £15,000 were made to a money purchase scheme on his behalf.

Directors' interests in the ordinary share capital of the Company are disclosed in the directors' report.

Notes *(continued)*

7 Exceptional items

The following exceptional items have been included in arriving at operating profit/(loss).

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Train operating expenditure:		
Property and occupancy costs	**972**	-
Staff costs:		
Costs of voluntary severance schemes and staff restructuring	**6,636**	12,383
Other operating charges:		
New rolling stock costs	**2,264**	-
Property repair and occupancy costs	**3,027**	-
	5,291	-

8 Other interest receivable and similar income

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Bank interest	**4,357**	178
Other interest	**50**	289
	4,407	467

Notes *(continued)*

9 Interest payable and similar charges

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Amounts payable on other loans	**3,432**	239
Finance lease interest	**2**	-
	3,434	239

10 Taxation

The taxation charge comprises:

	11 month period to 28 February 1998 £000	Period 18 November 1996 to 31 March 1997 £000
Corporation tax based on the profit for the period at 31%	**968**	-
Deferred tax (see note 19)	**185**	-
	1,153	-

The effective rate of tax differs to the standard rate primarily as a result of the availability of tax losses brought forward.

Notes *(continued)*

11 Tangible fixed assets

Group	Plant and equipment £000	Fixtures and fittings £000	Total £000
Cost			
At the beginning of the period	299	-	299
Additions	803	40	843
Disposals	(9)	-	(9)
At 28 February 1998	1,093	40	1,133
Depreciation			
At the beginning of the period	13	-	13
Charge for period	125	3	128
Disposals	(5)	-	(5)
At 28 February 1998	133	3	136
Net book value			
At 28 February 1998	**960**	**37**	**997**
At 31 March 1997	286	-	286

Included in the net book value of plant and equipment is £2,000 *(1997: £4,000)* in respect of assets held under hire purchase and finance leases. Depreciation charged in the period on these assets amounted to £2,000 *(1997: £nil)*.

Company	Plant and equipment £000	Fixtures and fittings £000	Total £000
Cost			
At the beginning of the period	3	-	3
Additions	69	40	109
At 28 February 1998	72	40	112
Depreciation			
At the beginning of the period	-	-	-
Charge for period	6	3	9
At 28 February 1998	6	3	9
Net book value			
At 28 February 1998	**66**	**37**	**103**
At 31 March 1997	3	-	3

Notes *(continued)*

12 Negative goodwill

	£000
Gross negative goodwill at 31 March 1997	(14,187)
Adjustment to negative goodwill during the period	1,064
Gross negative goodwill at 28 February 1998	(13,123)
Released at 31 March 1997	98
Released during the period	946
Released at 28 February 1998	1,044
Net book value of negative goodwill at 28 February 1998	**(12,079)**
Net book value of negative goodwill at 31 March 1997	(14,089)

The adjustment to negative goodwill in the period ended 28 February 1998 arose as a result of additional acquisition costs in respect of the acquisition of West Coast Trains Limited.

13 Fixed asset investments

	Investment in subsidiaries £000
Company	
Investments at 31 March 1997	4,197
Additions during the period	1,064
Investments at 28 February 1998	**5,261**

The Company owns all of the £1 Ordinary shares of CrossCountry Trains Limited and West Coast Trains Limited, both of which are registered in England and Wales and operate passenger rail services.

