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Key facts from 2003

541

We operate from 541 shops
around the world

3.2

Total retail floor space for the
combined businesses around the
world is 3.2 million square feet

13,000

We currently employ over
13,000 people

18	Chairman's statement
20	Chief Executive's statement
24	Operating review
32	Financial review
36	Board of Directors
33	Corporate governance
41	Directors' remuneration report
50	Corporate and social responsibility
51	Directors' report
53	Independent auditors' report to the members of HMV Group plc
54	Consolidated profit and loss account
55	Statement of total recognised gains and losses
55	Reconciliation of movements in shareholders' funds
56	Balance sheets
57	Consolidated cash flow statement
58	Reconciliation of operating profit to net cash flow from operating activities
59	Accounting policies
61	Notes to the financial statements
85	Group financial record
86	Pro forma financial information
87	Store directory
88	Shareholder information
88	Company information

Expert retail brands

Both the HMV and Waterstone's brands are synonymous with their respective product categories combining a rich heritage with contemporary appeal. They are market leading retailers offering range authority, product knowledge and expertise, customer service and stimulating store environments.

Recorded music

Worth US\$32 billion in 2002

The Global music market was particularly challenging in 2002, with some impact from unauthorised CD burning and internet distribution. However, the UK market proved more resilient, achieving 2% sales volume growth (Official Chart Company)

Video

The UK video market was worth £2.0 billion in 2002

Growth is being driven by DVD – which now accounts for 64% of the video market, up from 7% in 1999. With DVD players in less than one third of UK households, there is still great potential for growth

Range authority

Computer games

The UK games market was worth
£1.1 billion in 2002

With UK sales of games consoles up 44%
in 2002 to 3.3 million units, a strong base
has developed to support continued
games software growth

Books

The UK consumer book market
was worth some £2.0 billion in 2002

The consumer book market has a
record of modest but steady growth
rates. In addition, Waterstone's has
39 university campus stores

Internet

Trading websites complement our
store offering

HMV.co.jp is a leading music and DVD
e-tailer in Japan and HMV has strong
on-line positions in the UK and Australia.
HMV.com (Canada) and waterstones.co.uk
are run through strategic alliances
with Amazon

Passio peop

A combination of unrivalled product knowledge, enthusiasm and a passion for what they do means our employees are the key to the success of all of our businesses.

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le

Harry is DVD Visual New Release Buyer in HMV Canada, responsible for coordinating purchasing and marketing support for this rapidly growing area of the business. A key achievement was helping to deliver the most successful Christmas ever for visual sales. Harry recommends the Quentin Tarantino DVD Special Editions for fans of modern day gangster films.

John Mitchell and Sarah Nichols
 Sarah and John are music buyers for the
 HMV stores at, respectively, Oxford Circus
 and Selfridges, London. Both use their wide
 product expertise to improve range and
 merchandising opportunities of specialist
 categories, such as import music. John
 graciously deferred to Sarah's choice of
 CD album of the year – 'Magnolia Electric
 Company' by Songs: Ohia, which is described
 as "a beautiful alt-country album".
 'Twin Peaks – Series 1', as "one of the
 finest TV series available on the format",
 is Sarah's DVD recommendation.

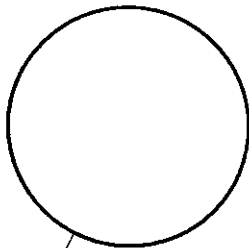
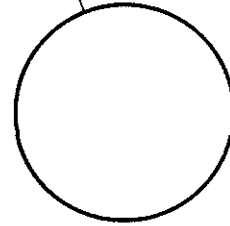
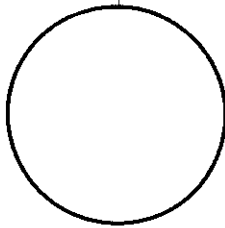
Lynn is Assistant Manager of Waterstone's Manchester Airport store, and is Waterstone's Bookseller of the Year. The award reflected the energy and enthusiasm she brought to her role, most importantly when helping and serving customers. Lynn recommends 'Quentin's' by Maeve Binchy and 'Pillars of the Earth' by Ken Follett.

Etsuko Nasu

Etsuko became Regional Manager responsible for five of the main Tokyo stores in HMV Japan in April 2003 after a wide variety of store management roles. Last year, as manager of our Shinjuku South store, Etsuko's team achieved significant operational improvements, including a 70% reduction in stock shrinkage. Her favourite DVD is 'Apocalypse Now Redux'.

Tim Watson

Tim has been with Waterstone's for 14 years and is the Manager of the Superstores South region and the Waterstone's Regional Manager of the Year. With his extensive experience and knowledge of bookselling, Tim knows more than most about what makes a great bookshop. Tim recommends 'Fingersmith' by Sarah Waters.

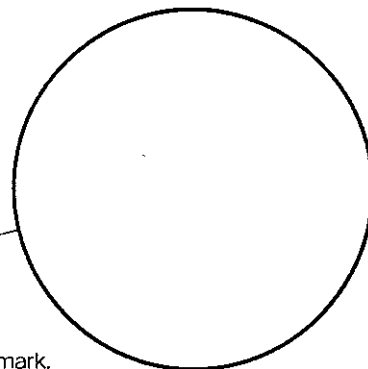


Mark Bowles

Mark joined HMV in 1999, and is now Head of Property for both HMV UK and Waterstone's. He negotiated the property deals which led to our 21 new store openings last year - as part of HMV UK's new store roll-out programme. When he's on the road looking at new store sites Mark likes to listen to Queens of the Stone Age's 'Songs for the Deaf', and on DVD his pick of the year is Led Zeppelin Live.

Nipper

The Group's most famous trademark, Nipper was immortalised in Francis Barraud's painting of 1898. Nipper first appeared on an HMV record label in 1907 and is still making regular store appearances today.

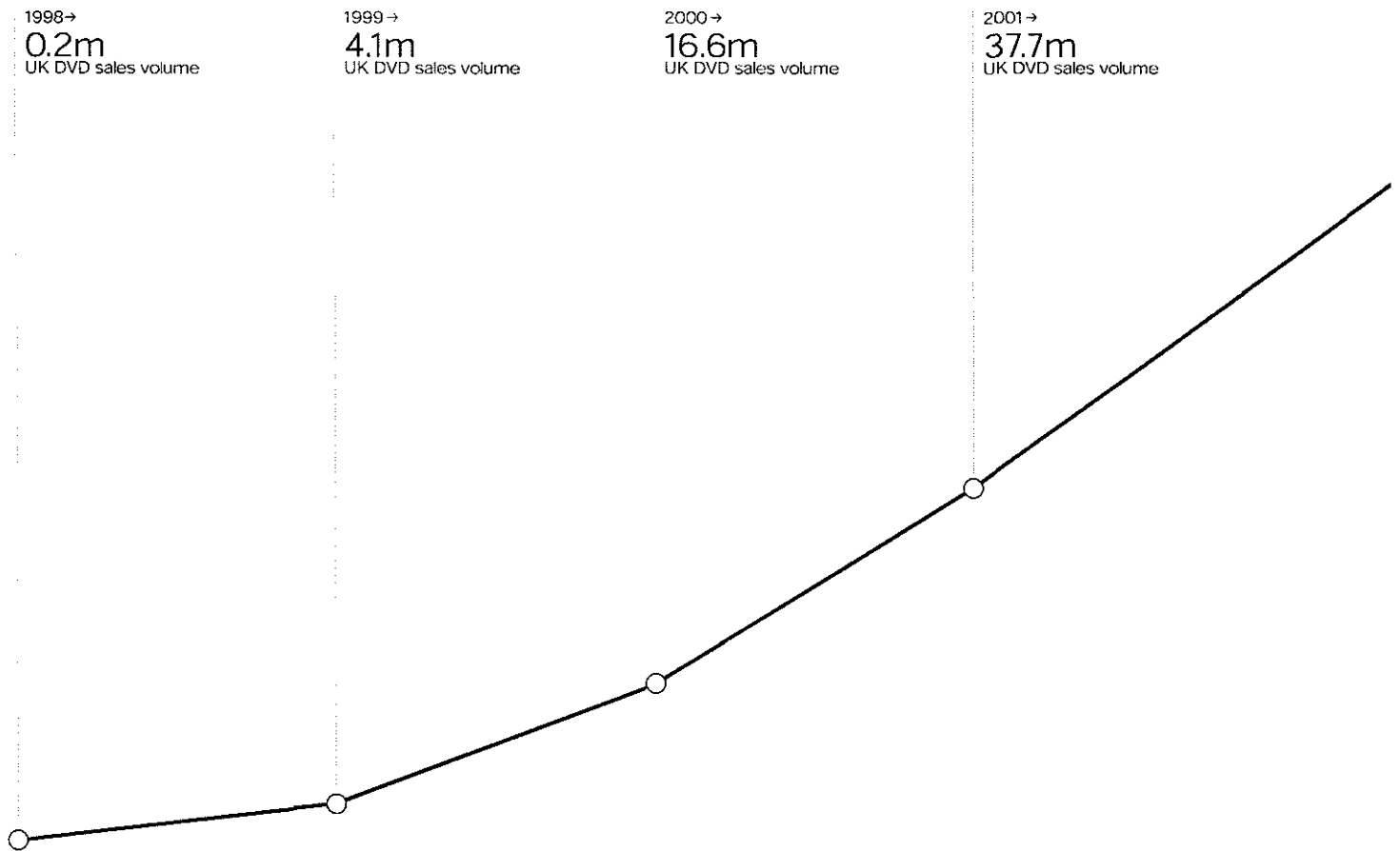


Branching out

The HMV UK new store opening programme continues to be a great success. The 21 new stores opened during the year strengthened the track record, with an average cash payback of just 13 months compared to 16 months for the openings over the prior four years. In the new financial year we expect to open at least another 15 stores, with plans over the medium term to increase the total store estate from the current level of 158 to around 300.

Waterstone's has made excellent progress on its strategy to apply the HMV blueprint. This includes the introduction of a more commercial focus via expanded promotional activity and sharper front of store merchandising, optimising the store estate and investing in the retailing skills of our people. This is being achieved without undermining the core Waterstone's values of range, service and book knowledge.

Self improvement



Get set, grow!

DVD is a key driver of growth in all HMV territories. As both hardware penetration increases and the range of software titles continues to fill out, HMV expects to further benefit from DVD growth.

2002
79.6m
UK DVD sales volume



The structure of the Japanese market makes it a very attractive place in which to invest. A fragmented music retail market means that HMV, operating through just 38 stores, has an audio market share close to that of the market leader. During the year, HMV opened four new stores providing excellent returns, and in the new financial year plans to accelerate its opening programme.

Rising in



the East

Throughout HMV and Waterstone's, a strict focus on the capital tied up in the business is embedded in the way that we work. Our investment in state of the art and bespoke inventory management information systems, combined with the expert product knowledge of our field and store employees, leads to superior returns without compromising the core HMV and Waterstone's brand values of product range and expertise.

Stock in trade

Chairman's statement Eric Nicoli

Business achievements 2002/03

HMV UK

21 new stores opened, including 150th "milestone" store at Truro

HMV.co.uk launches online digital music downloads in partnership with OD2.

Music Week Retailer of the Year award for the fifth successive year.

Waterstone's

Refurbishment of nine stores, representing 10% of sales.

£10 million stock renewal programme successfully completed.

Growth in DVD

Video category, helped by DVD, delivers 41% of UK sales, Christmas 2002.

British Video Association Retail Success of the year 2002 - specialist retail category.

Strong maiden interim results

Group operating profits increased 32.8% to £17.3 million. Maiden Interim dividend of 1.1p per share

Record Christmas trading

8.5% Group sales growth, including 4.6% LFL growth. 5.6% LFL growth in both Waterstone's and HMV Europe.

North America

Increased Canadian market share to 24.4%.

Canadian Music Industry Awards Retail Chain of the Year 2002 for the 15th successive year.

Asia Pacific

Four new store openings in Japan.

Market share growth in Japan: Music 0.3% to 6.9%, DVD 1.2% to 5.1%.

A year of achiev

Our first year as a listed company on the London Stock Exchange has seen HMV Group make appreciable progress, both in meeting the strategic objectives for growth laid out at the Initial Public Offering and delivering an excellent set of financial results. The Group financial performance was strong during the period. Sales were up 3.2% to £1,707.7 million, operating profit increased by 12.1% to £118.4 million and our net debt was reduced by £241.8 million (£95.0 million on a pro forma basis).

All HMV and Waterstone's people are to be congratulated for this excellent business performance, which was set against the backdrop of an ever more competitive retail environment, a decline in the worldwide music market and macro-economic conditions which, as the year unfolded, weakened consumer confidence.

We have much more to do, however, before the full potential of the Group is realised. At the IPO we stated as two main priorities for strategic growth the execution of a new store opening programme for HMV in the UK and the turnaround of the Waterstone's business, a programme which will continue over several years. I am pleased to report excellent progress on both of these fronts.

At HMV, 21 new UK stores were opened, taking the total number at the year end to 158. The outstanding performance of the new stores, and the extraordinary growth of our DVD sales, means that the Group can look forward with confidence to highly consistent and rapid returns from the further expansion of HMV UK during the new financial year.

At Waterstone's, the refurbishment of nine of our largest stores was completed to schedule in readiness for the crucial academic and Christmas selling periods, whilst application of the best-in-class retail standards established in HMV helped our books chain to improve financial ratios in a market which was ostensibly flat.

Our HMV businesses in North America and Asia Pacific have responded resolutely to the weakness seen in their regional music markets. These businesses have in several areas strongly outperformed their local market and leveraged their competitive positions to advance supply chain relationships and increase market share of DVD. This gives us confidence for our prospects for growth in our chosen international markets.

The Group possesses outstanding operational capabilities and has a capital structure apposite for realising the considerable potential for further expansion. Sales and profit growth remain our strong focus as we aim to maximise on behalf of our shareholders the opportunities to progress further. Our balance sheet, which shows strong free cash flow generation and net debt falling ahead of expectations, gives the Board confidence to reinforce the progressive dividend policy laid out at the IPO.



Eric Nicoli Chairman
30 June 2003

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Chief Executive's statement
Alan Giles

Fast forward

2002/03 was another year of excellent progress for HMV Group. The Group delivered excellent profit growth and achieved a £95 million reduction in net borrowings. This was achieved in a year when the UK, our largest market by sales and profit, experienced a softening in music sales and a general downturn in consumer confidence, which was exacerbated in the final quarter by the build-up to and eventual war in Iraq.

At the time of our IPO in May 2002 the Group identified several objectives that would enable us to pursue our ambition to be the most successful international retailer of music, books and video. I am pleased to report that, by successfully following a very focused strategy for ongoing growth, we continue to deliver against these objectives and advance nearer to our ambition.

The seven key points of our strategy as outlined in last year's annual report:

01 Apply the HMV blueprint across the Group

To transfer best practice from the highly successful business model developed by HMV in the UK.

02 Secure leadership in chosen markets

To operate in attractive markets where the Group can maintain or obtain market leadership.

03 Deliver unrivalled authority

To deliver leading market share through superior range, customer service and product knowledge in each catchment area.

04 Achieve superior financial performance

To generate superior financial performance by achieving "best in class" operational standards.

05 Exploit new product opportunities

To build on the Group's strong track record of the early adoption of new formats, such as DVD, thereby securing competitive advantage and market share growth.

06 Embrace alternative distribution channels and technologies

To ensure that the Group is well positioned to take advantage of viable alternative distribution channels and technologies that present viable strategic opportunities for its business.

07 Optimise store portfolio

To ensure that the Group has a suitably positioned, sized and configured store portfolio tailored to local markets designed to maximise long-term returns.

Growth strategy

HMV UK store openings

HMV Europe, operating through 166 stores primarily in the UK, has yet again proved itself to be the high-performing engine of the Group, delivering record sales, profit and cash flow. Total sales grew to £867.4 million – a 10.6% increase on the previous year, inclusive of a 3.7% like for like improvement.

Whilst highly successful, HMV's national coverage is under-represented compared to its retailing peers and there exist outstanding opportunities to increase our store numbers. HMV stores are sited in each of the top 50 UK markets ranked by Experian, but are not in over 50% of the next 150 markets. In these towns HMV has high brand awareness and a valuable consumer franchise but no distribution to, effectively, some 20% of UK shoppers. This group of catchments has become the focus of our expansion, and during the year we opened a record 21 new stores, including Carlisle, Colchester, Grimsby, Putney, Winchester and Truro, where our landmark 150th store opened in December.

We also added to our edge-of-town portfolio, with new store openings at Edinburgh's Fort Kinnaird and Ocean Terminal, Manchester West One and Liverpool Speke Park. For the first time, HMV now has a presence on railway concourses following the opening of new stores at London's Victoria and Manchester's Piccadilly stations.

As a focus for capital investment, shareholders can be assured of both the scale and consistency of returns from these new openings, with the 50 new stores opened in the past five years generating an average cash payback of just 16 months. We are highly selective in where we invest and, because of the strength of the HMV brand we are able to secure advantageous property terms which lead to these superior returns. This gives us great confidence that the 15 new stores planned for the new financial year will also be significantly value enhancing to the Group.

DVD market leadership

In HMV Europe, total DVD sales grew by 83% year on year, although with some cannibalisation of VHS, total video sales increased 32.4% for the full year. In the UK we have established a leading, 25.8% share of the DVD market, an outstanding feat given that HMV was not the market leader in VHS.

The explosive growth in DVD in the UK, HMV's largest market, has been achieved from a still emerging but rapidly growing base of approximately 30% household penetration for DVD players. Overall in 2002/03, the UK installed base for DVD hardware grew by 87%, according to the British Video Association, and the market is still matching the development of the US, but some 16 months later.

VHS was predominantly a new release driven format and back catalogue sales and collecting had not developed to the same extent as music. The superior quality of DVD and the additional content which suppliers now feature has, however, led to the development of a strong catalogue business.

The proven consumer appetite for DVD software plays directly to HMV's strengths as a range authority retailer and its expertise in continuously stimulating consumer interest in catalogue titles through pre-planned sales campaigns. With only 11,000 titles available on DVD so far, compared to 23,000 for VHS, there exists ample scope through continuing range expansion to support consumers' desire to collect DVD.

The challenge for HMV in DVD is to make consumers aware of the huge breadth of new product releasing to DVD, and to this end HMV continues to develop new initiatives. During the year HMV launched the ScreenXtra preview DVD, which is a very effective tool for raising awareness of release dates and HMV offers to our core DVD customers. HMV also introduced into stores the New to DVD sections, which highlight non-chart catalogue re-issues and this too is driving strong market shares for HMV.

Why have music sales been declining?

A combination of illegal Internet downloading and CD burning have taken some of the edge off of growth in global music sales, but does not sufficiently explain why some music markets continued to see positive growth. France has all the ingredients for music downloading – mature PC penetration and a rapidly growing broadband Internet market – but saw growth in its music market of 4% in 2002. In our view, this divergence is largely a function of how successful the local record labels and retailers have been in developing and promoting the market. We also believe that the high growth DVD product format is competing with music for a share of consumer expenditure, and is evidence that consumers' desire to own and collect product in physical format is undiminished.

Is DVD growth sustainable?

DVD has enjoyed phenomenal growth in the previous two years. We believe there is much more to come, stimulated by increasing household penetration of hardware, including recordable DVD, and an expansion in the number of software titles. Although we do not expect a repeat of the UK's 100%+ growth, DVD will lead our video category to high double-digit growth this year. Looking forward, we expect HMV's ability to maximise catalogue sales through promotions to help us maintain market leadership even when the growth in hardware begins to plateau.

Chief Executive's statement continued

The growth in DVD meant that video contributed over 40% of sales in HMV UK at Christmas, compared to 45% for music. Our businesses in North America and Asia Pacific, where HMV had not been as successful with VHS, are also making significant progress in introducing DVD to their product mix.

Expansion in Japan

Progress is also being made on our medium-term strategic growth plans for Japan, where we ended the year with 37 stores located in many of the key catchments. Japan did not escape the downturn seen in other world music markets during the period, declining by 9%. However, it remains the world's second largest market for music, with a strong indigenous J-Pop business, which represents three quarters of the market, and widespread interest in international artists.

Our estimated 7% market share in Japan's highly fragmented market means there is an opportunity for us to become the leading player through expanding our store portfolio. Our share of the market belies the strength of the HMV brand, which is one of the best known in Japan. Approximately 10% of our Japanese sales are now made online, reflecting our high brand awareness and the success of our e-commerce operation, but also the relative under-representation of our stores.

The HMV business in Japan is currently sub-scale, and the infrastructure we have in place is capable of supporting a considerably larger chain. Our 2002/03 new stores, at Oita, Machida, Hakata and Sapporo, have all performed well. Our expansion plan has targeted eight new store openings during the new financial year, a programme prudently aligned to the development of store managers required to meet HMV's high operational standards.

Lease lengths in Japan are typically shorter than in other major HMV territories, which means a low-risk investment profile for new store openings. The Group remains confident of achieving rapid returns as scale economies unfold and as we more deeply engrain into the HMV business in Japan the world class operating standards evident in HMV UK.

Waterstone's turnaround

Good progress was made during the first 12 months of our three-year recovery programme for Waterstone's. During the period Waterstone's tackled head-on some of the biggest challenges that had been set for the turnaround of the business, including the replacement of £10 million of slow-moving stock with fresher and more saleable titles, and the refurbishment of nine of our larger stores representing approximately 10% of Waterstone's turnover.

Most of this activity was carried out in the first half, prior to the peak academic and Christmas trading periods. The benefit was seen in Waterstone's like for like sales performance at Christmas, which was up 5.6% against a strong performance in the prior year. This in part reflected the successful application of promotional tactics similar to those developed in HMV UK. These included the launch, in close co-ordination with suppliers, of a highly marketable "Book of the Week" campaign for each of the six weeks prior to Christmas.

The refurbished Waterstone's stores provide a contemporary and commercial environment. A new children's concept was introduced and further coffee concessions were opened. All of these improvements have been made without compromising on the unrivalled range authority for which Waterstone's is renowned.

Looking forward, Waterstone's continues to rigorously apply the HMV Blueprint. This process has provided appreciable results that have been translated to sales and profit growth and balance sheet improvement, although not all ideas have translated successfully. As Waterstone's gradually improves profitability and restores operating margins to more acceptable levels the Group remains determined that its shareholders will benefit from the incremental value created.

New channels and formats

With a longer term horizon in mind, the Group continues to experiment with new technologies and distribution formats in the event that these should become viable and widespread channels to deliver the products we sell to consumers.

Can HMV compete with supermarkets for CDs, games, DVDs and books?

The supermarkets have been aggressively pursuing their expansion of non-food ranges in recent years, and are an established feature of the competitive environment. Although supermarket competition has brought some deflationary pressures and they have gained market share, their potential to replicate the range, service and environment found in HMV or Waterstone's is constrained by space and their focus on family-oriented, best-selling titles. Our stores typically have a lower share of these types of products than titles deeper into the range.

Are improvements at Waterstone's being made at the expense of its literary traditions?

The Group is proud of Waterstone's reputation for literary authority, which owes everything to the passion and dedication of its booksellers. It is true that the books market became more competitive since price controls were abandoned in 1995. The aim of our Waterstone's recovery programme is to improve the chain's retailing capabilities so that it is better equipped to meet the requirements of today's vastly more commercial books market. Our focus is on strengthening Waterstone's core brand value as the most authoritative range bookseller and on applying HMV's world-class retailing standards to Waterstone's.

The recent decline in the world music market has been widely attributed to CD burning and the illegal free sharing of music between users of peer-to-peer Internet sites. Currently, consumer research exists to support the seemingly opposite views that music downloading is to some degree both stimulating and substituting sales of physical product. Precise trends at this stage are difficult to decipher, but it is clear that downloading is emerging as a part of the distribution landscape. Whether this will move beyond piracy to a viable commercial model remains to be seen, however.

So that the Group can better understand the dynamics of legitimately selling music for download via the Internet, HMV Europe entered into a strategic partnership with the UK online music service provider OD2. This allows subscribers to the secure service to stream, download or permanently burn tracks to CD for a monthly fee of £4.99. As might be expected, given the free availability of pirated music from peer-to-peer Internet websites, sales from this channel so far have been modest. However, it has given us considerable insight to consumer preferences and behaviour and positions the Group to take advantage of downloading as and when it evolves into a legitimate and viable channel to market.