Group

Both of West Coast Trains Limited and CrossCountry Trains Limited each own one of 25 four pence ordinary shares in each of the following companies:

- ATOC Limited
- Rail Settlement Plan Limited
- Rail Staff Travel Limited

Notes *(continued)*

14 Stocks

	Group 28 February 1998 £000	Group 31 March 1997 £000
Raw materials and consumables	3,070	2,618

15 Debtors

	Group 28 February 1998 £000	Company 28 February 1998 £000	Group 31 March 1997 £000	Company 31 March 1997 £000
Amounts falling due within one year				
Trade debtors	22,660	-	27,826	-
Amounts owed by subsidiary undertakings	-	1,736	-	118
Other debtors	17,637	375	13,458	109
Prepayments and accrued income	3,746	493	2,664	-
	44,043	2,604	43,948	227
Amounts falling due after more than one year				
Prepayments and accrued income	34,869	-	30,800	-
Amounts owed by subsidiary undertakings	-	30,000	-	30,000
	78,912	32,604	74,748	30,227

Prepayments falling due after more than one year represent the pension surpluses recognised as fair value adjustments on the acquisition of West Coast Trains Limited and CrossCountry Trains Limited (see note 24), and deferred track access costs relating to Phase I of the Upgrade incurred by West Coast Trains Limited during the eleven months ended 28 February 1998.

Amounts due after more than one year by subsidiary undertakings to Virgin Rail Group Limited represent subordinated loans of £21 million to West Coast Trains Limited and £9 million to CrossCountry Trains Limited made according to the terms of the Franchise Agreements for the period of the franchises.

16 Cash at bank and in hand

At 28 February 1998 and at 31 March 1997, the balance of cash at bank and in hand, for the Group and Company, included £30 million held on deposit, as security for the performance bonds (see note 23).

The balance of cash at bank and in hand for the Group also included £1,600,000 held on deposit as security for the season ticket bond (see note 23).

Notes *(continued)*

17 Creditors: amounts falling due within one year

	Group 28 February 1998 £000	**Company 28 February 1998 £000**	Group 31 March 1997 £000	Company 31 March 1997 £000
Trade creditors	**52,535**	**839**	59,028	94
Amounts owed to subsidiary undertakings	**-**	**5,000**	-	-
Corporation tax	**968**	**168**	-	-
Other taxes and social security costs	**3,226**	**25**	3,509	-
Other creditors	**8,584**	**97**	5,013	45
Obligations under finance leases	**38**	**-**	41	-
Deferred consideration payable to franchise vendors	**-**	**-**	4,197	4,197
Accruals and other deferred income	**10,509**	**1,965**	1,800	712
Deferred season ticket income	**1,815**	**-**	1,488	-
	77,675	**8,094**	75,076	5,048

18 Creditors: amounts falling due after more than one year

	Group 28 February 1998 £000	**Company 28 February 1998 £000**	Group 31 March 1997 £000	Company 31 March 1997 £000
Other loans	**25,000**	**25,000**	25,000	25,000
Obligations under finance leases	**22**	**-**	51	-
	25,022	**25,000**	25,051	25,000

Under the terms of a loan instrument dated 7 March 1997, the Company issued £25,000,000 of unsecured loan stock. Interest of 15% per annum is payable quarterly in arrears. The Company may redeem all or any part of the stock at par at any time up to 7 March 2003, at which date all outstanding loan stock shall be redeemed.

Notes *(continued)*

18 Creditors: amounts falling due after more than one year *(continued)*

The maturity of obligations under finance leases and hire purchase contracts, net of finance charges, is as follows:

	Group 28 February 1998 £000	Group 31 March 1997 £000
Within one year	**38**	41
In the second to fifth years	**22**	51
	60	92

19 Provisions for liabilities and charges

	Group deferred tax £000	**Group other provisions £000**	**Group total £000**
At the beginning of the period	9,240	13,700	22,940
Provided during the period	185	1,365	1,550
Utilised in the period	-	(13,700)	(13,700)
At 28 February 1998	**9,425**	**1,365**	**10,790**

Provisions established and utilised during the period relate to restructuring costs.

The deferred tax provision, which has been provided for at 30% and represents the full potential provision may be analysed as follows:

	Group 28 February 1998 £000	Group 31 March 1997 £000
Prepayment in respect of pension surplus	**9,075**	9,240
Short term timing differences	**350**	-
	9,425	9,240

Notes *(continued)*

20 Called up share capital

	Number of shares	Group and Company 28 February 1998	Group and Company 31 March 1997
	Number	**£000**	£000
Authorised			
'A' ordinary shares of 10p	**14,500,000**	**1,450**	1,450
'B' ordinary shares of 10p	**10,000,000**	**1,000**	1,000
Non-voting ordinary shares of 10p	**37,526,300**	**3,753**	3,753
	62,026,300	**6,203**	6,203
Allotted, called up and fully paid			
'A' ordinary shares of 10p	**14,500,000**	**1,450**	1,450
'B' ordinary shares of 10p	**10,000,000**	**1,000**	1,000
Non-voting ordinary shares of 10p	**10,500,000**	**1,050**	1,050
	35,000,000	**3,500**	3,500

The 'A', 'B' and non-voting ordinary shares rank pari passu as regards dividends and other distributions. No dividend or distribution may be declared whilst any amounts are outstanding in respect of the loan stock (see note 18). The 'A' and 'B' shares have equal voting rights per share.

Under the terms of the Virgin Rail Group Share Option Scheme dated 20 March 1997, options have been granted to certain directors and senior employees of Virgin Rail Group Limited over 1,114,465 non-voting ordinary shares with an exercise price of £1.20.

Warrants

Under the terms of a warrant instrument dated 7 March 1997 and amended on 6 March 1998, warrants have been issued in respect of non-voting ordinary shares. The warrants have an aggregate 'subscription value' of £3,500,000, which is the aggregate amount required to be subscribed for additional shares in the Company on exercise of the warrants in full.

The warrant holders may exercise their right to subscribe for shares immediately prior to a public listing or under certain circumstance at any time before a public listing of the ordinary shares. Exercise rights lapse immediately after a such a listing.

The number of shares to which a warrant holder may subscribe is determined by the date on which subscription rights are exercised. The subscription value of the warrants they hold is as follows: if subscription rights are exercised prior to 7 September 1998, each £1 of subscription value entitles the warrant holder to one new share; if subscription rights are exercised between 8 September 1998 and 7 September 1999, each £1 of subscription value entitles the warrant holder to two and a half new shares; if subscription rights are exercised after 8 September 1999, each £1 of subscription value entitles the warrant holder to between two and one half and four and one half new shares, depending on the amount of unsecured loan stock outstanding. In certain specified circumstances, each £1 of subscription value may entitle the warrant holder to seven and one seventh new shares.

Notes *(continued)*

21 Reserves

Group

	Share premium account 28 February 1998 £000	**Profit and loss account 28 February 1998 £000**	Share premium account 31 March 1997 £000	Profit and loss account 31 March 1997 £000
At the beginning of the period	**31,550**	**(10,159)**	-	-
Shares issued during the period	-	-	31,550	-
Retained profit/(loss) for period	-	**12,388**	-	(10,159)
At 28 February 1998	**31,550**	**2,229**	31,550	(10,159)

Company

	Share premium account 28 February 1998 £000	**Profit and loss account 28 February 1998 £000**	Share premium account 31 March 1997 £000	Profit and loss account 31 March 1997 £000
At the beginning of the period	**31,550**	**(609)**	-	-
Shares issued during the period	-	-	31,550	-
Retained profit/(loss) for period	-	**1,018**	-	(609)
At 28 February 1998	**31,550**	**409**	31,550	(609)

22 Commitments

(a) Annual commitments under non-cancellable operating leases are as follows:

	28 February 1998		31 March 1997	
	Land and building	**Other**	Land and buildings	Other
Group	**£000**	**£000**	£000	£000
Operating leases which expire:				
Within one year	-	**439**	4	4,849
In the second to fifth years inclusive	**594**	**56,193**	588	57,495
After five years	**10,344**	**29,949**	10,226	29,941
	10,938	**86,581**	10,818	92,285

The Company did not have any commitments under non-cancellable operating leases.