As a channel to market, the Internet has settled down so that sales of physical product online as a share of the overall market are 5%-6% for books and music. We continue to make improvements to our online offer to drive sales and profitability. During the period, we eliminated the losses from running the HMV.com website in Canada by entering into a strategic alliance with amazon.ca whilst preserving our branding, and each of the Group's five transactional websites now trades profitably.

In July HMV UK will link with leading mobile phone operator Vodafone Live to offer a range of CDs, DVDs and games to mobile Internet customers. The offer has potential for purchases of physical product and downloads being charged directly to a customer's telephone bill and closely resembles the HMV mobile Internet offer, which represented 18% of total online sales in Japan.

In HMV's store at 360 Oxford Street, London, new flat-screen listening posts are being introduced, enabling customers to access and play clips from 250,000 music, DVD and games titles either via an online search or by scanning the barcode of specific titles. The kiosks are scheduled to be rolled out to all HMV UK stores over the next three years.

We are determined that we can maintain our proven track record in providing appropriate levels of support to the right distribution technologies and formats as and when they arrive, and continue to invest in innovative experiments as a way of assessing the strategic viability of new channels and technologies for our businesses.

Outlook

As we continue the execution of our growth strategy, the Group is able to look forward with confidence to the year ahead.

HMV UK is producing consistently world-class retailing standards and strong financial ratios, and as we anticipate our store expansion programme for the UK and the continuing growth in DVD we remain confident that this business can build on its outstanding levels of performance.

HMV UK's proven retailing skills are the benchmark for our international businesses in Asia Pacific and North America. As we continue to apply these techniques, build out our DVD business and, in Japan, pursue the opportunity to expand our store portfolio, we are confident of realising the potential that our market positions in these territories provide.

In Waterstone's, further operational improvements will be made as we continue with the three-year turnaround plan. We take great encouragement from the learning and progress that has so far been achieved and, through the application of the HMV model and a disciplined focus on managing the capital tied up in the business, we remain determined to restore Waterstone's to a more profitable level of return for our shareholders.



Alan Giles Chief Executive Officer
30 June 2003

Operating review

HMV Group achieved another record year of sales performance and profit generation, with HMV Europe once again proving itself to be the powerhouse of the Group. Overall sales increased by 3.2%, with like for like sales growth of 1.6%, including 1.9% growth in HMV and 0.9% like for like growth in Waterstone's. The Group improved operating profit by 12.1% to £118.4 million, and operating margin for the year increased to 6.9% from 6.4%.

Continued strong cash generation, driven by increased profitability and further improvements in working capital, offset by increased capital investment, delivered operating cash inflow of £134.3 million, compared with £159.0 million in the prior year. As a result, the Group continues to make rapid progress on reducing its borrowings, with year end net debt of £158.6 million, down from £253.6 million on a pro forma basis in the prior year.

A reorganisation of senior management followed David Pryde's resignation as Managing Director of HMV Europe. Steve Knott was appointed Managing Director of HMV Europe and his deep experience and knowledge of the business, gained through seven years spent as Operations Director of HMV UK, ensured a high level of continuity. Steve's move from his position as Managing Director at Waterstone's created a vacancy which Brian McLaughlin returned to occupy, in addition to his role as the Group's Chief Operating Officer, until a new Managing Director is appointed.

Following the year end, Paul Dezelsky, President of HMV Asia Pacific, assumed responsibility for Australia in addition to Japan, Hong Kong and Singapore.

At the end of July, Chris Walker, President of HMV North America retires following 14 years with HMV, and the Group extends its gratitude and best wishes to Chris for his retirement. Humphrey Kadaner joins HMV North America as President from Sony, where he managed Sony's store retail business in Canada and the US.

Below (left to right):

Steve Knott
Managing Director, HMV Europe
Paul Dezelsky
President, HMV Asia Pacific
Chris Walker
President, HMV North America

Above:

Brian McLaughlin
Chief Operating Officer and acting
Managing Director, Waterstone's

Sales

	2003 £m	2002 £m	Year on year growth ¹ %	Constant exchange growth ² %	Like for like sales growth ³ %
HMV					
Europe	867.4	784.4	10.6	10.3	3.7
Asia Pacific	277.0	275.7	0.5	4.8	(0.1)
North America	157.1	187.1	(16.1)	(9.9)	(4.0)
Total HMV	1,301.5	1,247.2	4.4	6.1	1.9
Waterstone's	406.2	407.3	(0.3)	(0.5)	0.9
Total Group	1,707.7	1,654.5	3.2	4.4	1.6

Operating profit

	2003 £m	2002 £m	2003 % of sales	2002 % of sales	Year on year growth %	Constant exchange growth ² %
HMV						
Europe	88.6	74.0	10.2	9.4	19.7	19.3
Asia Pacific	9.3	8.4	3.4	3.0	12.1	18.5
North America	(3.5)	1.0	(2.2)	0.5	–	–
Total HMV	94.4	83.4	7.3	6.7	13.2	13.2
Waterstone's	24.0	22.2	5.9	5.5	7.8	7.2
Total Group	118.4	105.6	6.9	6.4	12.1	12.0

1 Year on year growth over the corresponding period last year is based on results translated at the actual exchange rates being the weighted average exchange rates for the 52 weeks ended 26 April 2003 and 52 weeks ended 27 April 2002 respectively.

2 Constant exchange growth over the corresponding period last year is based on the weighted average exchange rates for the 52 weeks ended 27 April 2002.

3 HMV Group's like for like sales performance measures stores that were open at the beginning of the previous financial year (i.e. open at the beginning of May 2001) and that have not been expanded, closed or resited during that time. Like for like sales growth is calculated at constant exchange rates. Stores resized (up or down) are excluded from like for like sales performance. Sales are only over the net amount received.

4 Operating profit is shown before operating exceptional items.

Operating review continued HMV Europe

HMV Europe

The HMV Europe business, which operates through 166 stores, primarily in the UK, enjoyed another outstanding year of sales performance and profit growth. Turnover for the year grew to £867.4 million, a 10.6% increase on the prior year and a 3.7% like for like improvement, contributing to a 19.7% rise in operating profit to £88.6 million, with operating margin up to 10.2% from 9.4%.

A highlight of the year was the performance of the record 21 new store openings and two resites, which added 92,000 square feet of trading space to the HMV business in the UK. The new stores outperformed by some distance their sales and profit targets. As the cornerstone of HMV's strategic growth their performance enables the Group to look forward with confidence to the continuing store roll out programme for the new financial year, when a further 15 new stores are expected to open.

The overall sales performance reflects another year of exceptional growth for DVD and its increasing importance to the HMV business. Music now accounts for 51% of sales, down from 56% in 2001/02, with outstanding DVD growth of 83%, driving total video to 36% of sales, up from 31%.

According to the Official Chart Company ("OCC"), in 2002/03 the volume of UK music sales grew by 2%. Despite an increasingly competitive market, HMV UK retained its position as market leader holding market share at 25.1% (OCC volume). The support HMV gives to new artists played a key role in maintaining our share, with the range of promotional Playlist CDs extended and additional store space devoted to New Music. Reflecting the strength of HMV's proposition for its customers, for a fifth successive year HMV was named as the Best Retail Chain in the Music Week Awards.

"In my 14 years with HMV I've had a number of store management roles before joining Head Office as a buyer in 1998. A key achievement this year was my team's contribution to the record results achieved in the crucial Christmas trading period. On recommendations, I'll choose Paul Weller's best solo album to date, 'Illumination'."

Rob Campkin HMV UK
Head of Rock and
Pop/Dance and Urban

"Since joining HMV in 1994, I have managed stores in Chester, Hanley and Lancaster. I currently manage the Trafford Centre store, and was delighted for our success to be recognised with the Store Manager of the Year award. My favourite CD of the year is 'The beginning stages of...' by Polyphonic Spree because they are the most uplifting, motivating, feel good band ever!"

Yvonne Drake HMV UK
Manager of the Year,
Trafford Centre, Manchester

In DVD, HMV UK increased its share to 25.8% (OCC volume) and remains market leader in this rapidly developing market. This owed much to our ability to drive sales of catalogue titles through compelling campaigns and promotional offers. HMV also launched the ScreenXtra preview DVD as a tool for raising awareness of release dates and HMV offers to core customers. This retail first was a huge step forward in customer communication and has proved to be a powerful vehicle for keeping HMV ahead of its competitors by demonstrating authority in DVD.

HMV Europe's games business achieved sales growth of 14%, driven primarily by console sales, with software share impacted by the increased bundling of titles with hardware sold by competitors.

World-class retailing standards in HMV continued to facilitate the conversion of strong sales performance into profit growth, with operating margin improving to a record 10.2% from 9.4%. This in part reflected a 40 basis point improvement in product margins, primarily achieved through ever tighter control of stock obsolescence and shrinkage, including the benefit of further investment in stock security systems. Operating costs also continued to be tightly managed throughout the business.

The focus on operational effectiveness also delivered further improvements in balance sheet management. HMV Europe's market-leading stockturn (8.6 times) ensured working capital more than funded the division's fixed assets by an average of £45 million throughout the year.

The HMV e-commerce business also went from strength to strength, increasing sales and profitability. The online channel is of high importance to the stores as a marketing tool, and 75% of visitors to HMV.co.uk use the website to view the offers available in store. 90% of HMV website users buy in HMV stores and so the business has developed an in-store e-mail customer recruitment programme which drives customers back into the stores.

Key to the high operating standards demonstrated by HMV is the passion, commitment and specialist expertise of the people who work within the business, and during the year HMV made notable progress to meet targets on staff development, retention and recruitment. In addition, HMV retained the Investor in People Award originally received in 2000.

HMV completed its withdrawal from Germany, closing two stores during the year and the final store after the year end. The stores were originally established as a pilot, but insufficient consumer interest in the core HMV brand values of range authority and specialist knowledge meant that a roll-out of stores in Germany could not be justified. The total cost of closure of £1.0 million was expensed within operating profit.

In the first few months of this year, HMV has continued to identify new store opportunities for the UK, and nine new sites have already been secured for 2003/04, including Birmingham Bullring, Epsom, Stirling and the Whiteley's shopping centre in London.

"I have been at HMV's Oxford Street store since September 1999 where I am a Sales Assistant. HMV had a terrific Christmas, and I was pleased to sell the store's largest amount of games software. Game of the year for me was 'Puzzle Fighter' for the Gameboy Advance SP. I saw my team leader playing the game on his Gameboy and had to buy my own handheld console just to play 'Puzzle Fighter'. I haven't been able to put it down since!"

Dipo George Sales Assistant
HMV Oxford Street

Operating review continued HMV International

HMV Asia Pacific

In Asia Pacific, HMV operates through 75 stores, with 37 in Japan, 32 in Australia and a total six stores in Hong Kong and Singapore.

Total sales for the region, at constant exchange rates, increased by 4.8%, with like for like sales declining marginally by 0.1%. This reflected strong growth in Australia, offsetting a small decline in Japan, with conditions more difficult in Hong Kong and Singapore. Sales in all territories continued to be driven by DVD, which for the region overall increased by 54% at constant exchange rates, with total video now 22% of sales, up from 17% in 2001/02.

In a highly fragmented competitive environment, HMV increased its music market share in Japan, reflecting strong campaign and promotional activity based upon the HMV UK model. HMV also improved its brand awareness during the year, supporting the major Japanese music festivals Fuji Rock and Summer Sonic, and a programme of in-store events were staged throughout the chain.

Four new stores opened successfully during the year in Oita, Machida, Hakata and Sapporo, all of which performed well. These reflected the introduction of a new store design with a simple modern feel and fresh graphics. In addition, major and minor refits were carried out in over half of the stores to improve presentation, lighting, and space allocation. The store development team for Japan was also strengthened to accelerate new site opportunities, with a target of eight new store openings in the new financial year, most of which have already been secured.

Support for the expansion of the business in Japan was provided through new staff training programmes based on concepts originating in HMV UK. Strong progress was also made in developing the skills needed to maximise the Track management information system, and during the year the business made further advances in working capital management, improving stock turn for a fifth successive year.

HMV's e-commerce operation moved firmly into profit for the first time and generated over 10% of total sales in Japan. Sales growth followed the improvements made to fulfilment, site layout and catalogue, and a mobile Internet website contributed to an overall one million page hits per day for the HMV.co.jp website.

In Australia, HMV enjoyed an outstanding year of sales growth, with an exceptional DVD performance and significantly improved market share in music the main drivers. Merchandising improvements were made to all HMV stores to enhance presentation and competitiveness, and there was also a very strong focus on stock management. Two new stores were opened at Miranda and Surfers Paradise.

In Hong Kong and Singapore solid operational progress was made, notably through improvements in stock efficiency and property arrangements. Central costs were also significantly reduced at the start of the year in anticipation of more difficult economic conditions, which were more acutely realised than expected with the outbreak of the SARS epidemic in the final quarter.

Operating profit for the region was ahead by £1.0 million to £9.3 million, an 18.5% increase at constant exchange rates, with operating margin improving to 3.4% from 3.0%. This reflected the benefit of e-commerce profits, combined with resilient product margins, achieved despite the very competitive environment and the dilutive effect of lower margin DVD sales. The operating margin also benefited from a strong focus on the control of store and central costs.

HMV Asia Pacific also contributed further improvements in working capital management, by improving settlement terms with key suppliers and improving stockturn to 6.4 times.

"In 1997 I joined HMV Japan's Tokyo Ginza store as a stock processor, and later became rock buyer. I transferred to the e-commerce team at the time of launch, and it has been very exciting to contribute to this rapidly growing and pioneering part of the business. Outside of work, I like to follow my favourite football team, Chelsea FC."

Jiro Baba HMV Japan Internet

HMV North America

Primarily located in Canada, where HMV has market leadership operating through 99 stores, HMV North America encountered very difficult trading conditions, particularly in the first half of the year. Overall like for like sales fell 4.0%, with an 8.8% fall in the first half, improving to a 0.7% decline in the last six months. Total sales for the region decreased by 9.9% at constant exchange rates, reflecting the accelerated programme of store closures in the US business.

The music market in Canada again proved difficult, with Soundscan market volume falling by 17.2% in the year. Against this backdrop, HMV Canada consistently grew share, which overall was up to 24.4% from 23.8%. This resilient performance reflected the introduction of more aggressive campaigns and other promotional activity, funded in part by the negotiation of improved trading terms from suppliers.

The success of the DVD format continued to be the main driver of sales in the year, with 50% growth contributing to total video accounting for 27% of total sales, up from 19% in the prior year. DVD pricing in the market was particularly competitive, to which HMV Canada responded by introducing more aggressive price points, in part supported by improved trading terms from suppliers.

In April 2003 HMV Canada's e-commerce operation was relaunched as a co-branded site with amazon.ca. Under this arrangement, amazon.ca will provide inventory, content and customer service for HMV.com, but the new site will continue to offer unique HMV content, including information about HMV store locations, jobs and in-store events. Restructuring costs were £0.6 million and were expensed within operating profit.

The gradual downsizing of the legacy US business continued, and four stores were closed during the year and one after the year end, leaving a total of seven stores down from 12 at the prior year end. The net cost of the accelerated closure programme of £2.9 million was expensed within operating profit.

Inclusive of the above one-off charges, HMV North America recorded a £3.5 million operating loss for the period, down from a £1.0 million profit in 2001/02. Adjusting for the closure of the US stores and the restructuring of HMV.com, HMV Canada recorded an operating profit of £2.0 million, offset by £2.0 million of ongoing operating losses in the legacy US business.

Looking forward, HMV North America has a very clear focus on improving performance through better marketing and campaigns, effective management of costs and more efficient and proactive management of stock.

"I've been with HMV Canada for 13 years, initially in store roles. As TRACK Operations Manager I am responsible for improving the use of systems in stores to maximise operational effectiveness through documentation, training and implementation of best practices. My favourite CD from last year was 'Up' by Peter Gabriel and I love 'Six Feet Under - Season One' on DVD."

Martine Frobisher
HMV Canada
Track Operations Manager

Operating review continued Waterstone's

Waterstone's

In Waterstone's good progress was made during the first 12 months of a three-year recovery programme. Operating through 193 stores primarily in the UK, of which 39 are on university campuses, Waterstone's remains the leading retailer of books in the UK.

Total sales for the business for the year were £406.2 million, a 0.3% decrease over the prior year, reflecting some store closures. Like for like sales growth in a relatively flat book market was 0.9% for the full year. Sales performance during the period was subject to variability as the business implemented crucial elements of the recovery strategy. The focus during the summer and autumn was to improve the range, by replacing some £10 million of slow-moving stock with faster-moving, more saleable titles, and to refurbish nine large Waterstone's stores. The highlight was an outstanding Christmas performance, when like for like sales were up 5.6% against very strong comparatives (+9.1%) from the prior year. The Christmas performance was driven by the continued improvement in retailing standards and a well executed marketing strategy.

"I've been with Waterstone's for nine years, initially in various store roles. Maintenance of the core stock range shapes the standing and reputation of Waterstone's as the number one specialist book retailer. Hence, my role as Range Manager is to ensure that our customers are offered the widest choice of the most interesting books available. My book recommendation is 'The Cheese Monkeys' by Chip Kidd."

Pete Harvey Waterstone's
Range Manager

Operating profit increased by 7.8% to £24.0 million, with operating margin improving to 5.9% from 5.5%. This performance reflected margin improvements from improved terms and promotional support, combined with tighter control of shrinkage. The latter highlighted the benefit of investment in and utilisation of improved store systems, the improved stock range and increased focus by all levels of operational management. The operating margin also benefited from a consistent attention to cost control across the business, particularly store labour costs.

The benefits of operational improvements achieved to date are also reflected in Waterstone's working capital, with the average month end balance decreasing by £9.0 million. This success was reflected in a record stockturn of 3.4 times, up from 3.2 times in the prior year.

In Waterstone's the backlist accounts for the vast majority of sales, illustrating the extent to which the range is the lifeblood of the business. This is further reinforced by research among customers, which found that Waterstone's scored higher than other booksellers in the key criteria of range, availability and knowledge. Nevertheless, further improving the stock efficiency of the business' inventory without undermining the core brand value of range remains a focus for the coming year. In particular, the process of stock replenishment is being tightened to reduce the number of multiple copies of each title held.

Also crucial to Waterstone's set of brand values is the expertise and knowledge of booksellers. During the year, Waterstone's introduced a new field management team, enabling the business to draw on experience from key people from a variety of different retail backgrounds. Improvements to the career and personal development programme for Waterstone's booksellers were reflected in recruitment trends, where two-thirds of the branch manager appointments during the year were from within Waterstone's. Staff turnover was also reduced and improved processes for the recruitment of booksellers were reflected in high quality temporary staff employed over the key Christmas period.

The size of Waterstone's store portfolio was little altered during the period, save the previously announced closure of four stores. In the new financial year Waterstone's is extending the focus of the refit programme to over a quarter of the portfolio, where more fundamental aspects of store maintenance are being addressed. The new financial year has already seen the announcement of the opening of the first new Waterstone's store for four years, at Manchester's Trafford Centre, and further new stores are planned for this year.

"I joined Waterstone's in 1997 and have been Branch Manager since 2000.

At Bluewater our focus is on depth and quality of range, combined with excellence in customer service, which together are reflected in the performance of the store. It was fantastic that our success was recognised with my award of Branch Manager of the Year."

Elyse Goldsworthy Branch Manager Waterstone's Bluewater West

Financial review

Neil Bright

The 52 week period ended 26 April 2003 was one of substantial achievement. In May the Group completed both a flotation on the London Stock Exchange and arrangement of new bank facilities, thereby providing a suitable capital structure from which to prosper. The Group has demonstrated in its first year as a listed company its ability to deliver significant profit growth while reducing the capital employed, thereby generating excellent levels of cash flow.

As a result of the Group's flotation, the financial results for the 52 weeks ended 26 April 2003 in part reflect the Company's previous capital structure and include exceptional costs arising from the flotation. Consequently, to aid understanding, key financial measures such as net finance charges and earnings and dividends per share are shown on a pro forma basis as described on page 86.

Operating result

Group sales increased 3.2% to £1,707.7 million, with underlying growth of 4.4% at constant exchange rates including like for like sales growth of 1.6% (HMV 1.9%, Waterstone's 0.9%). With 30% of the Group's total sales arising in a currency other than sterling, adverse foreign exchange movements reduced sales growth this year by £20.2 million, but had no significant impact on profits.

The Group's operating profit increased by £12.8 million or 12.1% to £118.4 million, with the operating margin improving to 6.9% from 6.4%. This reflected improved gross margin, which includes store operating costs, up to 12.6% from 12.1% of sales. Within this, product margins improved by 50 basis points, primarily in Waterstone's and HMV UK. Store operating costs were well controlled throughout the business and included certain one-off costs totalling £3.9 million, in respect of the closure of HMV Germany and further store closures in HMV USA. Administration expenses increased by £2.2 million on the prior year but remained consistent at 5.7% of sales.

A full explanation of the trading performance of the Group is given in the Operating review on pages 24 to 31.

Finance charges

Finance charges before exceptional items were £22.1 million, £29.8 million lower than the prior year, reflecting the reduction in average borrowings following the change in the Group's capital structure, strong operating cash generation and lower interest rates. The current year includes a £1.4 million cost of replacing interest rate swaps covering £70 million of term debt, which were entered into before the flotation, with new swaps set at a lower fixed rate. The exceptional charges in the current financial year were associated with the Company's flotation in May 2002 and are described below.

Pro forma finance charges for the period, including the swap cancellation cost, were £21.9 million, a £3.7 million or 14.7% reduction on the pro forma comparative, primarily reflecting lower average net borrowings.

Profit before taxation

Profit before taxation excluding exceptional items was £96.2 million compared with £53.6 million in the prior year. Restated on a pro forma basis, profit before taxation was £96.5 million, an increase of £16.5 million or 20.6% on the prior year.

Taxation

The taxation charge for the financial year of £12.9 million (2002: £17.9 million) reflects the full year effective tax rate of 25% applied to profit before taxation and exceptional charges, offset by a 30% tax credit in respect of the exceptional charges arising in the UK. In the absence of the first time recognition of a deferred tax asset in respect of HMV Japan, the underlying tax rate on profit before exceptional charges would be 31%.

Cash flow and net debt

The Group continues to be a consistently strong generator of cash, with a £134.3 million operating cash inflow despite significantly increased levels of capital investment. Further working capital improvements contributed £26.2 million, which means that over the past three years, working capital improvements have generated £125 million of cash flow.

Underlying net debt at 26 April 2003 was £158.6 million, a reduction of £95.0 million or 37.5% on the pro forma prior year comparative. This debt reduction combined with the EBITDA growth ensured that the Group triggered a reduction in the interest margin payable on the Group's senior bank debt from 1.5% to 0.875% with effect from 23 May 2003.

Working capital

The Group has delivered significant benefit from improved working capital management in recent years, with further progress achieved in 2002/03. Group stockturn reached a record level of six times and supplier payment terms were further improved, contributing to the £26.2 million cash generation. Further improving the Group's working capital efficiency remains a key focus for management.

Capital expenditure

The Group's capital structure post flotation allows a higher level of investment, as reflected in the £49.0 million of capital expenditure in the current year, up from £23.5 million in 2001/02. This investment funded the successful opening of 21 new stores in HMV UK at a cost of £8.0 million, together with £10.3 million spent on an ongoing programme of upgrading existing HMV UK stores. Internationally, key capital projects included the refit of HMV Canada's Toronto superstore and the expansion of HMV Japan's flagship Shibuya store in Tokyo. In Waterstone's, £8.0 million was spent on refurbishment of the existing store portfolio, including the refit of nine of our largest stores.

	2003 £m	2002 £m
Cash flow and net debt		
Operating profit before flotation costs	118.4	105.6
Depreciation	42.2	39.5
EBITDA	160.6	145.1
Capital expenditure	(49.0)	(23.5)
Working capital inflow	26.2	44.7
Provision spend	(3.5)	(7.5)
Other	–	0.2
Pro forma operating cash flow	134.3	159.0
Net interest paid	(19.5)	
Taxation	(16.4)	
Interim dividend paid	(4.4)	
Exchange gain	1.0	
Net cash inflow	95.0	
Pro forma opening net debt	(253.6)	
Closing net debt	(158.6)	

Comparative cash flows for net interest, taxation and dividends reflect the previous capital structure and have therefore not been represented above.
For explanation of pro forma information see page 86.

Measurable progress

Financial review continued

Operating leases

All the Group's stores are held under operating leases. In HMV UK and Waterstone's the majority of leases are on standard "institutional" lease terms, now typically with a 15-year term subject to five year upwards only rent reviews. The majority of the Group's international stores and a minority of UK leases operate through turnover related leases, usually with minimum rent guarantees, and lease terms of five to 10 years.