Notes *(continued)*

22 Commitments *(continued)*

(b) As at the 28 February 1998 the Group had capital commitments of £321,000 *(1997: £nil).*

(c) The Group has, in the normal course of business, entered into a number of long term supply contracts. The most significant of these relate to track, station and depot access facilities.

(d) Under the terms of the Franchise Agreements for both West Coast Trains Limited and CrossCountry Trains Limited, the Company has to enter into unconditional agreements for the order of new rolling stock for both franchises. These unconditional agreements have to be entered into by 31 December 1998 in order for the Company not to be in default of the Franchise Agreements.

In relation to this requirement to order new rolling stock, the Company has entered into letters of intent with GECA Alsthom Metro-Cammell Limited/Fiat Ferroviaria S.p.A and Bombardier Inc. for the design, manufacture, delivery/testing and the ongoing service and maintenance of the new rolling stock for both West Coast Trains Limited and CrossCountry Trains Limited. Financing arrangements for the new rolling stock are currently under negotiation.

In the event that the arrangements with GECA Alsthom Metro-Cammell Limited/Fiat Ferroviaria S.p.A and Bombardier Inc. and the related financing for the new rolling stock have not become unconditional by 30 September 1998, the Company is required, in relation to West Coast Trains Limited, to reimburse GECA Alsthom Metro-Cammell Limited/Fiat Ferroviaria S.p.A for all expenditure and commitments made pursuant to the letter of intent up to a maximum of £10 million and, in relation to CrossCountry Trains Limited, to reimburse Bombardier Inc. for all expenditure and commitments made pursuant to the letter of intent up to a maximum of £13 million.

At 28 February 1998 the Company had agreed with a third party a right of participation in up to one half of the financing of the new rolling stock on equivalent terms to the successful finance provider. In the event the third party does not participate in the financing, they will receive an amount of up to £3 million, dependent upon the extent of participation.

(e) Under the Franchise Agreements, the Company has agreed with the Franchising Director annual amounts receivable or payable in respect of the operation of the franchises for future periods. For CrossCountry Trains Limited, the franchise receipt progressively changes from an amount of £103 million receivable to an amount of £0.1 million receivable in 2010, then small payments are required for the remainder of the franchise. For West Coast Trains Limited the franchise receipt decreases progressively from £70 million to £52 million receivable until 2002 when Phase I of the Upgrade of the West Coast Main Line is due to have been completed. Franchise payments to the Franchising Director start in 2004 and increase from £48 million to £218 million in 2012. The above amounts are set out in the Franchise Agreements and are subject to indexation.

The Franchise Agreement also contains provisions whereby, should West Coast Trains Limited fail to meet its contracted milestone for the introduction of new rolling stock in any period in which these milestones should be met, it will be liable to pay an 'upgrade default refund' in addition to any franchise payment which it would otherwise have to make to the Franchising Director.

Notes *(continued)*

22 Commitments *(continued)*

The contracted franchise receipts or payments are subject to a number of adjustments under the Franchise Agreements. Both West Coast Trains Limited and CrossCountry Trains Limited can apply to have the receipts raised in certain circumstances including adverse changes by the Regulator to the access charging regime or, so far as West Coast Trains Limited is concerned adverse changes to the Moderation of Competition policy. Changes can also be made if the Franchising Director amends the fares regulation formula in a way which adversely affects either one of West Coast Trains Limited or CrossCountry Trains Limited.

23 Contingent liabilities

Guarantees

In accordance with the Franchise Agreements the Company procured performance bonds in favour of the Office of Passenger Rail Franchising for both West Coast Trains Limited and CrossCountry Trains Limited. The bonds have been issued by Lloyds Bank up to £21 million for West Coast Trains Limited and up to £9 million for CrossCountry Trains Limited.

Under a separate agreement, the Company has lodged £30 million with Lloyds Bank as security.

Season ticket bond

The season ticket bond issued by West Coast Trains Limited in favour of the Office of Passenger Rail Franchising secures the refund of current season tickets in the event of:

- the termination of the Franchise Agreement;
- the making of a railway administration order;
- or the occurrence of an event of default.

The value of the season ticket bond for 1998 is up to £1.6 million.

Notes *(continued)*

24 Pension scheme

Prior to their acquisition by Virgin Rail Group Limited, West Coast Trains Limited and CrossCountry Trains Limited were participating employers in the British Rail shared cost section of the Railways Pension Scheme ('RPS'). Since their acquisition the subsidiaries have participated in their own separate shared costs sections of the RPS. The RPS is a funded scheme and provides benefits based on final pensionable pay. The assets of the RPS are held separately from those of the Company and its subsidiaries.

The first actuarial valuation of the subsidiaries' sections of the RPS were undertaken at the date of establishment of the sections. The next formal valuation will be undertaken with an effective date no later than 1 April 1999. In advance of this the Company has requested independent actuarial reviews to be undertaken as at 31 December 1997 using the method and assumptions used by the RPS Scheme Actuary for the initial valuations of the sections as at the dates of acquisition. The method used was the projected unit method. It was assumed that the investment return would be 8.5% per annum, future salary increases (excluding promotional increases) would be 3.5% in April 1998 increasing to 6.5% per annum thereafter. Present and future pensions were assumed to increase at 4.5% per annum. The assets of the sections were valued by discounting the projected income and capital payments from the investments allowing for dividends to grow at 4.0% per annum in respect of UK equities and 5.6% in respect of overseas equities (excluding Japan, for which a 7.7% per annum growth assumption was made). The market value of the assets attributable to both sections as at 31 December 1997 was £159,700,000 for West Coast Trains Limited and £47,700,000 for CrossCountry Trains Limited. The actuarial value of the assets as a percentage of accrued benefits (allowing for projected salaries) was 143% and 128% for each section respectively. Part of the surplus is being used to finance a reduced joint contribution rate of 12.5% of Section Pay (in general terms, basic salary less 1.5 times the basic state pension) until September 2003. This will be reviewed at the next valuation due no later than April 1999.

The pension charge for the eleven month period ended 28 February 1998, calculated in accordance with SSAP 24 was £2,400,000 *(1997:£300,000).*

The same method and assumptions were used for the SSAP24 calculations except that the investment return was assumed to be 9% per annum in the period prior to 2 July 1997 and 8.5% per annum for the accounting period thereafter. This reduction recognises the effect of the abolition of tax credits on UK equity dividends announced in the July 1997 Budget.

The employer's actual combined contributions in the period was £1,900,000 to the defined benefit schemes, and £21,000 to the money purchase schemes. The balance sheet prepayment as at 28 February 1998 was £30.3 million.

Notes *(continued)*

25 Reconciliation of operating profit/(loss) to net cash (outflow)/inflow from operating activities

	11 month period to 28 February 1998	Period 18 November 1996 to 31 March 1997
	£000	£000
Operating profit/(loss)	**12,568**	(10,387)
Depreciation charge	**128**	13
Amortisation of negative goodwill	**(946)**	(98)
(Increase)/decrease in stocks	**(452)**	237
(Increase)/decrease in debtors	**(3,780)**	12,689
Increase in creditors	**4,109**	11,052
(Decrease)/increase in provisions	**(12,335)**	12,100
Net cash (outflow)/inflow from operating activities	**(708)**	25,606