The Group has an annual minimum rental commitment of £107 million. The total future rental commitment at the balance sheet date amounted to £1.2 billion with the leases having an average life of 9.5 years. The net present value of these commitments is approximately £0.7 billion, the majority of which are in respect of prime, highly marketable locations.

Return on capital employed

The Group's increased working capital efficiency contributed to a £15.0 million reduction in year end capital employed to £53.0 million. Combined with the Group's improved profitability, return on capital employed rose to 223% from 155%, and after adjusting for the capitalisation of operating leases, the return increased to 19.2% from 16.0%.

Capital structure and refinancing

On 15 May 2002 the Company's shares were listed on the London Stock Exchange, allowing greater flexibility in funding future capital expenditure and incentivising employees. Associated with the flotation was a fundamental restructuring of the funding structure of the Group, which included a bonus issue for Ordinary shareholders and the conversion or redemption of the Company's existing non-equity share capital. In addition, the proceeds of the global offer were in part used to repay the £135 million and \$125 million Senior Subordinated Notes, while the Group arranged a new £275 million term facility and a new £150 million revolving credit facility, which were used to repay existing senior bank facilities.

Exceptional items

As discussed in our interim announcement, the flotation and refinancing of the Group at the beginning of the financial year, gave rise to some significant one-off costs. These included £6.0 million of flotation costs that were charged to the profit and loss account in the 52 weeks ended 27 April 2002 (£3.1 million cash flow impact in current financial year). Exceptional finance costs for the current financial year comprise £25.6 million arising on the tender for the Senior Subordinated Notes, £1.0 million of related professional fees and £9.7 million of costs relating to the issue of the original senior bank facility, which had previously been deferred and were being amortised over the term of the related debt. Costs of £8.4 million associated with the arrangement of a new bank facility have been deferred and are being amortised over the new five-year term, in accordance with applicable United Kingdom accounting standards.

In addition, a redemption premium of £11.6 million was charged to the profit and loss account on the redemption of the Senior Preference Shares on 28 June 2002 and further share issue costs of £18.0 million have been charged directly to the share premium account.

Earnings per share

Pro forma earnings per share for the current financial year were 18.0p. However, on the basis of the underlying tax rate previously discussed, underlying pro forma earnings per share were 16.5p, a 24.1% increase on the pro forma comparative of 13.3p.

Actual earnings per share were 7.9p for the year, rising to 17.1p when adjusted for the effect of exceptional items. Comparison with the prior year actual loss per share of 20.7p and adjusted loss per share of 12.7p, does not take into account the significant changes to the Group's capital structure shortly after the end of the previous financial year.

Dividend

The Board is recommending a final dividend of 3.4p per share in addition to the 1.1 p per share interim dividend already paid, bringing the total dividend for the year to 4.5p per share. This will be paid on 9 October 2003 to shareholders on the register at the close of business on 19 September 2003. Shares will be quoted ex-dividend from 17 September 2003.

The Group's profit and loss account also includes distributions in respect of non-equity senior and junior preference shares. These amounts are related to the previous capital structure of the Group, with all non-equity shares having been redeemed or converted as a result of the flotation.

Accounting policies

These financial statements comply with all accounting standards issued by the Accounting Standards Board applicable to financial statements at 26 April 2003. The Group's accounting policies are set out on pages 59 and 60, and are consistent with the prior year.

Retirement benefits

The Group continues to account for pensions under SSAP 24, but certain transitional disclosures required under FRS 17 are set out in Note 26 to the financial statements.

The Group has a number of pension schemes in operation. These primarily include defined benefit arrangements for approximately 1,000 employees almost entirely in the United Kingdom. Of these, 40% are in the Group's own HMV Scheme with the balance members of EMI Group plc's Fund. A process of pension separation from EMI commenced on the Group's flotation, and was completed on 31 May 2003.

A surplus on the EMI Fund has provided the Group with a partial contribution holiday, a pension cost only being recognised under SSAP 24 in respect of the HMV Scheme in 2002/03 (£1.0 million). In accordance with actuarial advice the Group has increased the employer contribution rate to 12.9% from 1 June 2003 (from 11%), which combined with the transfer of members from the EMI Fund will increase the Group's SSAP 24 pension cost and cash contributions in 2003/04 to approximately £3.5 million.

Under FRS 17 the Group would similarly not have been required to recognise a cost in respect of its membership of the EMI Fund in 2002/03. If calculated under FRS 17, the pension cost of the HMV Scheme in 2002/03 would have been £0.6 million higher than has been stated under SSAP 24. In 2003/04, after the transfer of members from the EMI Fund, the total illustrative FRS 17 pension cost of the Group's defined benefit arrangements is expected to be approximately £4.7 million.

In respect of the funding position of the HMV Scheme, the recently completed actuarial valuation as at 30 June 2002 identified a small deficit of £0.9 million, which is being funded by the increased contribution rate. The pension liabilities that will be transferred from the EMI Fund to the HMV Scheme will be fully funded as at the date of transfer. Therefore, the enlarged HMV Scheme will have a small deficit of £0.9 million on combined assets of approximately £33 million. Calculated under FRS 17, the enlarged HMV Scheme would show a deficit, net of deferred tax, of £11.8 million.

The potential impact on the Group of the eventual implementation of FRS 17 or a comparable international standard is limited since the defined benefit schemes were closed to new joiners from 1 January 2002. With just 50 pensioners in the HMV Scheme, pension liabilities will also be controlled by normal staff turnover reducing the active membership over time.

Treasury policies and financial risk management

The Group's Treasury Department is principally responsible for managing the Group's funding arrangements and certain financial risks, described below, to which the Group is exposed. Treasury manages these risks using policies approved by the Board.

Liquidity risk

The Group has committed bank facilities comprising a term loan of £250 million and a revolving credit facility of £150 million, which together with cash on deposit provides sufficient funding for the Group's operations. The adequacy of the funding arrangements is reviewed regularly.

In accordance with the facility agreement, £25 million of term debt was repaid during the financial year, and a further £25 million will be repaid next year. At 26 April 2003, the Group had undrawn committed bank facilities plus cash available to it totalling £241.4 million.

Interest rate risk

The Group's bank term debt carries a variable rate of interest linked to prevailing interest rates. In order to mitigate the risk of a rise in interest rates, the Group has entered into several interest rate derivative contracts such that 60% of the term debt carries a fixed rate of interest. The position is reviewed regularly.

At 26 April 2003, £100 million of term debt was floating rate, bearing an interest rate of LIBOR (3.67%) plus a margin of 1.50%, and £150 million of term debt has been fixed at a weighted average rate of 4.67% plus a margin of 1.50%. However, from 23 May 2003 the margin on the senior bank debt has reduced to 0.875% reflecting a lower ratio of net debt to EBITDA.

During the year the Group cancelled some of its interest rate contracts under which it was paying a fixed rate of 5.39%, and entered into a new contract under which it pays 3.57% (both figures excluding the interest margin). The cost of this transaction during the year was £1.4 million, but this will be offset by the lower interest payments under the new contract.

Counterparty risk

Treasury deposits any cash balances that arise with counterparties that have a strong credit rating, with an agreed limit for each counterparty, so as to limit the risk of loss arising from a failure. Counterparties include AAA-rated Liquidity funds, and various banks.

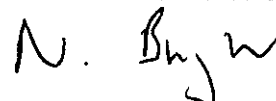
At 26 April 2003, the Group had cash deposits and bank balances totalling £104.6 million of which the largest deposit was £43.7 million held with a AAA-rated liquidity fund.

Foreign exchange risk

The Group uses forward foreign exchange contracts to hedge the foreign exchange risk of imports where volumes are significant. However, the Group's operating businesses generally source the majority of their product from suppliers within their country of operation and so the foreign exchange exposure is small.

The Group is also exposed to foreign currency translation risk through its investment in overseas subsidiaries. This is partially hedged by local debt, but the Group does not hedge the remaining exposure. Generally, the Group does not hedge any net translation exposure of overseas earnings, although it may in certain circumstances implement hedges to secure short-term financial objectives.

Further information is available in Note 19 to the Financial Statements.



Neil Bright Group Finance Director
30 June 2003

Board of Directors

Executive Directors

01 Alan Giles (49)

Chief Executive Officer

Appointed to the Board as Joint Chief Executive on 27 March 1998 and became sole Chief Executive on 26 March 1999. He joined WH Smith in 1982, after seven years in buying and marketing with Boots the Chemists. Mr Giles was appointed to the board of WH Smith Group plc in November 1995. Previous roles within WH Smith included Operations and Development Director for Do It All, and General Manager (Books) for WH Smith Retail. He served as Managing Director of Waterstone's from February 1993 to April 1999. He is a non-executive director of Somerfield plc.

02 Brian McLaughlin (53)

Chief Operating Officer

Appointed to the Board on 23 March 1999 and became the Group's Chief Operating Officer in January 2001. He was appointed Managing Director of HMV Europe in December 1996, and prior to that, was Managing Director of HMV UK, a position he had held since 1987. Mr McLaughlin has spent almost all his working life with HMV UK and, latterly, the Company, having originally joined as a sales assistant in 1968. Mr McLaughlin worked his way through the organisation via store and regional management positions before being appointed Operations Director and subsequently Managing Director. He is a member of the Government's Music Industry Committee.

03 Neil Bright (40)

Group Finance Director

Appointed to the Board as Finance Director on 27 March 1998. He is a Chartered Accountant, having trained and qualified with Coopers & Lybrand in London. Mr Bright joined HMV in August 1996 as Group Finance Director from its parent company, THORN EMI plc (as EMI Group plc was formerly known), where he was Group Planning Manager.

Non-Executive Directors

04 Eric Nicoli (52)

Chairman

Appointed to the Board on 25 January 2000 and became Chairman of the Company in March 2001. He has been Executive Chairman of EMI since July 1999, having been appointed to its board as a non-executive director in 1993. Mr Nicoli was formally Group Chief Executive of United Biscuits (Holdings) plc, having been appointed to the board in 1989. Mr Nicoli is non-executive Chairman of The Tussauds Group Limited, Chairman of the PerCent Club, a Deputy Chairman of Business in the Community and a trustee of Comic Relief Limited. Mr Nicoli is Chairman of the Nominations Committee and a member of the Audit and Remuneration Committees.

05 Roy Brown (56)

Deputy Chairman

and Senior Independent Director

Appointed to the Board on 23 April 2002. He joined the Unilever Group in 1974 and held several positions in finance, marketing, technical and general management before joining the main board of Unilever plc and NV in 1992. He was director responsible for Africa, Middle East, Central and Eastern Europe, and then European Foods before retiring in 2001. Mr Brown is non-executive Chairman of Thus plc, a non-executive director of GKN plc, Brambles Industries plc and BUPA and a member of the Lloyds Franchise Board. Mr Brown is Chairman of the Remuneration Committee, a member of the Audit and Nominations Committees and the Senior Independent Non-Executive Director.

06 David Kappler (56)

Appointed to the Board on 23 April 2002. He is Chief Financial Officer of Cadbury Schweppes plc, a post he has held for eight years, and which includes responsibility for IT, Mergers and Acquisitions, Strategic Development and Investor Relations. He held positions in Cadbury Limited and Cadbury Schweppes' Health and Hygiene Division from 1965 to 1984. He rejoined Cadbury Schweppes in 1989, following the acquisition of the Trebor Group of which he was Finance Director, becoming Director of Corporate Finance and then Chief Financial Officer. He served as a non-executive director of Camelot Group plc from 1995-2002. Mr Kappler is Chairman of the Audit Committee and a member of the Nominations and Remuneration Committees.

07 Lesley Knox (49)

Appointed to the Board on 23 April 2002. She was a founder director of British Linen Advisors, a specialist corporate finance advisor focusing on growth companies. Prior to that she spent 18 years at the Kleinwort Benson Group where she was a corporate finance director and for five years head of Institutional Asset Management. She is a non-executive director of the Alliance Trusts, MFI Furniture Group plc, Hays plc and Babbie Limited. She is also a Governor of the Museum of London and a director of arts charity Mall Galleries Limited. Ms Knox is a member of the Audit, Nominations and Remuneration Committees.

08 Mark McCafferty (44)

Appointed to the Board on 23 April 2002. He is Chief Executive, Avis Europe plc. He joined Avis in April 1998 as Group Managing Director and became Chief Executive in January 1999. Previously, Mr McCafferty was Managing Director, Worldwide Travel-Related Businesses at Thomas Cook Group. He spent 10 years at Thomas Cook, including seven years heading the North American businesses. He joined Thomas Cook from Midland Bank International in 1988 and is an Associate of the Institute of Bankers. Mr McCafferty is a member of the Audit, Nominations and Remuneration Committees.

09 Steven Tadler (43)

Appointed to the Board on 19 February 1998. He is a Managing Director with the London office of Advent International plc. He joined Advent in Boston in 1986, and before moving to London in 1997, was responsible for Advent's North American leveraged buy-out operations where retail/consumer was a sector specialisation. Prior to joining Advent, he worked for Manufacturers Hanover Trust Co, providing financing for a number of leveraged buy-outs, technology-oriented firms and special situations. Mr Tadler is a non-executive director of a number of companies. Mr Tadler is a member of the Audit, Nominations and Remuneration Committees.

Corporate governance

Statement of Compliance with the Combined Code

During the financial period ended 26 April 2003 the Company has been fully compliant with the Code of Best Practice as set out in Section 1 of the Combined Code on Corporate Governance ("the Combined Code") which is appended to the Listing Rules of the Financial Services Authority. Accordingly, the Board sets out below its report on how it applies the principles of the Combined Code, excluding those areas which are specifically reported on elsewhere in this Annual Report.

Statement of application of the principles of the Combined Code

The Board comprises six Non-Executive Directors, including the Chairman who is responsible for running the Board, and three Executive Directors being the Chief Executive Officer who has overall responsibility for running the Company's business, the Chief Operating Officer and the Group Finance Director. The Board considers four of the Non-Executive Directors to be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Eric Nicoli, the Chairman, is the Executive Chairman of EMI Group plc, a major supplier of the Company and is by virtue of this relationship not considered to be independent. Steven Tadler is a director of Advent International plc, which through its fund management is a major shareholder in the Company – he is therefore also not considered independent. The Company believes that the Directors have between them a wide range of experience which ensures an effective Board to lead and control the Group.

In accordance with recommendations of the Combined Code Non-Executive Directors comprise more than one third of the Board. Non-Executive Directors are appointed for initial terms of three years and the Articles of Association include a requirement that all Directors submit themselves for re-election by the shareholders at the Annual General Meeting held in the third calendar year following his or her election or re-election, as the case may be.

In accordance with the recommendations of the Combined Code, Roy Brown, the Deputy Chairman, was appointed as the Senior Independent Non-Executive Director on 23 July 2002. The other independent Non-Executive Directors are David Kappler, Mark McCafferty and Lesley Knox.

The biographical details of the members of the Board are set out on pages 36 and 37.

The Board, which together with sub-committees of the Board (other than the Audit, Nominations or Remuneration Committees), met on 16 occasions during the financial year ended 26 April 2003, provides effective leadership and manages overall control of the Group's affairs and to this end has reserved certain matters for decision by the Board only. These include approval of the annual budget, major capital expenditure, significant acquisitions and disposals, risk management policies and the approval of financial statements. The Board is supplied in a timely manner on a regular basis with information in a form and of a quality appropriate to enable it to discharge its duties.

On appointment to the Board, all Directors are given a briefing on their responsibilities as Directors and thereafter receive further guidance as and when required. Training programmes, including induction into the operations of the Company, are being developed for future newly appointed Directors. There are also procedures for the Directors to take independent professional advice at the cost of the Company, if appropriate. No advice was sought by the Directors in the year under review.

All the Directors have access to the advice and services of the Company Secretary who is responsible to the Board for ensuring that board procedures and applicable rules and regulations are followed. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

In general terms, the Chairman manages the Board to ensure that the Company has appropriate objectives and an effective strategy; that there is a Chief Executive Officer with a team able to implement the strategy; that there are procedures in place to inform the Board of performance against objectives and that the Company is operating in accordance with the highest standards of corporate governance.

The Board delegates certain of its responsibilities to Board Committees with clearly defined authority and terms of reference. The composition and main functions of these Committees are described below.

Board Committees

The Chairmen of each of the Board Committees will be available to answer shareholders' questions at the Annual General Meeting to be held on 29 September 2003.

The Audit Committee

The Audit Committee, which meets a minimum of three times a year, is comprised of David Kappler (Chairman), Roy Brown, Lesley Knox, Mark McCafferty, Eric Nicoli and Steven Tadler. The Audit Committee met on four occasions during the year under review.

The Chief Executive Officer, Group Finance Director, the Head of Internal Audit and the external auditors attend meetings at the invitation of the Audit Committee.

The main duties of the Audit Committee are to:

- Review, on behalf of the Board, the financial statements and preliminary and interim results;
- Review the nature and scope of the external audit and the findings of the external auditors;
- Review, on behalf of the Board, the Group's systems of internal control;
- Review and direct the internal audit function and findings;
- Make recommendations to the Board concerning the appointment and remuneration of the external auditors; and
- Review the cost effectiveness and objectivity and independence of the external auditors.

The ultimate responsibility for reviewing and approving the Group's annual report, financial statements and preliminary and interim results remains with the Board.

The Chairman of the Audit Committee reports the outcome of Audit Committee meetings to the Board.

The Remuneration Committee

The Remuneration Committee met on seven occasions in the year under review. The members of the Remuneration Committee are set out in the Directors' Remuneration Report on page 41. The Remuneration Committee meets as and when required each year.

The Chief Executive Officer and the Group Human Resources Director attend meetings at the invitation of the Remuneration Committee.

The principal functions of the Remuneration Committee are, on behalf of the Board and the shareholders:

- To determine the Company's policy for executive remuneration;
- To determine the remuneration packages of the Executive Directors, including pension rights and compensation payments; and
- To oversee the implementation and operation of share incentive schemes.

The Chairman of the Remuneration Committee reports the outcome of the Remuneration Committee meetings to the Board.

The Board's Remuneration Report on pages 41 to 49 sets out the Company's application of the principles of Section 1B of the Combined Code and the Companies Act 1985.

The Nominations Committee

The Nominations Committee comprises Eric Nicoli (Chairman), Roy Brown, David Kappler, Lesley Knox, Mark McCafferty and Steven Tadler. The Nominations Committee meets as and when required each year. It did not meet during the year under review.

The principal functions of the Nominations Committee are to:

- Consider the composition of the Board;
- Consider retirements and appointments to the Board; and
- Make recommendations in these respects to the Board.

The Chairman of the Nominations Committee reports the outcome of the Nominations Committee meetings to the Board.

Internal controls

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness, whilst the role of management is to implement Board policies on risk and control. A system of internal control is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Audit Committee reviews the effectiveness of the risk management process and significant risk issues are referred to the Board for consideration.

The Board confirms that it has reviewed the Group's system of internal controls including financial operational and compliance controls as well as risk management, and that these accord with the guidance on internal controls set out in the Turnbull Report, that such controls have been in place during the year under review and up to the date of approval of the annual report and accounts, and that there are satisfactory ongoing processes for identifying, evaluating and managing the significant risks faced by the Group. These processes accord with provision D.2.1 of the Combined Code.

The systems of internal control and the processes used by the Board to review the effectiveness of those systems include:

Group

- Regular Board meetings with a formal schedule of matters reserved to the Board for decision;
- Clearly defined organisational structures and appropriate delegated authorities;
- Regular performance monitoring with remedial action taken where necessary;
- Established procedures for planning, approving and monitoring major projects;
- A comprehensive system of financial reporting which includes an annual budget process, monthly reporting with rolling forecasts, and half year and annual reporting to enable the Group to meet its public financial reporting requirements;
- Certain centralised functions that are staffed by appropriately qualified individuals who draw on external professional advice. These functions include finance, tax, treasury, management information services, legal, company secretarial, and internal audit;
- A Policies and Procedures Manual which sets out, inter alia, authority limits and guidelines for capital expenditure, which include annual budgets and appraisal and review procedures. All operating businesses have to confirm compliance with the Manual on an annual basis;
- Detailed risk registers which describe the significant risks and control strategies in each area of the business and which are reviewed annually; and
- An internal audit function which carries out a programme of audits covering the management of significant corporate risks, and reports directly to the Audit Committee and the Board on the effectiveness of key internal controls.

Corporate governance continued

Audit Committee

- Approving the scope of the annual Group risk management programme;
- Reviewing the results of the risk identification process;
- Providing input on risks and internal controls into the annual Board strategy discussions;
- Reviewing the effectiveness of the risk management process and discussing significant risk issues with the Board;
- Considering reports from internal and external audit on the system of internal control and any material control weaknesses;
- Reviewing the internal audit and external audit work plans; and
- At the year end, before producing the statement in the Annual Report and Accounts, the Board, through the Audit Committee, considers reports generated from internal and external audit on any major problems that have occurred during the year.

Relations with shareholders

The Directors place high importance on maintaining good relationships with both institutional and private investors and ensure, through an Investor Relations programme, that shareholders are kept informed of significant Group developments. Shareholders can access further information on the Group via the website at www.hmvgroup.com. In addition, members of the Board meet regularly with institutional shareholders and analysts, and the Directors welcome the opportunity to meet with private investors at the Company's general meetings, where shareholders are invited to ask questions and express views on the Company's business. The Chairmen of all the Board Committees will be in attendance at the Company's Annual General Meeting in September.

Accountability and audit

The Board is aware of its responsibility to present a clear and balanced assessment of the Group's financial position and prospects. This assessment is provided primarily in the statements from the Chairman and Chief Executive, and in the Operating review and Financial review on pages 18 to 35.

The Audit Committee reviews the independence and objectivity of the external auditors with a view to confirming that, in its view, the maintenance of objectivity on the one hand and value for money on the other has been kept appropriately in balance. In this context, the Audit Committee considers that it is appropriate for the external auditor to provide to the Group tax advice, tax planning and other accounting services, including those in connection with supporting and reporting on financial representations in public documentation. The provision of other services is considered on a case-by-case basis. Details of the fees paid in the year under review are given on page 63.

Statement of Directors' responsibilities

The Directors are required by company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group 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; and
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with these requirements in preparing the financial statements on pages 54 to 84.

The Directors are responsible for maintaining adequate accounting records which disclose, with reasonable accuracy at any time, the financial position of the Group and which enable them to ensure that the financial statements comply with the Companies Act 1985. They also have a 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.

Going concern

The Directors believe, after making inquiries that they consider to be appropriate, that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Directors' remuneration report

The Board presents its Remuneration Report to the members of the Company. In preparing this report and establishing its policy the Board has given full consideration to, and follows the provisions of, the Combined Code and the Companies Act 1985.

In accordance with the Companies Act the tables setting out Directors' pension arrangements, remuneration, interests in shares and share options of the Company and benefits under long-term incentive schemes, on pages 44 to 48 have been audited. The other information on pages 41 to 43 and 48 and 49 is not required to be audited.

Constitution of the Remuneration Committee

The Remuneration Committee, which is chaired by Roy Brown and also comprises David Kappler, Lesley Knox, Mark McCafferty, Eric Nicoli and Steven Tadler meets as required each year (not normally less than four times a year) on behalf of the Board and the shareholders. The Remuneration Committee's remit is, to determine the Company's policy for executive remuneration, to determine the remuneration packages of the Executive Directors and certain other senior executives, including pension rights and compensation payments, and to oversee the implementation and operation of share incentive schemes.

Advisers

The Remuneration Committee takes advice and/or obtains services from the following individual and entities all of whom were appointed by the Company:

- (a) externally, from Inbucon-Meis, on executive salaries, incentives and employee share schemes;
- (b) externally, from Watson Wyatt LLP on pension matters;
- (c) externally, from Mayer, Brown, Rowe & Maw LLP and DLA, solicitors, on employment contracts and associated legal issues. Mayer, Brown, Rowe & Maw LLP also provide other legal services to the Group; and
- (d) internally, from the Group Human Resources Director, Mike Lymath; Mr. Lymath assists the Remuneration Committee by preparing an annual report on succession planning together with recommendations on share option grants and reviewing incentive arrangements. Mr Lymath is not present for any discussion about his own emoluments.

The Chief Executive of the Company, Alan Giles, is normally invited by the Remuneration Committee to attend meetings of the Committee but is not present for any discussion about his own emoluments.

General policy

The Company's remuneration policy aims to align the interests of Executive Directors and other senior executives with those of its shareholders. It is the Remuneration Committee's policy that variable performance-related pay and incentives should account for an increasing proportion of the overall remuneration package of Executive Directors so that the remuneration of Executive Directors is aligned with the Group's performance.

In setting the Company's remuneration policy, therefore, the Remuneration Committee believes that the Company should:

- (a) provide competitive awards, which will attract and retain high calibre management necessary to enable the Company to operate in the highly competitive retail sector and which reflect individual responsibilities and experience; and
- (b) provide incentive arrangements which are subject to challenging performance targets reflecting the Company's objectives and which motivate executives to focus on both annual and longer term performance.

Performance targets are designed to provide maximum awards for exceptional performance. The Remuneration Committee intends that Executive Director basic salary be positioned at or around the median level in the marketplace with the incentive arrangements (if performance targets are met) bringing overall remuneration into the upper quartile for the marketplace.

Executive Directors' remuneration is currently provided in the form of a combination of basic salary, an annual and a deferred share bonus, and share options (further details of which are given below) through the HMV Group plc Incentive Plan for Senior Executives ("the HIP Scheme").

This remuneration policy was originally adopted by the Board in 2001 and the Remuneration Committee intends to continue to recommend this policy to the Board for the next financial year and financial years after that. There are no current intentions to change this policy.

It is the Company's policy that no Executive Director should have a fixed term service contract or notice period exceeding one year and that no Non-Executive Director should have a letter of appointment for a term of more than three years. All the current Directors' service contracts or letters of appointment comply with this policy.

Directors' remuneration report continued

Components of the Executive Directors' remuneration

The main components of the Executive Directors' remuneration are:

Salary

The basic salary for each Executive Director is determined by taking into account an assessment of that Executive Director's performance, experience, responsibilities and market value. Salaries are reviewed with effect from 1 July each year.

Benefits in kind

Benefits in kind include provision of a company car or car allowance, pension, medical and life insurance, permanent health insurance, fuel allowance, relocation allowance and staff discount.

The HIP Scheme

In 2001 the Company introduced the HIP Scheme. The HIP Scheme has three elements – an annual non-pensionable performance related cash bonus, a deferred performance related annual bonus payable in shares (save for the award in 2001) and share options. The HIP Scheme is designed to provide an incentive for senior management to achieve and exceed targets set by the Remuneration Committee and to ensure that annual remuneration varies in line with corporate performance.

Annual bonus

The annual bonus ("the initial award") awarded to each Executive Director is a percentage of salary based on the performance of the Group. The annual bonus is a payment in cash after the end of the financial year to which the performance relates.

Deferred annual bonus

The HIP Scheme is currently operated so that an annual deferred bonus ("the deferred award") is awarded to the Executive Directors based on the performance of the Group. This normally vests following the third anniversary of the end of the financial year in respect of which the award is made. The maximum value of the deferred award (at the time the award is made) is the amount of the initial award paid in respect of the same year and vesting of such award is subject to further demanding cumulative performance targets based on the performance of the Group over that three year period (the targets being cumulative budgeted Group EBITDA after notional interest) and the performance of the individual. The award for the financial year 2000/01 vests not at the end of the three year period but instead a proportion of the award is paid at the end of each of the financial years in that three year period (provided the further performance targets have been met). Payments for the 2000/01 award will be made in cash. The payments for the 2001/02 award will be made in shares and it is intended that all awards in respect of future financial periods will be made in shares. Where payment is made in shares, the number of shares awarded is determined by reference to the value of the shares at the time the award is made, not when it is paid.

Performance targets in respect of the annual bonus and deferred annual bonus

Performance targets to determine the amount of the initial award and the maximum value (when awarded) of the deferred award are measured by reference to a target EBITDA after notional interest, target EBITDA and target stockturn.

If the target EBITDA after notional interest is reached then, for the Executive Directors, a sum equivalent to 25% of their salary is awarded under both the initial award and the deferred award. If the target EBITDA after notional interest is not reached, the Executive Directors may still receive an award on a sliding scale of up to 25% of salary for each of the initial award and the deferred award for performance between 90% and 100% of target EBITDA after notional interest.

For performance above target EBITDA after notional interest and providing that target EBITDA has been achieved, awards are made to the Executive Directors on a sliding scale of up to a further 50% of salary (making a maximum award of 75% of salary) for both the initial award and deferred award. The stockturn target must also be met for the maximum award to be made.

For the 52 weeks to 26 April 2003 all of the relevant targets have been met and the maximum awards of 75% of salary for each of the initial award and the deferred award will be made to the Executive Directors.

The performance targets outlined above were chosen by the Remuneration Committee because they align the interests of the Executive Directors with those of the Company's shareholders. The assessment of whether these performance targets have been met has been carried out by the Remuneration Committee by reference to the audited accounts.

The deferred awards made to date are set out on page 46.

Share options

Until the Initial Public Offering of the Company in 2002 the Company operated the HMV Group plc Senior Executive Share Option Scheme ("the 1998 Scheme"); no further grants will be made through the 1998 Scheme.

All grants made under the 1998 Scheme were subject to performance targets, as set out below. Details of the options held by the Executive Directors under the 1998 Scheme and not yet exercised are set out on page 47.

Outstanding grants made on 22 January 1999 are currently exercisable following the achievement of the relevant EBITDA targets for the 1998/99, 1999/00 and 2000/01 financial years.

Grants made on 7 September 2000 and 26 February 2002 became exercisable in tranches upon and following the Initial Public Offering of the Company in May 2002 (achievement of the Initial Public Offering being the performance target). The first tranche of these options became exercisable upon the Initial Public Offering. The second tranche became exercisable on the first anniversary of the date of Initial Public Offering (May 2003) and the third tranche will become exercisable on the second anniversary of the date of Initial Public Offering (May 2004).

Prior to the Initial Public Offering a new executive share option scheme, the HMV Group plc 2002 Executive Share Option Scheme ("the 2002 Scheme") was adopted. It is intended that this scheme be used for further grants of options to the Executive Directors under the HIP Scheme.

Options to acquire shares under the 2002 Scheme will be granted on a regular basis (usually annually) thus ensuring reward is spread over a number of years and is allied to the long term growth in shareholder value. The options can normally only be exercisable after three years and then subject to the achievement of earnings per share targets imposed by the Remuneration Committee at the date of grant. The grants of options made to the Executive Directors under the 2002 Scheme are also set out on page 47. For these options 40% of the option shall be exercisable if the Company's earnings per share exceeds the growth in the Retail Prices Index by at least 3% per annum. 100% of the option shall be exercisable if the Company's earnings per share growth exceeds the growth in the Retail Prices Index by at least 7% per annum. Vesting will occur on a straight line basis between these two points. Earnings per share was determined by the Remuneration Committee to be the appropriate criterion given its clear linkage with shareholder value. The assessment of whether these performance conditions have been met will be carried out by the Remuneration Committee by reference to the audited accounts.

The next grant of options under the 2002 Scheme is expected to take place in July 2003.

SIP

The Company also adopted in 2002 the HMV Group plc Share Incentive Plan ("the SIP"); this plan is intended to allow the Company to align the interests of all employees (including the Executive Directors, all of whom are eligible to participate) more closely with the interests of shareholders. The Company has established two new employee benefit trusts ("the UK Trust" and "the Overseas Trust") to facilitate the operation of these schemes.

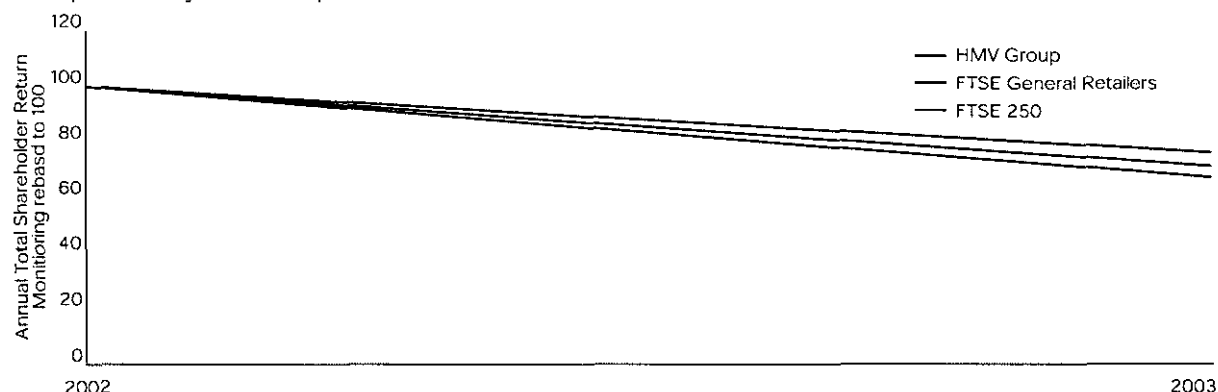
Under the SIP employees may acquire Ordinary Shares in three ways. First, the Company can use the SIP as part of its broad incentive arrangements by awarding free shares to employees; in this regard an award of 120 Free Shares was made to every eligible employee, including the Executive Directors, on the Initial Public Offering. The Free Shares are, for UK employees, held by the UK Trust, subject to the rules of the SIP, and are not normally vested in the individual employee until she/he has completed one year's service from date of award. There are no current plans to award further Free Shares to any employees. Secondly, the Company may invite employees to purchase Ordinary Shares, known as Partnership Shares, and thirdly, the Company may, if it wishes, agree to match the shares purchased with additional shares, known as Matching Shares. The Company has matched on a one for one basis since the inception of the plan and these Matching Shares do not vest until the employee has completed one year's service from the date of the award.

All the Executive Directors participate in the SIP and their awards are set out on page 48.

Performance graph

The graph below shows the percentage change in the total shareholder return from the date of flotation to the end of the financial year against both the FTSE 250 and the FTSE General Retailers Index, both of which the Board considers to be appropriate peer groups for the Company as the Company forms part of both these indices.

Total Shareholder Return: HMV Group vs FTSE General Retailers and FTSE 250 Index
for the period 15 May 2002 to 26 April 2003



The starting value for the Company is based on the offer price of 192p, on 15 May 2002.

Directors' remuneration report continued

Pension arrangements

For all Executive Directors, only basic salary is pensionable. The normal retirement date for Executive Directors is 60. Alan Giles is currently a member of the HMV Group Pension Scheme ("HVM Scheme") which is a contracted-out defined benefit scheme providing him with benefits of up to one-thirtieth of final pensionable pay for each year of service. Mr Giles contributes 4% of his base salary annually as a contribution to the HVM Scheme. In the event of his death during employment his dependants would receive a pension and a lump sum.

As at 26 April 2003 Brian McLaughlin was a member of the EMI Group Pension Fund ("EMI Fund") which is a contracted-out defined benefit scheme providing him with benefits of up to one-thirtieth of final pensionable pay for each year of service. Mr McLaughlin contributes 4% of his base salary annually as a contribution to the EMI Fund. In the event of his death during employment, his dependants would receive a pension and a lump sum.

As at 26 April 2003 Neil Bright was a member of the EMI Fund; Mr Bright joined the EMI Fund after 31 May 1989 and is therefore subject to the salary "capping" provided for in the Finance Act 1989. The EMI Fund therefore provides Mr Bright with benefits of up to one-thirtieth of the "capped" salary for each year of service. Mr Bright contributes 4% of his "capped" salary annually as a contribution to the EMI Fund. The Company, in addition, contributes to a separate money purchase plan which provides him with additional benefits through a FURBS (as noted below).

With effect from 1 June 2003 all members of the EMI Fund were offered the opportunity to transfer their pension benefits to the HVM Scheme. Mr McLaughlin and Mr Bright elected to make such a transfer which was effective from 1 June 2003. Their benefits remain identical to the benefits they enjoyed under the EMI Fund.

(1) Name	(2) Age	(3) Accrued pension at 26 April 2003 £000 p.a.	(4) Increase in accrued pension during the year £000 p.a.	(5) Increase in accrued pension during the year (net of inflation) £000 p.a.	(6) Transfer value of accrued pension at 26 April 2003 £000	(7) Transfer value of accrued pension at 27 April 2002 £000	(8) Directors' contributions during the year £000	(9) Increase in transfer value over the year, net of Directors' contributions £000	(10) Transfer value of increase in accrued pension during the year (net of inflation and Directors' contributions) £000
Alan Giles	48	156	44	42	1,195	1,170	14	10	306
Brian McLaughlin	53	323	88	84	3,470	2,880	15	575	890
Neil Bright	40	19	2	2	82	98	4	(20)	5

Notes:

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Details of Directors' remuneration

	Base salary and fees 2003 £000	Taxable expenses 2003 £000	Annual bonus 2003 £000	Deferred bonus 2003 £000	Total bonuses 2003 £000	Total remuneration 2003 £000	Total remuneration 2002 £000
Executive Directors							
Alan Giles	376	2	272	60	332	710	673
Brian McLaughlin	387	2	281	61	342	731	675
Neil Bright	245	1	166	38	204	450	421
Non-Executive Directors							
Eric Nicoli	110	-	-	-	-	110	10
Roy Brown	50	-	-	-	-	50	-
David Kappler	35	-	-	-	-	35	-
Lesley Knox	30	-	-	-	-	30	-
Mark McCafferty	30	-	-	-	-	30	-
Steven Tadler	30	-	-	-	-	30	10

Notes:

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Directors' interests in shares

The Directors who held office at any time during the financial year had the following interests (beneficial and non-beneficial) in the share capital of the Company in addition to the interests in executive share options and other employee share schemes set out below:

	Junior Preference Shares ⁽ⁱ⁾		Ordinary Shares ⁽ⁱⁱ⁾	
	26 April 2003	27 April 2002	26 April 2003	27 April 2002
Eric Nicoli	-	-	10,417	-
Roy Brown	-	-	1,042	-
Alan Giles	-	23,600	836,558	1,075,025
Brian McLaughlin	-	9,440	35,963	269,877
Neil Bright	-	-	306,145	533,776
David Kappler	-	-	7,813	-
Lesley Knox	-	-	7,813	-
Mark McCafferty	-	-	2,604	-
Steven Tadler ⁽ⁱⁱⁱ⁾	-	932,168	638,711	289,536

(i) Each Junior Preference Share was converted into approximately 0.86 Ordinary Shares on 8 May 2002

(ii) The interests in Ordinary Shares shown for 27 April 2002 have been restated to reflect the bonus issue of 4,33776 shares for each Ordinary Share held on 8 May 2002.

(iii) The interests shown above for Mr Tadler arise by virtue of his interest as a limited partner in certain of the Advent funds. Mr Tadler's interests as at 27 April 2002 have been restated to reflect only those Advent funds in which Mr Tadler had an interest (in accordance with Section 324 Companies Act 1985), instead of the entire Advent Holding disclosed in the 2002 Annual Report. In addition to the funds disclosed above, Advent International has an interest in a further 31,122,818 shares at 26 April 2003 (2002: Junior Preference Shares 45,275,760; Ordinary Shares 14,235,133).

(iv) In addition each of the Executive Directors had an interest as a potential beneficiary in three employee benefit trusts as at 26 April 2003 as follows:

(a) 421,563 Ordinary Shares held by the HMV Group Employee Trust which currently holds shares which it is intended will be used to fulfil the deferred share bonus;

(b) 1,387,828 Ordinary Shares held by the HMV UK Share Incentive Plan Trust, in which the Executive Directors currently participate as described below, and

(c) 412,078 Ordinary Shares held by the HMV Overseas Share Incentive Plan Trust in which the Executive Directors do not participate.

(v) The interests shown above for all the Executive Directors include the interest each Executive Director has under the SIP and which are set out, for clarification, on page 48.

Directors' remuneration report continued

During the year ended 26 April 2003 the Directors disposed of the following shares at a price of £1.92 each (as part of the Initial Public Offering and following the bonus issue and conversion referred to on page 45):

Alan Giles	260,274
Brian McLaughlin	243,462
Neil Bright	229,006
Steven Tadler*	457,896

*The disposal by Mr Tadler represents disposals by Advent funds in which he had an interest. An additional 22,312,000 shares were disposed of by further funds managed by Advent International Corporation, in which Mr Tadler did not have an interest.

There have been no changes to the shareholdings of the Directors since 26 April 2003 subject only to the participation by the Executive Directors in the SIP.

Deferred annual bonus

The following deferred awards are being held for the Executive Directors, the award made on 24 April 2001 being made in cash and the award made on 8 July 2002 being in Ordinary Shares:

	Date of award	Cash conditionally awarded	Number of shares conditionally awarded	Market price of shares at grant	Interests as at 27 April 2002	Interests as at 26 April 2003	Performance period ending	Amount of cash vested	Number of shares vested
Executive Directors									
Alan Giles	24 Apr 2001	£240,000	-	-	£240,000	£180,000	24 Apr 2004	£60,000	-
	8 Jul 2002	-	165,483	£1.55	-	165,483 shares	30 Apr 2005	-	-
Brian McLaughlin	24 Apr 2001	£243,750	-	-	£243,750	£182,812	24 Apr 2004	£60,938	-
	8 Jul 2002	-	165,483	£1.55	-	165,483 shares	30 Apr 2005	-	-
Neil Bright	24 Apr 2001	£150,000	-	-	£150,000	£122,500	24 Apr 2004	£37,500	-
	8 Jul 2002	-	101,612	£1.55	-	101,612 shares	30 Apr 2005	-	-

These awards are subject to the qualifying conditions on page 42.

Executive share options

The share options held by each person who, at any time during the financial year was a Director of the Company, are set out below.

	Date of grant	Number of options at 27 April 2002 ⁽ⁱ⁾	Original exercise price ⁽ⁱⁱ⁾	Number of options at 26 April 2003	Exercise price ⁽ⁱⁱⁱ⁾	Granted in year	Exercisable from	Expiry date
Executive Directors								
Alan Giles	22 Jan 1999	88,676	£1	473,330	18.73p	-	Now	22 Jan 2009
	7 Sept 2001	20,000	£1	106,754	18.73p	-	Now	7 Sept 2011
	7 Sept 2001	10,000	£1	53,377	18.73p	-	15 May 2004	7 Sept 2011
	22 May 2002	-	-	819,161	£1.67	819,161	22 May 2005	22 May 2012
Brian McLaughlin	22 Jan 1999	56,963	£1	304,054	18.73p	-	Now	22 Jan 2009
	7 Sept 2001	28,691	£1	153,145	18.73p	-	Now	7 Sept 2011
	7 Sept 2001	14,346	£1	76,575	18.73p	-	15 May 2004	7 Sept 2011
	26 Feb 2002	20,000	£1	106,754	18.73p	-	Now	26 Feb 2012
	26 Feb 2002	10,000	£1	53,377	18.73p	-	15 May 2004	26 Feb 2012
	22 May 2002	-	-	819,161	£1.67	819,161	22 May 2005	22 May 2012
Neil Bright	22 Jan 1999	44,610	£1	238,117	18.73p	-	Now	22 Jan 2009
	7 Sept 2001	18,000	£1	96,078	18.73p	-	Now	7 Sept 2011
	7 Sept 2001	9,000	£1	48,039	18.73p	-	15 May 2004	7 Sept 2011
	22 May 2002	-	-	502,994	£1.67	502,994	22 May 2005	22 May 2012

- (i) The number of Ordinary Shares under option at 27 April 2002 increased as a result of the bonus issue of 4,337,76 Ordinary Shares for each Ordinary Share held on 8 May 2002 being applied to the Ordinary Shares under option.
- (ii) The option price for each share under option at the time of the bonus issue on 8 May 2002 was recalculated from £1 to 18.73p.
- (iii) A grant of options under the 2002 Scheme was made on 22 May 2002. All other grants were made under the 1998 Scheme.
- (iv) No share options have been exercised by any of the Directors in the year ended 26 April 2003.
- (v) No share options have lapsed during the financial year.
- (vi) The market price of an Ordinary Share as at 26 April 2003 was £1.17, the highest market price for the year being £1.92 and the lowest market price being £1.02.
- (vii) The options are granted pursuant to the terms of the schemes set out on page 43.

Directors' remuneration report continued

Share Incentive Plan

The Executive Directors held the following awards of shares under the Share Incentive Plan as at 26 April 2003:

	(i) Free Shares	(ii) Partnership Shares	(iii) Matching Shares	(iv) Dividend Shares
Alan Giles	120	626	626	6
Brian McLaughlin	120	626	626	6
Neil Bright	120	626	626	6

(i) Free Shares awarded on 17 May 2002 at £1.67 which vest on 17 May 2005.

(ii) Partnership Shares purchased by participants on a monthly basis at prices between £1.05-£1.43.

(iii) Matching Shares awarded on a monthly basis at prices between £1.05-£1.43 which will vest one year after the date of purchase.

(iv)

The Executive Directors have continued to acquire Partnership Shares and be awarded Matching Shares on a monthly basis between 26 April 2003 and 13 June 2003 in accordance with the terms of the Share Incentive Plan.

Service agreements

No Executive Director has a service agreement containing a notice period exceeding one year.

The Remuneration Committee has considered the notice periods and termination arrangements set out below in the light of the Combined Code and continues to believe they are appropriate for the Executive Directors given their seniority and value to the Company and the Company's admission to trading on the London Stock Exchange.

The Non-Executive Directors do not have service agreements but have been engaged under letters of appointment all of which are dated 23 April 2002 which are terminable by the Company without liability for compensation. All non-executive appointments are for an initial period of three years and can be extended at the election of the Company for a subsequent period of three years.

The Executive Directors service contracts are summarised below.

	Date of service contract	Notice period from Company	Notice period from individual
Alan Giles	23 April 2002	12 months	12 months
Brian McLaughlin	23 April 2002	12 months	6 months
Neil Bright	23 April 2002	12 months	12 months

Eric Nicoli and Roy Brown, who are standing for re-election at the forthcoming Annual General Meeting, have letters of appointment as Non-Executive Directors. Alan Giles, who is also standing for re-election at the forthcoming Annual General Meeting, has a service agreement, which provides for a notice period of one year.

Compensation for early termination

The arrangements for early termination of an Executive Director's service agreement are decided by the Remuneration Committee and will be made in accordance with the service agreement provisions of each of the Executive Directors. Each service agreement provides for a payment in lieu of notice on early termination to the Executive Director which shall consist of base salary plus accrued bonus and/or vested deferred bonus to date and the cash equivalent of all other benefits.

The Remuneration Committee may exercise discretion over unvested share options and/or deferred bonus entitlement in accordance with the rules of the appropriate scheme.

In case of termination in breach of contract by the Company or termination by the Executive Director following material breach of contract by the Company within one year of a change of control of the Company, each Executive Director is entitled to compensation calculated on the same basis as set out above save that, in addition, he shall be entitled to an amount equal to the annual bonus he would have received for the 12 months after termination calculated on the basis of the Group's latest forecasts prior to the date of termination; the immediate vesting of all outstanding deferred bonus awards, the enhancement of pension arrangements by increasing the Executive Director's pensionable salary by 12 months, the provision of all other benefits to which the Executive Director is entitled for a period of 12 months (or the financial equivalent thereof) and the vesting of any unexercised share options (subject to the rules of the relevant share option scheme).

If payments for termination are dealt with in accordance with the above provisions the restrictive covenants contained in each Executive Director's service agreement in favour of the Company will continue to apply.

Outside directorships

No Executive Director may accept a non-executive directorship without the prior approval of the Board to ensure that they do not give rise to conflicts of interest. Alan Giles is a non-executive director of Somerfield plc, Brian McLaughlin and Neil Bright have no non-executive appointments. Executive Directors may retain the remuneration from such appointments.

Non-Executive Directors' remuneration

The Chairman and the Executive Directors determine the remuneration of the Non-Executive Directors for their services as members of the Board and its Committees in accordance with the Company's Articles of Association. An annual review takes place in July each year. The policy is to pay fees at a market competitive level in comparison with companies of broadly similar size in terms of market capitalisation. Currently the Non-Executive Directors receive a basic fee of £30,000 per annum except for Roy Brown who receives a basic fee of £45,000 per annum as the Deputy Chairman and Senior Independent Non-Executive Director and the Chairman, Eric Nicoli, who receives a basic fee of £110,000 per annum. David Kappler and Roy Brown each receive an additional £5,000 per annum, for chairing the Audit Committee and Remuneration Committee respectively. With effect from 1 May 2003 Roy Brown will also receive a further £5,000 per annum for chairing the trustees of the HMV Group Pension Scheme.

The Non-Executive Directors do not participate in any of the incentive or benefit schemes of the Group other than the provision of staff discount cards.

Shareholder approval

A resolution to approve the the Remuneration Report is being proposed at the Annual General Meeting.