Notes *(continued)*

26 Analysis of cash flows

		11 month period to 28 February 1998		Period 18 November 1996 to 31 March 1997
	£000	**£000**	£000	£000
Returns on investment and servicing of finance				
Interest received	**4,023**		358	
Interest paid	**(2,818)**		(239)	
Net cash inflow for returns on investments and servicing of finance		**1,205**		119
Capital expenditure and financial investment				
Purchase of tangible fixed assets	**(801)**		(3)	
Sale of tangible fixed assets	**4**		30	
Net cash (outflow)/inflow for capital expenditure and financial investments		**(797)**		27
Acquisitions and disposals				
Acquisition of subsidiaries	**(4,197)**		-	
Net cash acquired with subsidiaries	**-**		(1,407)	
Net cash outflow for acquisitions and disposals		**(4,197)**		(1,407)
Management of liquid resources				
Deposits placed on security for performance bonds	**-**		(30,000)	
Net cash outflow for management of liquid resources		**-**		(30,000)
Financing				
Finance lease repayments	**(32)**		-	
Issue of ordinary share capital	**-**		35,050	
Loan stock due after more than one year	**-**		25,000	
Net cash (outflow)/inflow from financing		**(32)**		60,050

Notes *(continued)*

27 Analysis of net funds

	At 31 March 1997 £000	Cash flow £000	**At 28 February 1998 £000**
Cash at bank	54,395	(4,529)	**49,866**
Deposits placed as security for performance bonds	30,000	-	**30,000**
	84,395	(4,529)	**79,866**
Debt due after one year	(25,000)	-	**(25,000)**
Finance leases	(92)	32	**(60)**
	59,303	(4,497)	**54,806**

	28 February 1998 £000	31 March 1997 £000
Reconciliation of net cash flow to movement in funds		
(Decrease)/increase in cash in the period	**(4,529)**	54,395
Cash outflow from increase in liquid resources	**-**	30,000
Cash outflow from lease finance	**32**	-
	(4,497)	84,395
Change in debt resulting from cash flows	**-**	(25,000)
Finance leases acquired with subsidiaries	**-**	(92)
Movement in net funds in period	**(4,497)**	59,303
Net funds at beginning of the period	**59,303**	-
Net funds at 28 February 1998	**54,806**	59,303

Notes *(continued)*

28 Related party transactions

At 28 February 1998 and 31 March 1997, certain of the Company's shareholders were trusts, or companies owned by the trusts (together the 'trust shareholders'), the principal beneficiaries of which were RCN Branson and his immediate family. None of the trust shareholders individually has a controlling interest in the Company. The trust shareholders have interests directly and indirectly in certain other companies which are considered to give rise to related party disclosures under Financial Reporting Standard No.8 'Related Party Disclosures'.

Certain administrative costs, relating predominantly to the provision of company secretarial and tax services, are recharged by Virgin Management Limited to the Company. Such costs, together with charges for the services of two non-executive directors and Mr Branson as president, and royalties payable on licences for use of the Virgin name amounted to £134,000 *(1997: £209,000)* for the period. Included in other creditors at the period end is an amount of £97,000 *(1997: £45,000)* owing to Virgin Management Limited.

Under the terms of a Loan Instrument dated 7 March 1997, the Company issued £25,000,000 of unsecured loan stock. Interest of 15% per annum is payable quarterly in arrears. £616,000 *(1997: £237,000)* interest was accrued during the period in respect of this loan. The interests of the Trust shareholders and other related party shareholders and their affiliates in this loan stock are set out below:

	28 February 1998 £
Trust shareholders	5,000,000
Bankers Trust International Plc	4,875,000
JP Morgan Int'l Capital Corporation	4,750,000
TPG Partners LP and TPG Parallel I, LP	5,500,000

Their interests in the warrants over the non-voting ordinary shares of 10 pence (see note 20) are set out below:

	28 February 1998
Trust shareholders	700,000
Bankers Trust International Plc	682,500
JP Morgan Int'l Capital Corporation	665,000
TPG Partners LP and TPG Parallel I, LP	770,000

29 Ultimate parent company and parent undertaking of larger group

The Company has no parent undertaking and therefore its results are not consolidated in the accounts of any other entity.