On behalf of the Board,

Roy Brown Deputy Chairman
30 June 2003

Corporate and social responsibility

HMV Group maintains a strong commitment to its customers, shareholders and employees and recognises that financial terms should no longer be the sole measurement of business success. Social, environmental and economic responsibilities have an important part to play in the performance of our operating businesses, and HMV and Waterstone's are committed to developing ways of integrating these into the fabric of their business activities in order to create long-term benefits for all stakeholders.

The Group continues to monitor stringently the economic, social and environmental issues that may affect the business in the future, and has developed strategies to minimise any threat.

The Group complies with best practice ethical codes of conduct, promising to retain its corporate integrity by remaining free from corruption and not subject to other influences, such as political parties, to which the Group gives no funding.

The Company has a strong commitment to communicating openly and honestly all shareholder and stakeholder information, both internal and external.

During the year, a range of initiatives were undertaken to enhance the Group's corporate and social responsibilities, the highlights of which are described in this report.

Social responsibility

The Group is proud of the focal positions held by its two retail brands in the local communities in which they operate. In Waterstone's, it is the aim of local branches to position themselves at the heart of the local community through a range of programmes, and these have included author events, literary festivals, local schools and family days. During the year, Waterstone's held a number of family days for children to meet with authors and children's characters and to participate in story telling and other activities. For World Book Day, local schools were invited to Waterstone's branches to participate in programmes to promote reading and raise wider awareness of the educational value of books.

HMV continued its support for The Ark Cultural Centre for Children in Temple Bar, Dublin. Dedicated to cultural work for, by and with children aged between three and 14 years, the Ark is an award-winning, custom-designed centre which features a 150 seat theatre, a gallery, and a workshop studio. It develops and presents programmes designed to offer encounters with art and artists of all disciplines, including music, and HMV supported the Centre by funding the production of its admission tickets.

The Company was an active participant in the Times 100 Case Studies student pack, which aims to raise standards in education by bringing business theory to life. The pack was sent free of charge to all 5,600 secondary schools and colleges in the UK. The Company also supported the BRIT school performing arts college, and the Group's Chief Operating Officer, Brian McLaughlin, served as a Governor.

HMV maintained its strong commitment to developing new music in local communities in the UK, and launched the HMV New Music Search to bring to the attention of the wider music industry new and aspiring artists. The scheme attracted over 600 entries in its first eight weeks, and offered the opportunity for a recording contract with db records, a live appearance at a Barfly concert venue and the chance to have a music track featured on an HMV Playlist CD sampler of new music.

Charities

HMV continued its long-standing support for Nordoff-Robbins Music Therapy. The charity aims to bring hope and healing into the lives of disabled and traumatised children and adults by using music as therapy for a varied range of needs, including learning and physical disabilities and trauma. The Centre helps a number of adults with chronic illnesses, learning disabilities, and emotional or neurological problems. HMV has supported Nordoff-Robbins through various fundraising activities, including sponsorship of a Silver Clef Award and, since 1996, the annual HMV Football Extravaganza, which has raised approximately £2 million. In 2003, HMV raised £400,000 for Nordoff-Robbins.

Health and safety

The Group's retail chains have created and implemented systems and procedures for the management of health and safety in its stores and the workplace. These initiatives are designed to comply with the statutory requirements of each country in which the Group operates, and in some cases may exceed those requirements. A comprehensive health and safety audit was carried out in all Waterstone's branches. Compliance levels exceeded the Waterstone's Board's target for the year.

Employees

HMV UK launched an Academy programme with the aim of optimising the potential of its sales assistants. 140 employees completed the programme in the period. In the first few months of the new financial year, the HMV Management Diploma was launched in conjunction with Ashridge Management College, a European leader in management development. Run over a three-year period, the programme, which leads to a formal qualification, aims to recognise and further develop key HMV store managers and high potential non-store managers. The Group's businesses also conduct, at regular intervals, attitude surveys of their employees.

Environment

Although retailing operations are perceived to have had low environmental impact, HMV Group recognises the fundamental environmental issues facing the business world and the importance of working to reduce such impacts and endeavours to comply with all relevant environmental legislation in each of the territories in which it operates. The Group seeks to uphold and implement best practice and works to promote effective resource management, including recycling and responsible waste disposal.

Directors' report

The Directors submit their annual report and audited financial statements for the 52 weeks ended 26 April 2003, which were approved on behalf of the Board on 30 June 2003.

Review of the Group

The principal activity of the Group is the retailing of books, recorded music, pre-recorded videos and electronic games. The retailing of books is principally carried out under the Waterstone's brand and the retailing of music, videos and games under the HMV brand. The Group has operations in ten countries, with the principal markets being those of the UK, Japan and Canada. The Chief Executive's report, Operating review and Financial review on pages 20 to 35 contain details of the principal operations of the Group during the year and likely future developments.

Results and dividends

The consolidated profit for the financial year after deducting taxation amounted to £47.0 million (2002: £30.7 million). The Board of Directors recommends a final dividend of 3.4p per Ordinary Share which, together with the interim dividend of 1.1p already declared, makes a total for the year of 4.5p per Ordinary Share (2002: nil). Subject to approval at the Annual General Meeting the final dividend will be paid on 9 October 2003 to those shareholders whose names are on the register on 19 September 2003. Retained profit for the year of £13.6 million (2002: loss £12.3 million) has been transferred to reserves.

Directors

The present Directors of the Company are listed, together with their biographical details on pages 36 and 37; all served as Directors throughout the year. The Company is satisfied that each Non-Executive Director is able to devote the amount of time required to attend to the Company's affairs.

The Company's Articles of Association require one third of the Directors to retire by rotation each year at the Annual General Meeting, such that each Director offers himself or herself for re-election at least once every three years. Accordingly, Eric Nicoli, Roy Brown and Alan Giles will retire by rotation and will offer themselves for re-election at this year's Annual General Meeting.

The interests of the Directors in the shares of the Company, together with their remuneration and, where applicable, summaries of their service agreements, are detailed in the Directors' remuneration report on pages 41 to 49.

No Director at any time during the 52 weeks ended 26 April 2003 had any material interest in any contracts with the Company or any of its subsidiaries other than the Executive Directors, who had such an interest through their service agreements with the Company, details of which are summarised on page 48, and Eric Nicoli who had such an interest through his position as Chairman of EMI Group plc, a major supplier of the Group.

None of the Directors at any time during the 52 weeks ended 26 April 2003 or subsequently was interested in any debentures of the Company or shares or debentures of the Company's subsidiaries.

Principal shareholders

As at 30 June 2003 the Company had been notified of the following interests in its Ordinary Shares in accordance with Sections 198-208 of the Companies Act 1985:

Name	Number of Ordinary Shares	Percentage of issued share capital
ISIS Asset Management	36,687,065	9.10
Advent International Corporation	31,761,529	7.88
Prudential plc	23,537,670	5.83
Standard Life Investments Limited	20,559,232	5.10
Invesco Perpetual Asset Management	20,386,837	5.05
HBOS plc	19,849,203	4.92
Legal & General Investment Management Limited	15,707,442	3.89

Policy on payment of creditors

The Group does not impose standard payment terms on its suppliers but agrees specific terms with each and ensures that each supplier is made aware of such terms. It is the Group's policy to pay its suppliers in accordance with the terms that have been agreed. The Company is a holding company and therefore has no trade creditors.

Directors report continued

Employee Policies

The Group is a decentralised organisation with the aim of employing and developing the best people, putting them in the right positions with a significant level of delegated authority and responsibility, and supporting them with the infrastructure and technology required to perform at the highest levels and at the lowest costs with the quickest response time.

Responsibility for employment matters therefore rests primarily with each business operation under the general guidance of central policy and procedure guidelines. The Group companies are committed to the maintenance of a work environment free of discrimination on the grounds of gender, nationality, ethnic or racial origin, non-job related disability, sexual orientation or marital status.

The Group gives full consideration to applications from disabled persons where the requirements of the job can be adequately fulfilled by a disabled person. Where existing employees become disabled, it is the Group's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide training, career development and promotion to disabled employees wherever appropriate.

In order to promote employee involvement in the Group, regular meetings are held between local management and employees to allow a free flow of information and ideas.

The Company encourages staff involvement in the Group's performance via a combination of employee bonus and share schemes. The Group has established a Share Incentive Plan ("SIP") details of which are set out on page 43 in which nearly all the Group's employees are entitled to participate provided they meet certain service conditions.

Share capital

Details of the new Ordinary Shares issued pursuant to the exercise of options under the Company's share option schemes are set out in Note 25.

Resolutions will be proposed at the Annual General Meeting to give the Directors authority to allot shares, dis-apply pre-emption rights in limited circumstances and for the Company to purchase its own shares. Full details of the business of the Annual General Meeting, with explanatory notes, appear in the Chairman's Letter and Notice of Meeting which accompany this Report.

The Company has a current authority (granted at the Annual General Meeting held on 1 October 2002 and which shall expire at the conclusion of the Annual General Meeting to be held on 29 September 2003) to make market purchases up to a maximum of 40,320,304 Ordinary Shares of £0.01 each, subject to certain limitations.

Charitable contributions

The Group made charitable donations of £16,000 in the period (2002: £9,000). It is Group policy not to make donations to political parties and therefore no political donations were made during the period.

The Company is seeking authority at the forthcoming Annual General Meeting to make political donations (although it has no intention of doing so) in order to prevent an inadvertent breach of the Political Parties, Elections and Referendums Act 2000 as set out in the Chairman's Letter and Notice of Meeting that accompany this Report.

Auditors

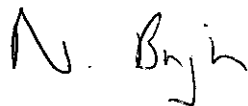
Ernst & Young LLP has indicated its willingness to continue in office and a resolution re-appointing it as the Company's auditor and authorising the Directors to determine its remuneration will be proposed at the Annual General Meeting.

Annual General Meeting

The Annual General Meeting will be held at 2.30 pm on 29 September 2003 at The Lincoln Centre, 18, Lincoln's Inn Fields, London, WC2A 3ED.

On behalf of the Board,

Neil Bright Group Finance Director
30 June 2003



Independent auditors' report to the members of HMV Group plc

We have audited the Group's financial statements for the 52 week period ended 26 April 2003 which comprise the Consolidated Profit and Loss Account, Consolidated Statement of Total Recognised Gains and Losses, Reconciliation of Consolidated Shareholders' Funds, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement and the related notes 1 to 30. These financial statements have been prepared on the basis of the accounting policies set out therein. 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any 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' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards and the Listing Rules of the Financial Services Authority.

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 are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the Corporate Governance Statement 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 other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Chairman's Statement, Chief Executive's Statement, Review of Operations, Financial Review, Corporate Governance Statement, Remuneration Report and Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom 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 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 26 April 2003 and of the profit of the Group for the period 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.

Ernst & Young LLP

Ernst & Young LLP Registered Auditor

London

30 June 2003

Consolidated profit and loss account

for the period¹ ended:

	Notes	52 weeks ended 26 April 2003			52 weeks ended 27 April 2002		
		After exceptional items £000	Exceptional items ² £000	Before exceptional items £000	Before exceptional items £000	Exceptional items £000	After exceptional items £000
Turnover	1	1,707,684	-	1,707,684	1,654,476	-	1,654,476
Cost of sales		(1,492,681)	-	(1,492,681)	(1,454,416)	-	(1,454,416)
Gross profit		215,003	-	215,003	200,060	-	200,060
Administrative expenses		(96,188)	-	(96,188)	(94,418)	-	(94,418)
Other operating expenses		(460)	-	(460)	(65)	(6,033)	(6,098)
Group operating profit	1 & 2	118,355	-	118,355	105,577	(6,033)	99,544
Profit on disposal of investment	11	-	-	-	-	996	996
Profit on ordinary activities before interest		118,355	-	118,355	105,577	(5,037)	100,540
Finance charges	6	(58,464)	(36,325)	(22,139)	(51,945)	-	(51,945)
Profit on ordinary activities before taxation		59,891	(36,325)	96,216	53,632	(5,037)	48,595
Taxation on profit on ordinary activities	8	(12,865)	10,898	(23,763)	(18,232)	300	(17,932)
Profit attributable to members of the holding company		47,026	(25,427)	72,453	35,400	(4,737)	30,663
Dividends on Equity Shares	9	(18,148)	-	(18,148)	-	-	-
Redemption premium on Non-Equity Junior Preference Shares	10	(1,777)	-	(1,777)	(31,812)	-	(31,812)
Preference dividends and redemption premium on Non-Equity Senior Preference Shares	10	(13,526)	(11,582)	(1,944)	(11,154)	-	(11,154)
Senior Preference Shares dividend arrears		(36,648)	(36,648)	-	-	-	-
Appropriated in previous years		36,648	36,648	-	-	-	-
Transfer to (from) profit and loss reserve	29	13,575	(37,009)	50,584	(7,566)	(4,737)	(12,303)
Earnings per share - basic	7	7.9p	(9.2)p	17.1p	(12.7)p	(8.0)p	(20.7)p
Earnings per share - diluted	7	7.8p	(9.1)p	16.9p	(12.7)p	(8.0)p	(20.7)p

1 See Accounting Policies on pages 59 and 60 for the description of the 2003 and 2002 reporting periods.

2 Full details of the exceptional items are given in Note 11.

3 All results relate to continuing activities.

4 There is no difference between the results stated above and their historical cost equivalents.

Statement of total recognised gains and losses

for the period¹ ended:

	2003 £000	2003 £000	2002 £000	2002 £000
Profit for the period		47,026		30,663
Currency retranslation	2,208		1,035	
Net exchange (losses) gains on foreign currency borrowings and Senior Preference Shares	(5,017)		244	
Tax on exchange differences	190		222	
Other recognised gains and losses		(2,619)		1,501
Total recognised gains and losses relating to the period		44,407		32,164

Reconciliation of movements in shareholders' funds

for the period¹ ended:

	2003 £000	2002 £000
Profit for the period	47,026	30,663
Ordinary dividend	(18,148)	-
Preference dividend on Non-Equity Shares	(50,174)	-
Other recognised gains and losses	(2,619)	1,501
Proceeds of issue of Equity Shares	374,991	-
Costs of share issue written off to share premium account	(17,996)	-
Redemption of Senior Preference Shares	(49,992)	-
Creation of capital reserve	226	-
Increase in goodwill on acquisition	-	(25,000)
Net increase in shareholders' funds for the period	283,314	7,164
Opening shareholders' funds	(416,008)	(423,172)
Closing shareholders' funds	(132,694)	(416,008)

1 See Accounting Policies on pages 59 and 60 for the description of the 2003 and 2002 reporting periods.

Balance sheets

at period end:

	Notes	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Fixed assets					
Intangible assets	12	2,000	-	-	-
Tangible assets	13	148,074	142,319	249	479
Investment: own shares	14	-	909	-	-
Investments: subsidiaries	15	-	-	669,468	654,962
		150,074	143,228	669,717	655,441
Current assets					
Stocks	16	156,600	168,279	-	-
Debtors: amounts falling due within one year	17	52,474	58,082	263,041	359,695
Debtors: amounts falling due after more than one year	17	16,037	8,075	109	-
Debtors	17	68,511	66,157	263,150	359,695
Investments and short-term deposits	20	1,835	1,151	-	-
Cash at bank and in hand	20	102,756	77,255	48,663	21,246
		329,702	312,842	311,813	380,941
Creditors: amounts falling due within one year					
Borrowings	18	(36,241)	(49,787)	(23,084)	(34,141)
Other creditors	21	(343,490)	(387,874)	(358,860)	(473,932)
		(379,731)	(437,661)	(381,944)	(508,073)
Net current liabilities		(50,029)	(124,819)	(70,131)	(127,132)
Total assets less current liabilities		100,045	18,409	599,586	528,309
Creditors: amounts falling due after more than one year					
Borrowings	18	(220,543)	(419,312)	(220,543)	(419,312)
Other creditors	22	(590)	(72)	(500)	-
		(221,133)	(419,384)	(221,043)	(419,312)
Provisions for liabilities and charges					
Other provisions	24	(11,606)	(15,033)	-	-
		(132,694)	(416,008)	378,543	108,997
Capital and reserves					
Called up share capital	25	4,033	1,848	4,033	1,848
Share premium account	29	308,249	3,431	308,249	3,431
Profit and loss account (including goodwill previously written off)	29	(445,202)	(421,287)	66,035	103,718
Capital reserve		226	-	226	-
Equity shareholders' funds		(132,694)	(777,633)	378,543	(252,628)
Non-equity shareholders' funds	10	-	361,625	-	361,625
Total shareholders' funds		(132,694)	(416,008)	378,543	108,997

The financial statements on pages 54 to 84 were approved by the Board of Directors on 30 June 2003 and were signed on its behalf by:

Alan Giles Chief Executive
Neil Bright Group Finance Director

N. Bright *Alan Giles*

Consolidated cash flow statement

for the period¹ ended:

	Notes	2003 £000	2002 £000
Net cash inflow from operating activities		180,631	180,102
Returns on investments and servicing of finance			
Interest received		4,872	783
Interest paid		(40,604)	(46,721)
Exceptional finance charges paid	11	(26,587)	-
Costs incurred in connection with the raising of debt		(8,425)	(3,501)
Non-equity dividends/redemption premiums paid to shareholders		(55,937)	-
Net cash outflow from returns on investments and servicing of finance		(126,681)	(49,439)
Tax paid		(16,355)	(5,214)
Capital expenditure and financial investment			
Purchase of tangible fixed assets	13	(48,972)	(23,501)
Purchase of intangible fixed assets	12	(1,000)	-
Disposal of tangible fixed assets		456	300
Purchase of investment in own shares	14	-	(32)
Net cash outflow from capital expenditure		(49,516)	(23,233)
Acquisitions and disposals			
Settlement of deferred consideration	27	(50,000)	-
Sale of investment	11	-	996
Net cash (outflow) inflow from acquisitions and disposals		(50,000)	996
Equity dividends paid to shareholders		(4,436)	-
Net cash (outflow) inflow before management of liquid resources and financing		(66,357)	103,212
Management of liquid resources	20	(795)	2,868
Financing			
New loans/movements in short-term facilities		276,763	(16,230)
Loan repayments		(266,984)	(30,381)
Proceeds of issue of Equity Shares (net of expenses)		356,996	-
Redemption of Senior Preference Shares		(49,992)	-
Tender of Senior Subordinated Notes		(220,616)	-
Net cash inflow (outflow) from financing		96,167	(46,611)
Net cash inflow (outflow) from management of liquid resources and financing		95,372	(43,743)
Increase in cash in the period	20	29,015	59,469

1 See Accounting Policies on pages 59 and 60 for the description of the 2003 and 2002 reporting periods.

Reconciliation of operating profit to net cash flow from operating activities

for the period¹ ended:

	Notes	2003 £000	2002 £000
Group operating profit	1	118,355	99,544
Depreciation charge	13	42,217	39,526
Amounts provided in respect of flotation costs	11	–	6,033
Cash flow in respect of flotation costs		(3,138)	(2,175)
Loss (profit) on disposal of fixed assets		476	(62)
Amounts charged in respect of provisions	24	3,897	–
Amounts utilised in respect of provisions		(7,367)	(7,467)
(Increase) decrease in working capital:			
Stock		11,000	15,992
Debtors		949	(2,990)
Creditors		14,242	31,701
Net cash inflow from operating activities		180,631	180,102

1 See Accounting Policies on pages 59 and 60 for the description of the 2003 and 2002 reporting periods.

Accounting policies

Basis of preparation

The consolidated accounts of the Company and its subsidiaries are made up to the Saturday immediately preceding 30 April each year. Consequently, the financial statements for the current period cover the 52 weeks ended 26 April 2003, whilst the comparative period covered the 52 weeks ended 27 April 2002. The consolidated accounts are prepared under the historical cost convention and in accordance with applicable accounting standards and specifically in accordance with the following accounting policies.

Basis of consolidation

The consolidated accounts comprise the accounts of the Company and its subsidiaries. The comparative results of all subsidiaries were taken from their accounts made up to or about 26 April 2003. The results of subsidiaries acquired during a period are included from the date that effective control passed.

Turnover

Turnover represents the value of goods and services supplied, less discounts given. Turnover excludes value added tax ("VAT") and similar sales-related taxes.

Goodwill

Goodwill arising on acquisitions prior to 25 April 1998 was set off directly against reserves. Goodwill previously eliminated against reserves has not been reinstated on implementation of FRS 10 "Goodwill and Intangible Assets".

Positive goodwill arising on acquisitions since 25 April 1998 is capitalised, classified as an asset on the balance sheet and amortised on a straight-line basis over its useful economic life up to a presumed maximum of 20 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

If a subsidiary, associate or business is subsequently sold or closed, any goodwill arising on acquisition that was set off directly against reserves or that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

Intangible assets

Intangible assets are valued at cost and amortised over their useful life up to a presumed maximum of 20 years, unless the asset can be demonstrated to have an indefinite life. Assets amortised over 20 years or less are reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable. Non-amortisation is supported by an annual impairment review.

Foreign currencies

Transactions denominated in foreign currencies are recorded at the rates of exchange ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into sterling either at period end rates or, where there are related foreign exchange contracts, at contract rates. The resulting foreign exchange differences are dealt with in the determination of profit (loss) for the period.

On consolidation, average exchange rates have been used to translate the results of overseas companies and businesses, and the assets and liabilities of overseas companies and businesses are translated into sterling at period end rates.

Exchange differences are dealt with as a movement in reserves where they arise from the translation of the opening net assets of overseas operations, the retranslation of retained earnings of overseas operations from average to closing rates of exchange and the translation or conversion of foreign currency borrowings taken to hedge overseas assets. In addition, exchange differences arising on the retranslation of goodwill at historic rates are also taken to Group reserves.

Advertising costs

Advertising costs are expensed as incurred.

Leased assets

In respect of property operating leases, benefits received and receivable as an incentive to sign a lease are spread on a straight-line basis over the shorter of the lease term and the period to the date of the first rent review. All other operating lease payments are charged directly to the profit and loss account in the financial period to which the payments relate.

Accounting policies continued

Tangible fixed assets

The capitalised cost of tangible fixed assets includes only those costs that are directly attributable to bringing an asset to its working condition for its intended use.

Depreciation of tangible fixed assets is calculated on cost, at rates estimated to write off the cost less the estimated residual value of the relevant assets by equal annual amounts over their estimated useful lives.

The annual rates used are:

Short-term leasehold property	Period of the lease
Plant, equipment and vehicles	10 to 33%

The carrying values of tangible fixed assets are reviewed for material impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Stocks

Stocks, which represent finished goods and goods for resale, are stated at the lower of cost and net realisable value on a first-in, first-out basis.

Deferred taxation

The charge for taxation is based on the profits for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date. Deferred tax assets are recognised only to the extent 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.

Pension costs

The Company operates both defined benefit and defined contribution pension schemes.

For the defined benefit schemes pension costs are charged to the profit and loss account so as to spread the cost of the pensions over the working lives of the employees. Valuation surpluses or deficits are amortised over the expected remaining working life within the Group of the relevant employees (estimated to be eight years in respect of the United Kingdom). The amortisation of valuation surpluses is restricted to an amount equal to the regular pension cost. Accordingly, employee expense in respect of the EMI Group scheme, which covers certain employees in the United Kingdom, has been taken as £nil for both the current and prior periods for reasons of conservatism.

For the defined contribution schemes, contributions are charged in the profit and loss account as they become payable in accordance with the rules of the scheme.

Derivative instruments

The Group may from time to time use derivative instruments for hedging purposes, including cross-currency swaps, forward foreign exchange contracts, foreign currency options and interest rate contracts.

A financial derivative is considered to be a "hedge" by the Group when it alters the risk profile of an existing underlying exposure of the Group in line with the risk management policies of the Group.

Interest differentials on derivative instruments are recognised by adjusting net interest payable. Premiums or discounts arising on derivative instruments are amortised over the life of the instrument.

Forward rate agreements, currency swap agreements and forward foreign exchange contracts are valued at the contract rate in respect of their ongoing carrying value in the financial statements and at closing market rates of exchange for market valuation. The fair value of options is based on market prices at the year end.

The Group generally does not hedge translation exposure of overseas earnings or net assets, although the Group may implement short-term hedges to secure short-term financial objectives.

The underlying asset or liability associated with the financial instrument is valued at the rate implicit in the instrument.

Capital instruments

Shares are included in shareholders' funds. Other instruments are classified as liabilities if they contain an obligation to transfer economic benefits and if not they are included in shareholders' funds. The finance cost recognised in the profit and loss account in respect of capital instruments other than Equity Shares is allocated to periods over the term of the instrument at a constant rate on the carrying amount.

Notes to the financial statements

1. Segmental analyses

	2003			2002		
	Turnover £000	Operating profit £000	Average employees Number	Turnover £000	Operating profit £000	Average employees Number
By class of business:						
HMV ¹						
Europe	867,384	88,552	4,522	784,371	74,008	4,235
Asia Pacific	277,016	9,328	1,726	275,722	8,323	1,682
North America	157,055	(3,492)	2,228	187,086	1,018	2,716
Total HMV	1,301,455	94,388	8,476	1,247,179	83,349	8,633
Waterstone's ²	406,229	23,967	4,445	407,297	22,228	4,574
Total	1,707,684	118,355	12,921	1,654,476	105,577	13,207
Operating exceptional items		-			(6,033)	
Operating profit		118,355			99,544	
By origin:						
United Kingdom	1,203,085	104,906	8,463	1,124,466	87,933	8,293
Rest of Europe	70,528	7,613	504	67,202	8,303	516
Asia Pacific	277,016	9,328	1,726	275,722	8,323	1,682
North America	157,055	(3,492)	2,228	187,086	1,018	2,716
Total	1,707,684	118,355	12,921	1,654,476	105,577	13,207
Operating exceptional items		-			(6,033)	
Operating profit		118,355			99,544	

Turnover analysed by destination is not materially different from turnover analysed by origin.

Turnover excludes transactions made between companies within the Group.

In 2002 operating exceptional items arose in the UK and reflected professional fees and related costs incurred in respect of the Group's Listing on the London Stock Exchange on 15 May 2002.

1 HMV is the music and video retailing division which trades under the HMV brand.

2 Waterstone's is the book retailing division of HMV Group, primarily trading under the Waterstone's brand.

Notes to the financial statements continued

1. Segmental analyses (continued)

	Operating assets (liabilities)		Total assets	
	2003 £000	2002 £000	2003 £000	2002 £000
By class of business:				
HMV				
Europe	(58,749)	(48,736)	162,381	150,067
Asia Pacific	22,197	26,105	108,974	95,742
North America	(8,613)	(6,908)	27,766	29,763
Total HMV	(45,165)	(29,539)	299,121	275,572
Waterstone's	71,879	69,093	180,655	180,498
Total	26,714	39,554	479,776	456,070
By geographical area:				
United Kingdom	13,972	9,562	325,257	312,340
Rest of Europe	(842)	10,795	17,779	18,225
Asia Pacific	22,197	26,105	108,974	95,742
North America	(8,613)	(6,908)	27,766	29,763
Total	26,714	39,554	479,776	456,070

Total assets comprise fixed assets and current assets.

The reconciliation of operating assets to net liabilities is as follows:

	Note	2003 £000	2002 £000
Operating assets		26,714	39,554
Non operating assets (liabilities)		14,616	(36,526)
Taxation, net interest and dividends payable		(21,831)	(28,343)
Capital employed		19,499	(25,315)
Net borrowings	20	(152,193)	(390,693)
Net liabilities		(132,694)	(416,008)

Capital expenditure and depreciation by class of business are as follows:

	Capital expenditure		Depreciation	
	2003 £000	2002 £000	2003 £000	2002 £000
HMV				
Europe	25,536	14,392	21,038	17,834
Asia Pacific	7,299	3,498	6,205	6,451
North America	3,835	1,220	2,404	2,704
Total HMV	36,670	19,110	29,647	26,989
Waterstone's	12,302	4,391	12,570	12,537
Total	48,972	23,501	42,217	39,526

2. Operating profit

	2003 £000	2002 £000
Operating profit is stated after charging:		
Depreciation of tangible fixed assets	42,217	39,526
Operating lease rentals		
Property – Minimum rentals (i)	107,452	102,882
– Percentage rentals (i)	13,471	14,342
	120,923	117,224
Plant, equipment and vehicles	112	132

(i) HMV Group leases stores under non-cancellable operating lease agreements that are generally subject to periodic rent review. These agreements provide for either or both minimum rentals and percentage rentals based on sales performance.

3. Fees to auditors

	2003 £000	2002 £000
Charged to operating profit:		
Audit fees	367	260
Non-audit fees for UK Group entities	95	746
	462	1,006

Non-audit fees relate to tax planning, tax advice and the audit of pension schemes. In addition, fees of £1.0 million were charged to the share premium account in connection with the Company's flotation on 15 May 2002.

4. Directors' emoluments

Full details of Directors' remuneration and interests are set out in the Directors' remuneration report on pages 41 to 49.

5. Employees costs

	2003 £000	2002 £000
Employee costs, including Directors' emoluments:		
Wages and salaries	186,344	183,100
Social security costs	13,308	15,169
Other pension costs (see Note 26)	2,611	2,442
	202,263	200,711

The average monthly number of employees during the period is disclosed in Note 1.

Notes to the financial statements continued

6. Finance charges

	2003 £000	2002 £000
Interest payable on:		
Bank loans and overdrafts	20,408	25,367
Other loans	605	24,924
Amortisation of deferred financing fees	2,052	3,012
Notional interest relating to discount on provisions	759	1,180
	23,824	54,483
Bank interest receivable	(1,685)	(2,538)
Total net interest payable	22,139	51,945
Exceptional finance charges	36,325	-
Total finance charges	58,464	51,945

Included within the total net interest payable are net non-cash charges totalling £2.2 million (2002: £3.6 million). These include the amortisation of deferred financing fees and the notional interest in respect of discount on provisions as disclosed above, and within interest payable on other loans, £0.6 million (2002: £0.6 million unrealised) relating to a realised exchange gain on the US dollar Notes. Also included within the total net interest payable is a £1.4 million cost of cancelling £70 million of interest rate swaps, further details of which are given in the Financial Review.

Further details of the exceptional finance charges are given in Note 11.

7. Earnings per share

	2003 £000	2002 £000
Profit attributable to members of the holding company	47,026	30,663
Less: redemption premium and preference dividends charged to profit and loss account	(15,303)	(42,966)
Basic and diluted profit (loss)	31,723	(12,303)
Exceptional items, less tax thereon	37,009	4,737
Adjusted basic and diluted profit (loss)	68,732	(7,566)
	2003 Number '000	2002 Number '000
Weighted average number of Ordinary Shares	402,781	59,388
Dilutive share options	3,055	-
Weighted average number of Ordinary Shares – Diluted	405,836	59,388

Earnings per Ordinary Share is calculated as follows:

	2003 Basic Pence	2003 Diluted Pence	2002 Basic Pence	2002 Diluted Pence
Profit (loss) per Ordinary Share	7.9	7.8	(20.7)	(20.7)
Exceptional items, less tax credit thereon	9.2	9.1	8.0	8.0
Adjusted profit (loss) per Ordinary Share	17.1	16.9	(12.7)	(12.7)

The adjusted earnings per Ordinary Share is shown in order to highlight the underlying performance of the Group. The weighted average number of shares excludes shares held by an Employee Benefit Trust as an investment in own shares and has been adjusted for the issue of shares during the period. The diluted earnings per share calculations reflect the weighted average dilutive effect of options outstanding during the year of 3,054,775. The weighted average number of Ordinary Shares in the prior year periods has been adjusted to reflect the bonus issue, which took place on 8 May 2002.

8. Taxation

	2003 After exceptional items £000	2002 After exceptional items £000
Taxation on profit on ordinary activities:		
United Kingdom, current year:		
Corporation tax	18,454	17,754
Double taxation relief	(2,519)	(1,300)
Over provision in prior periods	(3,434)	-
	12,501	16,454
Overseas tax, current year	4,189	2,698
Overseas tax under provided in prior periods	564	31
Total current tax	17,254	19,183
Deferred tax:		
United Kingdom	1,654	(1,286)
Overseas	(6,043)	35
Total deferred tax	(4,389)	(1,251)
Taxation on profit on ordinary activities	12,865	17,932

The operating exceptional items charged in the financial period generated a tax credit of £10.9 million (2002: £0.3 million).

The current tax charge is reconciled with the standard rate of UK corporation tax as follows:

	2003 £000	2002 £000
Profit before taxation	59,891	48,595
Corporation tax at UK statutory rate of 30%	17,967	14,578
Effects of:		
Permanent differences on exceptional items	-	1,212
Permanent disallowables (including overseas income taxed at different rates)	60	1,348
Fair value and goodwill adjustments	(588)	(1,483)
Tax losses brought forward from earlier periods	(311)	(299)
Tax losses for the period not utilised	2,366	3,058
Timing differences	630	738
Prior period (over) under provision	(2,870)	31
Total current tax charge	17,254	19,183

Key factors affecting the tax charge are:

- (i) The tax charge is increased by tax losses generated in overseas territories which are not fully utilised and in respect of which no deferred tax asset is recognised.
- (ii) The deferred tax asset on the balance sheet is largely in respect of UK and Japanese timing differences. A deferred tax asset has been recognised for the first time in respect of Japan reflecting the expectation that taxable profits will be available against which future tax relief can be offset. The credit to the profit and loss account has reduced the tax charge in 2003 by £6.0 million

Notes to the financial statements continued

9. Equity dividends

	2003 £000	2002 £000
Equity – Ordinary		
Interim – paid: 1.1p (2002: nil) per 1p share	4,436	–
Final – proposed: 3.4p (2002: nil) per 1p share	13,712	–
	18,148	–

10. Redemption premium and preference dividends

In accordance with the provisions of FRS 4 "Capital Instruments", the Company has charged to the profit and loss account dividends and redemption premium in respect of its Senior and Junior Preference Shares on the basis described below.

The Company's Junior Preference Shares were converted on 15 May 2002 to a total of 145,815,137 new Ordinary Shares. The rate of conversion reflected the benefit to the Junior Preference shareholders of a 13.0% per annum redemption premium from issue. Prior to conversion a further redemption premium of £1.8 million was charged in the period and, as permitted by FRS 4, credited back to the profit and loss account reserve.

The Company's Senior Preference Shares were redeemed in full on 28 June 2002. A non-equity dividend of £1.9 million was charged for the period to 28 June 2002, adding to the cumulative dividend arrears of £36.6 million as at 27 April 2002. These amounts were settled in full, together with a redemption premium of £11.6 million.

11. Exceptional items

<i>Operating exceptional items</i>	2003 £000	2002 £000
Flotation costs – other operating expenses	–	(6,033)
<i>Exceptional finance charges</i>	2003 £000	2002 £000
Tender for Senior Subordinated Notes	(25,593)	–
Related professional fees	(995)	–
Write off of deferred financing fees	(9,737)	–
	(36,325)	–

Exceptional finance charges arose on the tender for the Senior Subordinated Notes and the refinancing of the Group. A tax credit of £10.9 million arose in respect of these costs.

In addition, a redemption premium of £11.6 million was charged to the profit and loss account on the redemption of the Senior Preference Shares on 28 June 2002 and further share issue costs of £18.0 million have been charged directly to the share premium account.

The operating exceptional item for the 52 weeks ended 27 April 2002 represents flotation fees and expenses of £6.0 million incurred in respect of the initial public offer of HMV Group plc on 15 May 2002. A tax credit of £0.3 million arose in respect of these costs.

<i>Non-operating exceptional items</i>	2003 £000	2002 £000
Profit on disposal of investment	–	996

The non-operating exceptional credit in the prior period related to a gain on the disposal of the Group's remaining investment in Daisy & Tom Limited (now known as Chelsea Stores Limited).

12. Intangible fixed assets

<i>Group</i>	Trademarks £000
Cost at 27 April 2002	-
Additions	2,000
Cost at 26 April 2003	2,000
Amortisation at 26 April 2003 and 27 April 2002	-
Net book value at 26 April 2003	2,000
Net book value at 27 April 2002	-

The Company had no intangible fixed assets.

On 8 May 2002, HMV (IP) Limited, a wholly owned subsidiary of HMV Group plc acquired, conditional upon flotation, various trademark registrations and applications for the acronym "HMV" and the dog and trumpet trademark from EMI for a consideration of £2.0 million, £1.0 million of which was settled in the period. These trademarks are considered to have an indefinite life, therefore no amortisation has been charged.

13. Tangible fixed assets

<i>Group</i>	Short leasehold property £000	Plant, equipment and vehicles £000	Total £000
Cost at 27 April 2002	11,332	276,838	288,170
Currency retranslation	(821)	(1,421)	(2,242)
Disposals	-	(31,939)	(31,939)
Additions	1,086	47,886	48,972
Cost at 26 April 2003	11,597	291,364	302,961
Depreciation at 27 April 2002	7,410	138,441	145,851
Currency retranslation	(849)	(1,325)	(2,174)
Charge for year	753	41,464	42,217
Disposals	-	(31,007)	(31,007)
Depreciation at 26 April 2003	7,314	147,573	154,887
Net book value at 26 April 2003	4,283	143,791	148,074
Net book value at 27 April 2002	3,922	138,397	142,319

<i>Company</i>	Short leasehold property £000	Plant, equipment and vehicles £000	Total £000
Cost at 27 April 2002	-	3,053	3,053
Disposals	-	(66)	(66)
Additions	-	62	62
Cost at 26 April 2003	-	3,049	3,049
Depreciation at 27 April 2002	-	2,574	2,574
Charge for year	-	263	263
Disposals	-	(37)	(37)
Depreciation at 26 April 2003	-	2,800	2,800
Net book value at 26 April 2003	-	249	249
Net book value at 27 April 2002	-	479	479

Notes to the financial statements continued

14. Investment: own shares

	Cost £000	Accumulated amortisation £000	Net book value £000
Ordinary Shares			
Balance at 27 April 2002	909	-	909
Transferred	(638)	-	(638)
Provided during the year	-	(271)	(271)
Balance at 26 April 2003	271	(271)	-

The investment in own shares represents the Company's shares held by an Employee Benefit Trust ("The Trust") for subsequent transfer to employees under the deferred bonus element of the Senior Executives HIP scheme. Details of the HIP scheme are provided in the Directors' remuneration report on page 42.

At 26 April 2003 the Trust held 421,563 shares with a nominal value of £4,200 and a market value of £0.5 million. At 27 April 2002 the Trust held 272,783 old Ordinary Shares and 313,632 Junior Preference Shares. A fundamental restructuring of the Company's share capital preceded the flotation of the Company's new Ordinary Shares on 15 May 2002. This included a bonus issue in respect of existing Ordinary Shares and the conversion into new Ordinary Shares of all Junior Preference Shares, including accumulated redemption premium thereon. Following the restructuring the Trust held a total of 1,727,043 new Ordinary Shares. Of these 1,305,480 were transferred to two new employee benefit trusts ("the UK and Overseas Trusts") for nil consideration to satisfy the initial grant of 120 Free Shares to every eligible employee on the Initial Public Offering. The Trust has waived any entitlement to the receipt of dividends in respect of all of its holding of the Company's Ordinary Shares. The Trust's waiver of dividends may be revoked or varied at any time.

All shares held by the Trust have been financed by loans from a subsidiary of the Company, which at 26 April 2003 totalled £nil (2002: £937,000).

The Group also established the UK and Overseas Trusts to hold the Company's shares in connection with the HMV Group plc Share Incentive Plan, details of which are provided in the Directors' remuneration report on page 43. At 26 April 2003 the UK and Overseas Trusts held 1,799,906 shares with a nominal value of £18,000. These shares, whose market value at 26 April 2003 was £2.1 million, are held in the Group balance sheet at nil value.

15. Investments: subsidiaries

Company	Cost £000	Provision £000	Net book value £000
At 27 April 2002	784,962	(130,000)	654,962
Additions	14,506	-	14,506
At 26 April 2003	799,468	(130,000)	669,468

The Company increased the value of its investment in Rustico Holdings Limited during the year.

15. Investments: subsidiaries (continued)

Subsidiary undertakings

The following information relates to those subsidiaries whose results or financial position, in the opinion of the Directors, principally affect the figures of the Group. All subsidiaries are 100% owned.

Name of undertaking	Country of incorporation
HMV Music Limited	England and Wales
HMV (IP) Limited	England and Wales
HMV USA LP ¹	USA
HMV Canada Inc	Canada
HMV Japan KK	Japan
HMV Hong Kong Limited	Hong Kong
HMV Singapore Pte Limited	Singapore
HMV Australia Pty Limited	Australia
HMV Tonträger GmbH	Germany
HMV Ireland Limited ¹	Ireland
Rustico Holdings Limited	Ireland
Waterstone's Booksellers Limited	England and Wales
Waterstone's Booksellers Amsterdam BV	Netherlands
Waterstone's Booksellers Belgium SA	Belgium
Waterstone's Booksellers Ireland Limited ¹	Ireland

1 Not directly held by the Company.

All subsidiaries listed above are included in the consolidation. The principal activity of all subsidiaries in the HMV Group is the retailing of books or music and video.

16. Stocks

Stocks primarily comprise finished goods and goods for resale. The replacement cost of stock is considered to be not materially different from the balance sheet value.

17. Debtors

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Due within one year:				
Trade debtors	10,469	9,557	-	-
Amounts owed by subsidiary undertakings	-	-	260,908	357,887
Corporation taxation recoverable	1,802	81	-	-
Deferred taxation	5,790	9,616	2,069	1,670
Other debtors	11,649	17,702	-	-
Prepayments and accrued income	22,764	21,126	64	138
	52,474	58,082	263,041	359,695
Due after more than one year:				
Deferred taxation	8,119	-	109	-
Other debtors	7,893	8,046	-	-
Prepayments and accrued income	25	29	-	-
	16,037	8,075	109	-
Total debtors	68,511	66,157	263,150	359,695

Notes to the financial statements continued

18. Borrowings

The following disclosures describe the Company's borrowings and facilities at 26 April 2003 and 27 April 2002. Concurrent with the Company's flotation on the London Stock Exchange on 15 May 2002 the Company repaid its existing bank facilities and drew down on a new £275 million bank term debt facility and a £150 million bank revolving credit facility. In addition, the Company's Senior Subordinated Notes were repaid from the proceeds of the flotation.

	Group ¹ 2003 £000	Group ² 2003 £000	Company ² 2003 £000	Group ¹ 2002 £000	Group ² 2002 £000	Company ² 2002 £000
Borrowings repayable within one year or on demand:	38,157	36,241	23,084	51,462	49,787	34,141
Borrowings repayable after one year:						
Between one and two years	40,000	38,240	38,240	1,999	1,999	1,999
Between two and five years	185,000	182,303	182,303	204,169	201,301	201,301
Not wholly repayable within five years:						
£ Senior Subordinated Notes	-	-	-	135,000	131,830	131,830
US\$ Senior Subordinated Notes	-	-	-	86,207	84,182	84,182
	225,000	220,543	220,543	427,375	419,312	419,312
Total borrowings	263,157	256,784	243,627	478,837	469,099	453,453

1 Borrowings are stated gross of cash balances, before unamortised deferred financing fees.

2 Borrowings are stated gross of cash balances, after unamortised deferred financing fees.

Senior Facility Agreement

The Senior Facility Agreement existing at 27 April 2002 was repaid on flotation of the Company on the London Stock Exchange on 15 May 2002. A new syndicated bank Senior Facility Agreement was entered into, consisting of a £275 million term loan facility and a £150 million revolving credit facility. The committed facilities under these agreements are as set out below.

Facility	Total available at	
	26 April 2003 £ million	27 April 2002 £ million
Sterling amortising term loan facility	250.0	-
Sterling amortising term loan facilities	-	105.8
US dollar amortising term loan facilities	-	136.2
Multi currency revolving credit facility	150.0	150.0
Total	400.0	392.0

Deferred financing fees totalling £9.7 million relating to the previous Senior Facility Agreement have been charged to the profit and loss account as an exceptional finance cost in the year ended 26 April 2003.

Further fees totalling £8.4 million relating to the arrangement of the new Senior Facility Agreement have been deferred and are being amortised over the five year term of the Senior Facility Agreement.

Interest on advances under the new Senior Facility Agreement was payable during the financial year ended 26 April 2003 at a rate per annum equal to LIBOR plus a margin of 1.5%. Since the year end, from 23 May 2003, the margin has reduced to 0.875%.

18. Borrowings (continued)

Senior Subordinated Notes

On 22 May 1998 the Company issued Senior Subordinated Notes (the "Notes") totalling £211,687,117. The Notes comprised £135,000,000 10¼% sterling denominated Notes (the "Sterling Notes") and US\$125,000,000 10¼% US dollar denominated Notes (the "US dollar Notes") both of which were due to mature in 2008. The proceeds of the flotation were used to repay the Notes, giving rise to an exceptional interest charge of £25.6 million, which has been charged to the profit and loss account in the 52 weeks ended 26 April 2003.

Security

The borrowings under the new Senior Facility Agreement are secured by the Guarantors that comprise HMV Group plc and any wholly-owned subsidiaries of the Company who accede to the new Senior Facility Agreement as guarantors. As a condition of the Agreement, the aggregate gross assets, revenue and profit before interest and tax of the Guarantors must comprise not less than 75% of the total gross assets, revenue and profit before tax and interest of the Company and its Subsidiaries. The guarantors currently comprise HMV Group plc, HMV Music Limited, Waterstone's Booksellers Limited, HMV (IP) Limited and HMV UK Limited. The Company has granted security comprising first ranking fixed and floating charges over all the assets and undertakings of the guarantors.

Under their banking arrangements, overdraft and cash balances of the Company and of certain subsidiaries are pooled or offset and cross-guaranteed. Such pooling and offset arrangements are reflected in the Group balance sheet as appropriate.

19. Derivatives and other financial instruments

Objectives, policies and strategies for the role of derivatives and the other financial instruments

The Group finances itself through cash generated by operations and bank borrowings. The financial instruments of the Group comprise borrowings, cash and liquid resources, derivatives and various items including trade debtors and creditors that arise directly from its operations.

The Group has committed bank facilities comprising a sterling denominated term loan of £250 million and a revolving credit facility of £150 million, which provides funding for its operations in the UK and indirectly to its operations in other territories, through letter of credit provisions. The Group may also provide funds to overseas subsidiaries by lending intra-Group on commercial terms, or by issuing a guarantee in respect of local bank borrowings.

The Group also enters into derivative transactions and has procedures in place to monitor and control their use. The Group's use of derivatives is to modify the currency exposure of its debt to match underlying cash flow and assets, to limit borrowing costs and to hedge product purchases. In all cases underlying exposures justify the use of derivatives.

The financial risks to which the Group is exposed, described below, are managed by Treasury using policies approved by the Board.

Liquidity risk

The Group has committed bank facilities comprising a term loan of £250 million and a revolving credit facility of £150 million, which together with cash on deposit provides sufficient funding for the Group's operations. The adequacy of the funding arrangements is reviewed regularly.

Interest rate risks

The Group's bank term debt carries a variable rate of interest linked to prevailing interest rates. In order to mitigate the risk of a rise in interest rates, the Group has entered into several interest rate derivative contracts such that 60% of the term debt carries a fixed rate of interest. The position is reviewed regularly.

Counterparty risk

Treasury deposits any cash balances that arise with counterparties that have a strong credit rating, with an agreed limit for each counterparty, so as to limit the risk of loss arising from a failure. Counterparties include AAA-rated Liquidity funds, and various banks.

Notes to the financial statements continued

19. Derivatives and other financial instruments (continued)

Foreign exchange risk

The Group uses forward foreign exchange contracts to hedge the foreign exchange risk of imports where volumes are significant. However, the Group's operating businesses generally source the majority of their product from suppliers within their country of operation and so the foreign exchange exposure is small.

The Group is also exposed to foreign currency translation risk through its investment in overseas subsidiaries. This is partially hedged by local debt, but the Group does not hedge the remaining exposure. Generally, the Group does not hedge any net translation exposure of overseas earnings, although it may in certain circumstances implement hedges to secure short-term financial objectives.

Non-equity shares

All of the Company's non-equity share capital has been redeemed or converted following the listing on the London Stock exchange on 15 May 2002.

The disclosures below exclude short-term debtors and creditors and balances in respect of non-equity shares. All Group borrowings are stated gross of deferred financing fees as shown in Note 18 on page 70.

Interest rate profile of financial liabilities

	2003				2002			
	Total £000	Variable rate £000	Fixed rate £000	No interest £000	Total £000	Variable rate £000	Fixed rate £000	No interest £000
Sterling								
- Direct	(250,500)	(100,000)	(150,000)	(500)	(240,790)	(105,790)	(135,000)	-
- Synthetic	-	-	-	-	(136,194)	(136,194)	-	-
US dollar	(440)	(440)	-	-	(87,697)	(1,490)	(86,207)	-
Japanese yen	(7,830)	(7,830)	-	-	(6,940)	(6,940)	-	-
Euro	-	-	-	-	(216)	(216)	-	-
Canadian dollar	(4,887)	(4,887)	-	-	(7,000)	(7,000)	-	-
Other	(90)	-	-	(90)	(72)	-	-	(72)
Total	(263,747)	(113,157)	(150,000)	(590)	(478,909)	(257,630)	(221,207)	(72)

Fixed rate financial liabilities

	2003			2002		
	Weighted average interest rate %	Weighted average period for which fixed Years	No interest weighted average maturity Years	Weighted average interest rate %	Weighted average period for which fixed Years	No interest weighted average maturity Years
Sterling	6.17	1.6	-	10.88	6.1	-
US dollar	-	-	-	10.25	6.1	-
Other	-	-	>1	-	-	>1

The variable rate financial liabilities comprise senior bank borrowings bearing interest at rates set in advance for periods ranging from one week to six months by reference to the relevant benchmark, being LIBOR for sterling, PRIME for US and Canadian dollars and Euribor for Euro borrowings (See Note 18). The figures shown in the tables above take into account the effect of interest rate swaps used to manage the interest rate profile of the financial liabilities. Since the year end, the weighted average interest rate on the fixed rate financial liabilities has reduced to 5.54%, due to the reduction in the interest margin, on 23 May 2003.

19. Derivatives and other financial instruments (continued)

Interest rate profile of financial assets

The Group had the following financial assets:

	2003 £000	2002 £000
Assets held as part of the Group financing arrangements		
- Sterling	83,306	60,528
- US dollar	436	-
- Japanese yen	8,952	4,942
- Euro	4,317	7,252
- Canadian dollar	1,172	1,039
- Other	6,408	4,645
	104,591	78,406
Long-term debtors on which no interest is received		
- Japanese yen	7,046	6,830
- Other	872	1,246
	7,918	8,076

The assets held as part of Group financing arrangements include cash in bank accounts and cash in transit, being cash and card receipts received at the stores but not yet paid into or credited to the bank accounts and short-term money market deposits. The long-term debtors principally include "key money" held as security by landlords of certain stores in Japan. The Group had no fixed rate financial assets at 26 April 2003 (2002: £nil).

Currency exposures

The principal currency exposures of the Group as at 26 April 2003 and 27 April 2002 were as follows:

	Net foreign currency monetary assets (liabilities)			Net foreign currency monetary assets (liabilities)		
	US dollar 2003 £000	Sterling 2003 £000	Total 2003 £000	US dollar 2002 £000	Sterling 2002 £000	Total 2002 £000
<i>Functional currency of Group operation</i>						
Sterling	-	-	-	(86,207)	-	(86,207)
Japanese yen	(141)	(348)	(489)	(165)	(172)	(337)
Euro	-	(692)	(692)	-	7,078	7,078
Other	(309)	5,740	5,431	(543)	(1,166)	(1,709)
Total	(450)	4,700	4,250	(86,915)	5,740	(81,175)

The exposures defined in the table above comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating (or functional) currency of the operating unit involved and give rise to the net currency gains and losses recognised in the profit and loss account. The amounts shown take into account the effect of foreign exchange contracts entered into to manage these currency exposures.

The profile of currency exposures is profoundly different in 2003 compared to 2002, primarily due to the repayment of the US dollar Notes which has effectively eliminated the US dollar exposure.

Fair value of financial assets and financial liabilities

The table below is a comparison by category of book values and fair values of all the Group's financial instruments at 26 April 2003 and 27 April 2002.

	Book value 2003 £000	Fair value 2003 £000	Book value 2002 £000	Fair value 2002 £000
<i>Primary financial instruments</i>				
Long-term creditors	(590)	(590)	(72)	(72)
Short-term borrowings and current portion of long-term borrowings	(38,157)	(38,157)	(51,462)	(51,462)
Long-term borrowings	(225,000)	(225,000)	(427,375)	(448,165)
Cash and short-term deposits	104,591	104,591	78,406	78,406
Long-term debtors	7,918	7,918	8,076	8,076

Notes to the financial statements continued

19. Derivatives and other financial instruments (continued)

<i>Derivative financial instruments</i>	Contract amount 2003 £000	Book value 2003 £000	Fair value 2003 £000	Expected maturity before 26 April Year	Contract amount 2002 £000	Book value 2002 £000	Fair value 2002 £000	Expected maturity before 27 April Year
Cross currency swaps	-	-	-	-	136,390	-	(2,791)	2003
Interest rate caps	-	-	-	-	100,000	-	-	2003
Interest rate swaps	70,000	-	0	2005	70,000	-	(358)	2005
Interest rate swaps	80,000	-	(3,440)	2006	80,000	-	(349)	2006
Forward foreign exchange contracts								
- Financial activities	66,303	-	(17)	2004	68,969	-	(713)	2003
- Commercial activities	16,819	-	(268)	2004	10,424	-	(82)	2003

Fair value

Forward rate agreements, currency swap agreements, interest rate swaps and forward foreign exchange contracts are valued at the contract rate in respect of their ongoing carrying value in the financial statements and at closing market rates of exchange for market valuation. The fair value of options is based on market prices at the period end.

The fair value of short-term borrowings and investments is based on the carrying amount as a result of their short maturity. The fair value of long-term borrowings is based on current market rates and quoted market prices (where available), otherwise the carrying value is used.

Book value

The book value of financial instruments does not include an allocation of deferred financing fees.

Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised.

	Gains £000	Losses £000	Net Gains (losses) £000
Unrecognised gains (losses) at 28 April 2001	17,367	(11)	17,356
Gains (losses) arising in previous periods, recognised in period to 27 April 2002	(17,367)	11	(17,356)
Gains (losses) arising before 28 April 2001 not recognised in period to 27 April 2002	-	-	-
Gains (losses) arising, but not recognised in period to 27 April 2002	291	(4,584)	(4,293)
Unrecognised gains (losses) at 27 April 2002	291	(4,584)	(4,293)
Gains (losses) arising in previous periods, recognised in period to 26 April 2003	291	(4,235)	(3,944)
Gains (losses) arising before 27 April 2002 not recognised in period to 26 April 2003	-	(349)	(349)
Gains (losses) arising, but not recognised in period to 26 April 2003	373	(3,749)	(3,376)
Unrecognised gains (losses) at 26 April 2003	373	(4,098)	(3,725)
Of which:			
Gains (losses) expected to be recognised in less than one year	373	(658)	(285)
Gains (losses) expected to be recognised after more than one year	-	(3,440)	(3,440)

19. Derivatives and other financial instruments (continued)

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities as at 26 April 2003 is as follows:

	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	Thereafter £000	Total £000
Currency							
Sterling	(25,000)	(40,000)	(50,000)	(40,000)	(95,000)	-	(250,000)
Canadian dollar	(4,887)	-	-	-	-	-	(4,887)
Japanese yen	(7,830)	-	-	-	-	-	(7,830)
US dollar	(440)	-	-	-	-	-	(440)
Total	(38,157)	(40,000)	(50,000)	(40,000)	(95,000)	-	(263,157)

Borrowing facilities

	2003 £000	2002 £000
Undrawn committed facilities available to the Group		
Expiring within one year	10,541	8,445
Expiring in more than one year but not more than two years	-	-
Expiring in more than two years	123,083	171,695
Total	133,624	180,140

Under the terms of the Senior Facility Agreement existing at 27 April 2002, the Company repaid all amounts outstanding under the Senior Facility Agreement on flotation of the Company on the London Stock Exchange. Deferred financing fees totalling £9.7 million relating to the existing Agreement have been charged to the profit and loss account as an exceptional finance cost in the year ended 26 April 2003.

On 24 April 2002 the Company entered into a new syndicated bank Senior Facility Agreement, conditional upon flotation, consisting of a £275 million term debt and a £150 million revolving credit facility. This was utilised on 15 May 2002 to repay the previous facility.

Interest on advances under the new Senior Facility Agreement was payable during the financial year at a rate per annum equal to LIBOR plus a margin of 1.5%. Since the year end, on 23 May 2003, the margin on the senior bank debt reduced to 0.875%.

In addition to direct drawings under the revolving credit facility in the UK, the Group utilised the facility by drawing letters of credit to support facilities provided by local banks overseas. Although these locally provided facilities nominally expired in less than one year, they could be renewed provided that the letter of credit drawn under the revolving credit facility is renewed. The table above reflects the undrawn portion of these locally provided facilities as expiring in less than one year.

As at 26 April 2003, letters of credit issued totalled £26.9 million, of which £13.8 million was undrawn (2002: £12.7 million). Also, the Group has given a parent guarantee to support an uncommitted local facility totalling £2.1 million, which was undrawn at 26 April 2003.

Notes to the financial statements continued

20. Cash, liquid resources and financing

The Group's net borrowings at 26 April 2003 comprised:

	2003			2002
	Cash £000	Liquid resources £000	Financing £000	Net borrowings £000
Investments and short-term deposits	-	1,835	-	1,835
Cash at bank and in hand	102,756	-	-	102,756
Cash at bank and in hand	102,756	1,835	-	104,591
Borrowings due within one year	(13,157)	-	(23,084)	(36,241)
Borrowings due after more than one year	-	-	(220,543)	(220,543)
	(13,157)	-	(243,627)	(256,784)
At 26 April 2003	89,599	1,835	(243,627)	(152,193)

Net borrowings are repayable as follows:

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
In one year or less	68,350	28,619	25,579	(12,895)
Between one and two years	(38,240)	(1,999)	(38,240)	(1,999)
Between two and five years	(182,303)	(201,301)	(182,303)	(201,301)
More than five years	-	(216,012)	-	(216,012)
	(152,193)	(390,693)	(194,964)	(432,207)

The following definitions have been used:

- Cash: Cash at bank and in hand and deposits repayable on demand if available within 24 hours without penalty, less overdrafts.
- Liquid resources: Investments and deposits, other than those included as cash, which are readily convertible into known amounts of cash.
- Financing: Borrowings, less overdrafts that have been treated as cash.

Analysis of movement in the Group's net borrowings in the period

	At 27 April 2002 £000	Cash flow £000	Other non-cash changes ¹ £000	Exchange movements £000	At 26 April 2003 £000
Cash at bank and in hand	77,255	25,279	-	222	102,756
Overdraft	(11,904)	3,736	-	231	(7,937)
Cash	65,351	29,015	-	453	94,819
Debt due after more than one year	(419,312)	203,460	(5,281)	590	(220,543)
Debt due within one year	(37,883)	7,377	1,916	286	(28,304)
Financing	(457,195)	210,837	(3,365)	876	(248,847)
Liquid resources (cash deposits)	1,151	795	-	(111)	1,835
Total	(390,693)	240,647	(3,365)	1,218	(152,193)

1 Represents borrowings due within one year.

2 Represents issue costs incurred in connection with the raising of debt and the classification of the Term debt that is due within one year. The issue costs have been offset against the relevant debt instrument in accordance with FRS 4 "Capital Instruments". The cash impact of these costs is included with Returns on investment and servicing of finance in accordance with FRS 1 (Revised).

20. Cash, liquid resources and financing (continued)

Reconciliation of net cash flow to movement in net debt

	2003 £000	2002 £000
Increase in cash	29,015	59,469
Cash outflow from financing	210,837	46,611
Issue costs of long-term loans	8,425	-
Cash outflow (inflow) from short-term deposits	795	(2,868)
Change in net debt resulting from cash flows	249,072	103,212
Exchange differences	1,218	57
Amortisation of deferred financing fees	(11,790)	(3,012)
Decrease in net debt	238,500	100,257
Opening net debt	(390,693)	(490,950)
Closing net debt	(152,193)	(390,693)

21. Other creditors: amounts falling due within one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Trade creditors	196,220	191,198	-	-
Amounts owed to subsidiary undertakings	-	-	326,498	390,982
Corporate taxation	21,528	19,919	1,142	782
Other taxes including VAT and social security costs	6,585	9,342	809	580
Deferred consideration payable	-	50,000	-	50,000
Other creditors	66,544	76,616	7,129	23,669
Accruals and deferred income	38,901	40,799	9,570	7,919
Dividends payable	13,712	-	13,712	-
	343,490	387,874	358,860	473,932

22. Other creditors: amounts falling due after more than one year

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Other creditors	590	72	500	-

23. Deferred taxation

	Group 2003 £000	Group 2002 £000	Company 2003 £000	Company 2002 £000
Excess of accumulated taxation allowances over depreciation provided against tangible fixed assets	(8,119)	(5,998)	(109)	(110)
Other timing differences	(5,790)	(3,618)	(2,069)	(1,560)
	(13,909)	(9,616)	(2,178)	(1,670)
Movements during the year:				
Opening balance	(9,616)	(8,365)	(1,670)	(751)
Currency translation	96	-	-	-
Credited to profit on ordinary activities	(4,389)	(1,251)	(508)	(919)
Closing balance	(13,909)	(9,616)	(2,178)	(1,670)

Notes to the financial statements continued

23. Deferred taxation continued

No provision has been made for further taxes which could arise if subsidiary undertakings are disposed of or if overseas companies were to remit dividends to the UK in excess of those anticipated in these accounts; it is considered impracticable to estimate the amount of such taxes.

At 26 April 2003 there are deferred tax assets of approximately £4.5 million (2002: £4.0 million) resulting from tax losses and other timing differences which have not been recognised and will be recoverable when there are suitable taxable profits in the appropriate territory against which they can be relieved.

There is no unprovided deferred tax liability as at 26 April 2003 or 27 April 2002.

24. Provisions for liabilities and charges

Group	Total £000
At 27 April 2002	15,033
Currency retranslation	(716)
Provisions utilised	(5,148)
Charged to operating profit	3,897
Credited against operating profit	(2,219)
Notional interest relating to discount on provisions	759
At 26 April 2003	11,606

Provisions for liabilities and charges include amounts in respect of store closures and certain fair value acquisition adjustments that principally relate to onerous leases with unexpired durations of between one and eight years.

The utilisation of provisions in the current financial year of £5.1 million reflected the closure of stores in HMV USA (£3.7 million) and Waterstone's (£1.4 million).

The £3.9 million provision created in the financial year was in respect of the closure of HMV Germany (£1.0 million) and further store closures in HMV USA (£2.9 million).

The £2.2 million credit to operating profit was in respect of fair value acquisition provisions made in 1998 in accordance with FRS 7, which principally related to onerous leases with unexpired durations of up to a further eight years.

The Company did not have any provisions at either 26 April 2003 or 27 April 2002.

25. Share capital

At 26 April 2003 the authorised share capital of the Company comprised 518,590,193 1p Ordinary Shares of which 403,290,659 were allotted, called up and fully paid. During the period under review, significant changes were made to the authorised and issued share capital of the Company, as described below.

On 8 May 2002 the Company undertook a bonus issue, whereby 4,337,76 new Ordinary Shares were issued for every existing Ordinary Share held.

The authorised share capital of the Company was then increased to £5,430,000 and \$162,600 by the creation of 360,504,127 new Ordinary Shares. This enlarged share capital was divided into:

- 81,300 12.875% Senior Cumulative Redeemable "A" Preference Shares of \$1 each and 81,300 12.875% Senior Cumulative Redeemable "B" Preference Shares of \$1 each;
- 29,400 12.875% Senior Cumulative Redeemable "C" Preference Shares of £0.615 each;
- 518,590,193 1p Ordinary Shares; and
- a Sterling Deferred Share with a nominal value of £226,017.

All of the Senior and Junior Preference Shares and the Sterling Deferred Share were subsequently cancelled at the Annual General Meeting on 1 October 2002.

The Initial Public Offering comprised the issue of 195,312,500 new Ordinary Shares, the sale of 84,255,525 existing Ordinary Shares by existing shareholders, and the issue of 17,652 new Ordinary Shares to satisfy options exercised in the Company, bringing the number of new Ordinary Shares issued on 15 May 2002 to 279,585,679. Subsequent issues of Ordinary Shares to satisfy share options exercised brought the total number of issued Ordinary 1p Shares to 403,290,659.

Junior Preference Shares

On 8 May 2002, all of the Junior Preference shares converted into 145,815,137 new Ordinary Shares and a non-voting sterling deferred share. The non-voting Sterling Deferred Share was subsequently converted into a capital reserve and was cancelled together with the authorised Junior Preference Shares.

Senior Preference Shares

The Senior Preference Shares were redeemed at 112.875% of the sum of the issue price and accumulated unpaid dividends (£105.9 million) on 28 June 2002. The authorised Senior Preference Shares were subsequently cancelled.

Share premium

On 15 May 2002, the share premium account was credited with £354.8 million after deduction of underwriting commissions and other fees and expenses payable by the Company of £18.0 million and after accounting for the bonus issue.

<i>Group and Company</i>	2003 Number	2002 Number	2003 £000	2002 £000
Authorised				
Ordinary Shares of 1p each	518,590,193	10,270,847	5,186	103
Preferred Ordinary Shares "A" of 1p each	-	1,000,000	-	10
Preferred Ordinary Shares "B" of 1p each	-	1,000,000	-	10
Junior Redeemable Preference Shares of 1p each	-	68,416,926	-	1,684
12.875% Senior Cumulative Redeemable "A" Preference Shares of US \$1.00 each	-	81,300	-	50
12.875% Senior Cumulative Redeemable "B" Preference Shares of US \$1.00 each	-	81,300	-	50
12.875% Senior Cumulative Redeemable "C" Preference Shares of 61.5p each	-	29,400	-	18
			5,186	1,925
Allotted, called up and fully paid				
Ordinary Shares of 1p each	403,290,659	9,430,220	4,033	94
Preferred Ordinary Shares "A" of 1p each	-	1,000,000	-	10
Preferred Ordinary Shares "B" of 1p each	-	1,000,000	-	10
Junior Redeemable Preference Shares of 1p each	-	68,416,926	-	1,684
12.875% Senior Cumulative Redeemable "A" Preference Shares of US \$1.00 each	-	81,300	-	50
			4,033	1,848

The Company has two share option schemes under which options to subscribe for the Company's Ordinary Shares have been granted to certain Directors and senior management. At 27 April 2002 910,601 options were in issue. As a result of the bonus issue, these options converted to options over 4,860,514 HMV Group plc 1p Ordinary Shares and the option price was adjusted accordingly. During the 52 weeks ended 26 April 2003 13,943,535 options were granted (2002: 625,819), 1,250,000 options lapsed (2002: 282,025) and 1,151,301 options were exercised (2002: 27,529). At 26 April 2003, therefore 16,402,609 options were in issue.

- (i) Repaying pari passu the amounts subscribed (1p per share) for the Ordinary Shares.
- (ii) Distributing pari passu any balance among the holders of the Ordinary Shares.

HMV Group employees are members of a number of pension schemes. The main schemes that cover employees in the United Kingdom, are the HMV Group Pension Scheme (the "Scheme" - established with effect from July 1998) and the EMI Group Pension Fund (the "Fund").

The Pension Benefit Section is of the defined benefit type. The benefits it provides are based on final pensionable pay and are guaranteed to increase in payment by 5% per annum or by the increase in the cost of living, if less. Members contribute at the rate of 4% of pensionable pay.

Notes to the financial statements continued

26. Pension arrangements continued

A qualified actuary made an actuarial valuation as at 30 June 2002. The valuation was based on an assumed investment return of 7.0% a year, salary increases of 4.0% a year, and annual pension increases of 2.5%, and used the projected unit method. The result of the valuation was a level of asset cover of 94%, representing a funding deficit of £0.9 million. In addition, the total cost of accruing benefits was given as 16.8% of pensionable pay (including an allowance for administrative expenses), of which members of the Pension Benefit Section pay 4.0%, leaving the Company's regular cost at 12.8% of pensionable pay. The market value of the assets of the Pension Benefit Scheme at 30 June 2002 was about £13.1 million. The next actuarial review will take place no later than 30 June 2005.

In the light of the small deficit of assets over the cost of benefits, the Company will contribute at a rate of 12.9% of pensionable pay from 1 June 2004. This rate, calculated in accordance with the recommendations of the actuary, is sufficient to eliminate the deficit over a period of seven years. Actual employer contributions to the Pension Benefit Section for the 52 weeks ended 26 April 2003 were £1.0 million (2002: £0.9 million).

Pension Saver Section

This Section was established for all other employees of the Group including those who were then members of the WH Smith Retirement Savings Plan up to 30 June 1998.

It is of the defined contribution type and is open to permanent staff of the Company who have completed three months' service and are eligible to join. Members can choose to pay from 2% to 5% of pensionable pay. The Company matches the amount paid by the member up to a maximum of 5% of pensionable pay. Members have a choice of ways to invest their and the Company's contributions in an individual fund to buy pension benefits of their choice. It also provides life assurance whilst members are employed by the Company.

The Fund

The flotation of the Company's shares on the London Stock Exchange on 15 May 2002 and the concurrent dilution of EMI Group plc's investment in the Company started a process of separation of pension arrangements, which will be complete with effect from 1 June 2003. Consequently throughout the 52 weeks ended 26 April 2003 relevant HMV Group employees in the UK remained members of, and continued to participate in, the Fund.

The separation of pension arrangements provided each member with the option of taking up membership of the Scheme. For members who so elect (transferring members), a transfer value in respect of their accrued rights will be paid from the Fund to the Scheme. The benefits granted to transferring members will be broadly comparable with those which they had individually accrued in the Fund. Certain executives are entitled to enhanced levels of benefits under the Fund as "executive members". Some of those executives are subject to the "earnings cap" (which limits the amount of their salary which may be treated as pensionable under an Inland Revenue exempt approved pension scheme) and are members, or may become eligible for membership, of top-up arrangements for life insurance, pension and disability benefits. The present value of the liabilities represented by these accrued rights, was approximately £21.0 million as at 27 April 2003. The transfer of assets would be expected to be broadly consistent with this amount, but would not be finalised until the point of transfer, which is dependent on the finalisation of an actuarial valuation of the Fund currently in progress.

EMI Group plc is the principal employer of the Fund. The Fund is of the defined benefit type, is based in the UK, is an Inland Revenue exempt approved scheme for the purposes of the Income and Corporation Taxes Act 1988 and is contracted out of the State Earnings Related Pension Scheme. The Fund is open to all permanent employees of EMI Group over the age of 18 employed in the UK. Benefits provided by the Fund are based on final pensionable pay. Pensions payable from the Fund are guaranteed to increase by 5% per annum or by the increase in the cost of living if less. Members contribute to the Fund at the rate of 4% of pensionable pay. The latest available actuarial valuation of the Fund was made by a qualified actuary as at 31 March 2000. At that date, the market value of the assets of the EMI Fund was taken to be £1,079.0 million. The market value of the assets was sufficient to cover 117% of the value of the benefits that had accrued to the members, after allowing for assumed increases in earnings, on the actuarial assumptions used, treating the EMI Fund as an ongoing entity. Part of the above excess assets disclosed by the 2000 valuation has been used to finance a special increase of 3% to pensions in payment and part has been allocated towards a reduction in employer contributions below the long-term rate, with the balance being carried forward as a reserve in the EMI fund.

Employer expense in respect of the Fund has been calculated in accordance with the recommendations of the actuary. On the basis of actuarial advice, it is calculated that employer expense would represent a credit to the profit and loss account on full application of SSAP 24 principles. However, for reasons of conservatism, such expense has been taken as nil for the 52 weeks ended 26 April 2003 (2002: £nil).

26. Pension arrangements (continued)

FRS 17 Retirement Benefits

In accordance with the transitional implementation rules set out in FRS 17 "Retirement Benefits", additional disclosures are set out below. These have been updated by professionally qualified actuaries to take into account the requirements of FRS 17 and to assess the liabilities of the Scheme at 26 April 2003. Scheme assets are stated at their market value at 26 April 2003.

<i>Major assumptions</i>	As at 26 April 2003 % per annum	As at 27 April 2002 % per annum
Rate of price inflation	2.5	2.5
Rate of salary increase	4.0	4.0
Rate of increase for pensions in payment	2.5	2.5
Rate used to discount scheme liabilities	5.4	5.75
Expected rate of return on equities	8.0	7.5
Expected rate of return on bonds	5.0	5.2

On full compliance with FRS 17, on the basis of the above assumptions, the amounts that would have been charged or credited to the consolidated profit and loss account and consolidated statement of total recognised gains and losses for the 52 weeks ended 26 April 2003 are set out below:

	2003 £'000
Operating profit	
Current service cost	(1,700)
Past service cost	--
Total charge to operating profit	(1,700)
Finance income	
Interest on pension scheme liabilities	(1,000)
Expected rate of return on assets in the pension scheme	1,100
Net credit to other finance income	100
Total profit and loss charge before deduction for taxation	(1,600)
Consolidated statement of total recognised gains and losses	
Actual return less expected return on assets	(3,900)
Experience gains and losses arising on liabilities	(700)
Changes in assumptions underlying the present value of the scheme liabilities	(2,900)
Actuarial loss recognised in the consolidated statement of total recognised gains and losses	(7,500)
<i>Further disclosures</i>	%
Difference between the expected and actual return on scheme assets expressed as a percentage of the scheme assets	(32.0)
Experience gains and losses on scheme liabilities expressed as a percentage of the present value of the scheme liabilities	(3.0)
Total actuarial loss recognised in the consolidated statement of total recognised gains and losses, expressed as a percentage of the present value of the scheme liabilities	(32.5)

Notes to the financial statements continued

26. Pension arrangements (continued)

	As at 26 April 2003 £000	As at 27 April 2002 £000
<i>Market value of assets</i>		
Equities	10,600	12,300
Bonds	1,600	1,800
Total market value of assets	12,200	14,100
Present value of scheme liabilities	(23,100)	(16,800)
Deficit in the Scheme	(10,900)	(2,700)
Deferred tax	3,300	800
Net pension liability	(7,600)	(1,900)

	2003 £000
<i>Movement in deficit during the year</i>	
Deficit in scheme at the beginning of the year	(2,700)
Contributions paid	900
Current service cost	(1,700)
Net credit to other finance income	100
Actuarial loss	(7,500)
Deficit in scheme at the end of the year	(10,900)

In respect of HMV Group employees' participation in the EMI Fund, the Company is unable to identify its share of the underlying assets and liabilities in this multi-employer Fund on a reasonable and consistent basis. Consequently, it has taken advantage of the exemption in FRS 17 and will treat the Fund on a defined contribution basis until the arrangement ceases and the members transfer to the HMV scheme. Accordingly, no FRS 17 transitional disclosures are required at 26 April 2003.

If the above numbers had been recognised in the financial statements, the Group's net assets and profit and loss reserve as at 26 April 2003 would have been as follows:

	2003 £000	2002 £000
<i>Net assets</i>		
Net assets excluding net pension liability	(132,694)	(416,008)
Pension provision under SSAP 24	-	-
Net pension liability	(7,600)	(1,900)
Net assets including net pension liability	(140,294)	(417,908)

	2003 £000	2002 £000
<i>Reserves</i>		
Profit and loss reserve excluding net pension liability	(445,202)	(421,287)
Pension provision under SSAP 24	-	-
Net pension liability	(7,600)	(1,900)
Profit and loss reserve including net pension liability	(452,802)	(423,187)

27. Related party transactions

The EMI Group plc ("EMI") was a related party of HMV Group plc as at 27 April 2002 with a shareholding of 45%. Following the Company's flotation on the London Stock Exchange, this shareholding was diluted to 14.5%. This remaining stake was sold by EMI Group plc in November 2002. In addition, Mr Eric Nicoli serves as Chairman of both parties.

The EMI Group plc

EMI revolving credit facility

EMI had made available to the Company a £50.0 million working capital facility, which was cancelled on 15 May 2002.

Deferred consideration

Deferred consideration of £50.0 million was paid to EMI on the listing of HMV Group plc on the London Stock Exchange on 15 May 2002.

Trading with the EMI Group

Purchases made by HMV Group plc subsidiaries from EMI Group plc subsidiaries in the period amounted to £89.0 million (2002: £94.5 million) and the creditors' balance outstanding at the balance sheet date was £13.1 million (2002: £11.1 million).

Purchase of intangible assets

On 8 May 2002, HMV (IP) Limited, a wholly owned subsidiary of HMV Group plc acquired, conditional upon flotation, various trademark registrations and applications for the acronym "HMV" and the dog and trumpet trademark from EMI for a consideration of £2.0 million.

28. Contingent liabilities

The management of HMV Group is not aware of any legal or arbitration proceedings pending or threatened against any member of HMV Group which may result in any liabilities significantly in excess of provisions in the financial statements.

29. Share premium account and reserves

Group	Share premium account £000	Capital reserve £000	Profit and loss account		
			Goodwill £000	Profit and loss reserves £000	Total £000
At 27 April 2002	3,431	-	(647,495)	226,208	(421,287)
Bonus issue	(495)	-	-	-	-
Issue of new shares	373,251	-	-	-	-
Issue costs	(17,996)	-	-	-	-
Creation of capital reserve	-	226	-	-	-
Redemption of Senior Preference Shares	(49,942)	-	-	-	-
Currency retranslation	-	-	-	2,208	2,208
Net exchange gain on foreign currency borrowings	-	-	-	747	747
Tax on exchange differences	-	-	-	190	190
Transfer from profit and loss account	-	-	-	13,575	13,575
Reversal of redemption premium on non-equity shares	-	-	-	1,777	1,777
Payment of accrued preference dividends on non-equity shares	-	-	-	(36,648)	(36,648)
Exchange loss on redemption of non-equity shares	-	-	-	(5,764)	(5,764)
At 26 April 2003	308,249	226	(647,495)	202,293	(445,202)

The cumulative amount of goodwill eliminated against the profit and loss account at 26 April 2003 is £647,495,000 (2002: £647,495,000).

Notes to the financial statements continued

29. Share premium account and reserves (continued)

<i>Company</i>	Share premium account £000	Capital reserve £000	Profit and loss account		
			Goodwill £000	Profit and loss reserves £000	Total £000
At 27 April 2002	3,431	-	-	103,718	
Bonus issue	(495)	-	-	-	-
Issue of new shares	373,251	-	-	-	-
Issue costs	(17,996)	-	-	-	-
Creation of capital reserve	-	226	-	-	-
Redemption of Senior Preference Shares	(49,942)	-	-	-	-
Currency retranslation	-	-	-	-	-
Net exchange loss on foreign currency borrowings	-	-	-	(357)	(357)
Tax on exchange differences	-	-	-	190	190
Transfer to profit and loss account	-	-	-	3,119	3,119
Reversal of redemption premium on non-equity shares	-	-	-	1,777	1,777
Payment of accrued preference dividends on non-equity shares	-	-	-	(36,648)	(36,648)
Exchange loss on redemption of non-equity shares	-	-	-	(5,764)	(5,764)
At 26 April 2003	308,249	226	-	66,035	66,035

In accordance with the exemption permitted by Section 203(3) of the Companies Act 1985, the profit and loss account of the Company is not separately presented. The profit on ordinary activities after taxation, dealt with in the accounts of the Company is £36.6 million (2002: £125.7 million).

30. Financial commitments

<i>Group</i>	2003 £000	2002 £000
Capital expenditure: contracted but not provided	1,419	2,349

At the period end, the Group had annual commitments under non-cancellable operating leases as follows:

<i>Land and buildings</i>	2003 £000	2002 £000
Expiring within one year	6,086	7,318
Expiring between two and five years inclusive	26,531	26,292
Expiring in over five years	89,668	85,846
	122,285	119,456

<i>Other</i>	2003 £000	2002 £000
Expiring within one year	1	6
Expiring between two and five years inclusive	-	31
Expiring in over five years	-	-
	1	37

Group financial record

	52 weeks ended 26 April 2003 £ million	52 weeks ended 27 April 2002 £ million	52 weeks ended 28 April 2001 £ million	52 weeks ended 29 April 2000 £ million	53 weeks ended 29 April 2000 £ million	52 weeks ended 24 April 1999 £ million
Summarised profit and loss account						
Turnover						
Europe	867.4	784.4	654.0	549.7	558.4	490.4
Asia Pacific	277.0	275.7	285.4	241.2	242.5	203.9
North America	157.1	187.1	199.0	182.7	185.4	173.9
Total HMV	1,301.5	1,247.2	1,138.4	973.6	986.3	868.2
Waterstone's	406.2	407.3	404.3	398.2	403.9	390.6
Total Group	1,707.7	1,654.5	1,542.7	1,371.8	1,390.2	1,258.8
Operating profit before exceptional items						
Europe	88.6	74.0	48.7	38.7	41.2	35.9
Asia Pacific	9.3	8.4	7.0	5.5	5.9	3.9
North America	(3.5)	1.0	2.8	7.4	7.9	6.4
Total HMV	94.4	83.4	58.5	51.6	55.0	46.2
Waterstone's	24.0	22.2	18.6	23.4	25.4	39.8
Total Group	118.4	105.6	77.1	75.0	80.4	86.0
Operating exceptional items	-	(6.0)	(24.2)	-	(2.6)	(7.7)
Share of loss of associate	-	-	-	-	-	(1.3)
Non-operating exceptional profit on disposal	-	1.0	-	-	-	-
Net finance charges before exceptional items	(22.2)	(52.0)	(66.5)	-	(60.8)	(61.6)
Exceptional finance charges	(36.3)	-	(4.2)	-	-	-
Profit (loss) before tax	59.9	48.6	(17.8)	-	17.0	15.4
Tax	(12.9)	(17.9)	1.2	-	(7.6)	(5.0)
Profit (loss) for the financial period	47.0	30.7	(16.6)	-	9.4	10.4
Summarised balance sheet						
Fixed assets						
Intangible fixed assets	2.0	-	-	-	-	-
Tangible fixed assets	148.1	142.3	161.4	-	177.7	145.7
Investments	-	0.9	0.9	-	0.4	0.3
	150.1	143.2	162.3	-	178.1	146.0
Current assets and liabilities						
Stocks	156.6	168.3	185.8	-	194.5	182.2
Debtors	68.5	66.1	62.2	-	62.4	52.6
Creditors (excluding net borrowings)	(344.1)	(387.9)	(318.8)	-	(261.9)	(246.9)
Provisions	(11.6)	(15.0)	(23.7)	-	(23.7)	(29.5)
	(130.6)	(168.5)	(94.5)	-	(28.7)	(41.6)
Total assets and liabilities (excluding net borrowings)	19.5	(25.3)	67.8	-	149.4	104.4

1 The Group Financial Summary has been prepared on the basis of the current accounting policies as set out on pages 59 and 60.

Pro forma financial information

The key financial results are restated below on a pro forma basis to reflect the fundamental change in capital structure, which took place at the beginning of the financial year. The results are for illustrative purposes only and do not reflect the actual results for the period.

	Notes	2003 £m	2002 £m
Turnover		1,707.7	1,654.5
Operating profit	1	118.4	105.6
Net finance charges	2	(21.9)	(25.6)
Profit before taxation		96.5	80.0
Taxation	3	(29.9)	(26.4)
Earnings		66.6	53.6
Pro forma earnings per share	4	18.0p	13.3p
Underlying pro forma earnings per share	4	16.5p	13.3p
Dividend per share	5	4.5p	3.7p
Cash flow from operations before flotation cost spend	6	183.8	182.2
Capital expenditure		(49.0)	(23.5)
Other		(0.5)	0.3
Operating cash flow		134.3	159.0
Underlying net debt	7	(158.6)	(253.6)

Notes

- 1 Operating profit for the 52 weeks ended 27 April 2002 is stated before £6.0 million of exceptional flotation costs.
- 2 Pro forma net finance charges for each period are calculated on the basis that the Group's new capital structure had been in place from 29 April 2001, and exclude the effect of the exceptional costs relating to the flotation and refinancing.
- 3 The tax charge for each period is adjusted on the basis of an underlying effective rate of 31% (2002: 33%). The rate for the current year excludes the benefit from the first time recognition of a deferred tax asset in HMV Japan.
- 4 Pro forma earnings per share for each period, adjusted for the change in capital structure, is calculated by reference to the number of Ordinary Shares in issue at the balance sheet date (26 April 2003: 402.7 million shares). The underlying pro forma earnings per share is further adjusted to reflect the underlying tax rate of 31%.
- 5 The full year dividend for the 52 weeks ended 27 April 2002 is an indication of the distribution the Company would have made had the Group's new capital structure been in place from 29 April 2001. Dividends for each period exclude any distributions in respect of the junior or senior preference share capital of the Company converted or redeemed on flotation.
- 6 Cash flow from operations is stated before the cash outflow of £3.1 million (27 April 2002: £2.1 million) arising from operating exceptional flotation costs incurred.
- 7 Pro forma underlying net debt is calculated on the basis that the Group's new capital structure had been in place from 29 April 2001. Pro forma underlying net debt at 27 April 2002 therefore reflects the following adjustments: proceeds of the sale of the Company's Ordinary Shares on flotation (£375.0 million) less costs incurred on flotation charged to the share premium account (£18.0 million), settlement of £6.0 million flotation costs charged at April 2002 (£2.1 million by April 2002, £3.1 million by April 2003, £0.8 million non-cash), costs associated with arranging the new bank facility (£8.4 million), deferred consideration paid to EMI Group plc (£50.0 million), interest payable on the tender offer for the Senior Subordinated Notes (£25.6 million) and associated fees (£1.0 million), the settlement of accrued interest on the Notes and original bank facilities (£16.2 million) and the redemption of the Senior Preference Shares (£105.9 million).

Store directory

<p>HMV Europe UK 360 Oxford Street Aberdeen Aylesbury Ballymena Banbury Basildon Basingstoke Bath Belfast Donegall Belfast Forestside Bexleyheath Birmingham High Street Birmingham Palasades Birmingham The Fort Blackburn Blackpool Bluewater Bolton Bournemouth Bracknell Bradford Brent Cross Brighton Brighton Churchill Square Bristol Bristol Cribbs Causeway Bromley Cambridge Canary Wharf Canterbury Cardiff Cardiff* Chelmsford Cheltenham Chester Colchester* Coleraine* Covent Garden Coventry Crawley Croydon Darlington Derby Doncaster Dundee Ealing East Kilbride Edinburgh Fort Kinnaird* Edinburgh Ocean Terminal Edinburgh Princes Street Edinburgh St James Enfield Exeter Falkirk* Fulham Gateshead Gatwick North Terminal Glasgow Argyle Street Glasgow Braehead Glasgow Sauchiehall Street Glasgow Union Street Gloucester Grimsby* Guildford Hampstead Hanley Harrow* Heathrow Terminal 1 Heathrow Terminal 4 Hounslow Hull Inverness Ipswich Isle of Man Isle of Wight Islington* Jersey Kettering Kings Lynn Kingston Lancaster Leadenhall Leeds Headrow Leeds White Rose Leicester Lincoln Lisburn* Liverpool Livingstone* London Victoria Station* Luton Maidstone Manchester 21 Market Street</p>	<p>Manchester 90 Market Street Manchester Trafford Centre Manchester Piccadilly Station* Manchester West One* Mansfield Merry Hill Middlesbrough Milton Keynes Monks Cross Newbury* Newcastle Newport Northampton Norwich Nottingham Listergate Nottingham Victoria Oldham Oxford Oxford Circus Peterborough Plymouth Poole Portsmouth Preston Putney Reading Oracle Reading Friar Street Redditch* Richmond Romford Rotherham Scarborough Selfridges Sheffield High Street Sheffield Meadowhall Shrewsbury* Slough Solihull Southampton Southend Speke Park* St Albans St Helens* Stockport Stratford Sunderland Sutton Swansea Swindon Telford Thurrock Trocadero Tunbridge Wells Uxbridge Wakefield Warrington Watford* Wellingborough Wimbledon Winchester* Wolverhampton Wood Green Worcester York</p> <p><i>Ireland</i> Blanchardstown Cork Dublin Grafton Street Dublin Henry Street Dublin Swords Limerick Tallaght</p> <p>HMV Asia Pacific <i>Japan</i> Abeno Aqua City Odaiba Canal City Ginza Hakata* Harajuku Hawks Town Hiroshima Ikebukuro Metropolitan Ikebukuro Sunshine 60 Kawanishi Kokura** Kyoto Rakuho Kyoto Kawaramachi Machida* Nagoya-Seikatsusoko Nigata Onitama Okayama</p>	<p>Otaru Sakae Sannomiya Sapporo* Sendai Ichibancho Sendai Vivre Shibuya Shinjuku East Shinjuku South Shinsaibashi Shin-Yuigaoka Sukiyabashi Tachikawa Temmabashi Tenjin Ueno Yokohama Kohoku Yokohama Vvre Universal City Walk Osaka Yokohama World Porters</p> <p><i>Australia</i> Bankstown Brisbane Queen Street Burwood Carindale Chadstone Chatswood Chatswood Chase Cheltenham Southland Chermiside Erina Glen Waverley The Glen Hurstville Indooroopilly Kotara Liverpool Loganholme Macquarie Maroochydore Melbourne Bourke Street Miranda* Mt Druitt Mt Gravatt Pacific Fair Pagewood Parramatta Lvl 3 Parramatta Lvl 5 Penrith Prahara Chapel Street Preston Northland Surfers Paradise* Sydney Mid City Tuggerah</p> <p><i>Hong Kong</i> Causeway Bay Central Building Shatin Tsimshatsui</p> <p><i>Singapore</i> CityLink Heeren Centre</p> <p>HMV North America <i>Canada</i> Abbotsford Seven Oaks Bame* Bramalea Brampton Trinity Common Burlington Mapleview Burnaby Metrotown Calgary Chinook Calgary Market Mall Calgary North Hill Calgary Signal Hill Calgary South Centre Calgary Sunridge Calgary TD Cambridge Chicoutimi Place du Royume Coquitlam Dartmouth Mic Mac Mall Edmonton Bonnie Doon Edmonton Centre Edmonton Kingsway Edmonton Millwoods Edmonton Southgate Etobicoke Sherway Gardens Gatineau L'Outaouais Guelph Stone Road Halifax Hamilton EC Hamilton Limeridge Kelowna Orchard Park Kingston Cataragui</p>	<p>Kitchener Fairview Langley Willowbrook Laval Lethbridge Park Place Levis Galeries Chagnon London Fanshawe London Westmount London White Oaks Markham Markville Medicine Hat Mississauga Square One Mississauga Erin Mills Montreal Megastore Montreal Place Versailles Nanaimo Woodgrove Nepean Bayshore Nepean Merivale Newmarket Upper Canada Oakville Pickering Pointe Claire Prince George Pine Centre Orleans Place D'Orleans Oshawa Ottawa Bank/Sparks Ottawa Rideau Centre Ottawa St Laurent Quebec Fleur De Lys Quebec Galeries de la Capitale Red Deer Bower Place Regina Cornwall Centre Regina Northgate Regina Southland Richmond Saskatoon Lawson Heights Scarborough Sherbrooke St Bruno St Catharine's Pen Centre Ste Foy Place Laurier St Laurent Place Vertu Surrey Guildford Thornhill Promenade Thunder Bay Intercity Toronto Bloor Street Toronto Eaton Centre Toronto Dufferin Mall Toronto Fairview Toronto First Canadian Place Toronto Queen Street Toronto Superstore Toronto Weston Road Toronto Yonge & Eglinton Toronto Yorkdale Trois Rivières Victoria Hillside Victoria Mayfair Victoriaville Ville d'Anjou Ville Mount Royal Waterloo West Edmonton II West Vancouver Park Royal Windsor Devonshire Mall Winnipeg Garden City Winnipeg Kildonan Winnipeg Polo Park Winnipeg Portage Place Winnipeg St Vital</p> <p><i>US</i> Boston Manhasset New York Fifth Avenue New York Harlem Atlanta Lenox Square Ohio Southpark Solomon Pond</p> <p>Waterstone's Aberdeen Langstone Aberdeen Union Street Aberystwyth Atrincham Arnerdam Aylesbury Basingstoke Bath Bath University Bedford Belfast Fountain Street Belfast Royal Avenue Brakenhead Birmingham High Street</p>	<p>Birmingham New Street Birmingham University Blackpool Bluewater Thames Bluewater West Bolton Bournemouth Arcade Bournemouth University Bradford Wool Exchange Bradford University Brighton Clock Tower Bristol College Green Bristol Cribbs Causeway Bristol Galleries Bristol University Bromley Brunel University Brussels Bury Cambridge Sidney Street Camden Canterbury Cardiff St David's Cardiff The Hayes Chelmsford Cheltenham Chester Eastgate Chichester Chiswick City University Clare Market University Colchester Culver Square Colchester High Street Cork Cork University Covent Garden Garrick Street Coventry Coventry Academic Cranfield University Crawley Croydon Derby Derby University Dorking Dublin Dawson Street Dublin Hodges Figgis Dublin Jervis Street Dundee Durham Durham University Ealing Broadway Earls Court East Anglia University Eastbourne Edinburgh East End Edinburgh George Street Edinburgh West End Egham University Epsom Essex University Exeter High Street Exeter Roman Gate Finchley Folkestone Gateshead Glasgow Sauchiehall Glasgow Argyle Street Glasgow Braehead Goldsmith College Gower Street Guildford High Street Guildford North Street Guildhall University Hampstead Hanley Harrods Harrogate Hatfield Hereford Hertford Academic Hertford University Hatfield Hull Hull University Ilford Imperial College Inverness Ipswich Islington James Street Keele University Kensington Kettering Kings Lynn Kings Road Kingston Academic Kingston Bentalls</p>	<p>Lancaster Lancaster University Leadenhall Market Leamington Spa Leeds 36 Albion Street Leeds 93 Albion Street Leicester Market Street Leicester The Shires Liverpool Central Ludgate Circus Luton University Macclesfield Maidstone Earl Street Manchester Airport Manchester Deansgate Manchester St Ann's Margaret Street Merry Hill Middlesbrough Milton Keynes Newbury Newcastle Emerson Chambers Newcastle Grey Street Northampton Norwich Notting Hill Gate Nottingham Bridlesmith Gate Nottingham Wheelgate Nuneaton Old Brompton Road Oxford Oxford Street Park Road University Perth Peterborough Bridge Street Peterborough Queensgate Piccadilly Hatchards Plymouth Preston Queen Mary Reading Broad Street Reading Oracle Reading University Richmond Salisbury Scarborough Sheffield Meadowhall Sheffield Orchard Square Shrewsbury Solihull Southampton Above Bar Southampton University Southampton West Quay Southend Southport Staffordshire University (Stoke) Stirling Thistle Stockport Merseyway Stratford Sutton Swansea Swansea University Swindon Brunel Plaza Swindon Regent Street Taunton Teesside University Telford Thames Valley University Trafalgar Square Tunbridge Wells Ulster University Warrington Watford Watford Academic Wimbledon Winchester High Street Winchester The Brooks Wolverhampton Wolverhampton Academic Worcester Wrexham York 28 Ousegate</p>
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* New stores opened in 52 weeks ended 26 April 2003.
** Opened since 26 April 2003.

Shareholder information

Financial calendar

Ex-dividend date for final dividend	17 September 2003
Record Date for final dividend	19 September 2003
Annual General Meeting	29 September 2003
Final dividend payable	9 October 2003
Interim Results announcement	January 2004
Interim dividend payable	February 2004
Announcement of results for year ending 24 April 2004	June 2004

Ordinary Shares

The total number of Ordinary Shares in issue as at 26 April 2003 was 403,290,659 shares which were held by a total of 971 shareholders.

Share price information

The latest information on the HMV Group plc Ordinary Share price is available on www.hmvgroup.com

Registrars

All enquiries relating to Ordinary Shares, dividends and changes of address should be addressed to the Company's registrar, Computershare Investor Services plc.

Payment of dividends

Shareholders whose dividends are not currently paid to mandated accounts may wish to consider this method of payment, which has a number of advantages: dividends are paid direct into the shareholder's nominated account, cleared funds are provided on the payment date, and the relevant tax voucher is sent to the shareholder's registered address.

Company information

Registered office

Shelley House
2-4 York Road
Maidenhead
Berkshire SL6 1SR

Registered number
3412290

Corporate website
www.hmvgroup.com

Other websites
www.hmv.co.uk
www.hmv.co.jp
www.hmv.com
www.hmv.com.au
www.waterstones.co.uk

Auditors

Ernst & Young LLP
Becket House
1 Lambeth Palace Road
London SE1 7EU

Financial advisors
UBS
2 Finsbury Avenue
London EC2M 2PG

Citigroup
Citigroup Centre
33 Canada Square
Canary Wharf
London E14 5LF

Principal bankers

The Royal Bank of Scotland
135 Bishopsgate
London EC2M 3UR

Dresdner Kleinwort
Wasserstein
Riverbank House
2 Swan Lane
London EC4R 3UX

Lawyers

Mayer, Brown, Rowe & Maw
11 Pilgrim Street
London EC4V 6RW

Registrars

Computershare Investor
Services plc
PO Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH