

HIGHWAY INSURANCE COMPANY LIMITED

FINANCIAL STATEMENTS

31ST DECEMBER 2003

COMPANY REGISTRATION NUMBER: 3730662



DIRECTORS' REPORT

The directors are pleased to submit their report and the audited financial statements for the year ended 31st December 2003.

REVIEW OF BUSINESS

The Company is an insurance company regulated by the Financial Services Authority.

RESULTS AND DIVIDEND

The profit for the financial period amounted to £11,030,000 (2002: profit £8,844,000). The directors do not recommend the payment of a dividend (2002: £Nil).

DIRECTORS

The following have been directors from 1st January 2003 to the date of this report, unless otherwise stated:

- * R G Dunlop (Chairman)
- G Avenel (Resigned on 6th February 2003)
- * D F Barker (Appointed on 23rd April 2003)
- * D E Coleridge (Appointed on 20th March 2003)
- * S R Davies
- P M J Fraser
- * R A Gamble (Appointed on 27th March 2003)
- * A J Gibson
- * C D Hill
- * Mrs J A Kellie
- Q J Lovis (Resigned on 13th February 2003)
- D W Murray
- * I W J Patrick
- * J M Stoker
- * A L Thomas (Appointed on 17th March 2003)
- * Director of the ultimate holding company, Highway Insurance Holdings PLC.

The interests of the directors at 31st December 2003 in the share capital of the ultimate holding company, with the exception of directors who were also directors of the ultimate holding company, whose interests are shown in the accounts of that company, were as follows:

	At 31st December 2003		At 1st January 2003 or date of appointment if later	
	Ordinary 20p shares in		Ordinary 20p shares in	
	Highway Insurance Holdings PLC		Highway Insurance Holdings PLC	
	Holding	Options	Holding	Options
P M J Fraser	-	1,500,000	-	1,500,000

Option to acquire ordinary shares in the Company were granted to P M J Fraser on 6 September 2002. The exercise price of the options is 34.5 pence per share. The options are exercisable between 6 September 2006 and 5 September 2012. The Rules of the Plan provide, *inter alia*, that in order to vest 100%, the average middle market value of a Highway share, calculated over any three consecutive calendar months expiring no earlier than two years after the grant of the option, should be at least 65 pence. If the average middle market price is equal to 55 pence then only 50% of the options granted will be exercisable. Between 55 pence and 65 pence the options becoming exercisable would increase on a straight-line basis.

DIRECTORS' REPORT

AUDITORS

On 13 August 2003 Ernst & Young resigned as auditors and KPMG Audit PLC were appointed in their place. In accordance with Section 394 of the Companies Act 1985 Ernst & Young have confirmed that there are no circumstances connected with ceasing to hold office which they consider should be brought to the attention of the Company's members.

A resolution for the reappointment of KPMG Audit PLC as auditors will be presented at the forthcoming Annual General Meeting of the Company.

By Order of the Board

A handwritten signature in black ink, appearing to be 'Philip Lampshire', with a long, flowing tail.

Philip Lampshire
Secretary

Highway House
171 Kings Road
Brentwood
Essex CM14 4EJ
24th March 2004

DIRECTORS' RESPONSIBILITIES

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

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

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

INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF HIGHWAY INSURANCE COMPANY LIMITED

We have audited the financial statements on pages 4 to 13

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

Respective responsibilities of directors and auditors

The director is responsible for preparing the director's report and, as described on page 3, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

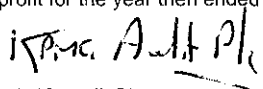
Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31st December 2003 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



KPMG Audit Plc
Chartered Accountants & Registered Auditor
8 Salisbury Square
London
EC4Y 8BB
24th March 2004

Technical Account

	Notes	2003 £ 000's	2002 £ 000's
Gross premiums written	2	252,195	95,711
Outward reinsurance premiums		(66,973)	(5,972)
Net premiums written		185,222	89,739
Change in the gross provision for unearned premiums		(71,732)	(11,665)
Change in the provision for unearned premiums, reinsurers' share		29,496	15
Change in net unearned premiums		(42,236)	(11,650)
Net earned premiums		142,986	78,089
Allocated investment return transferred from the non-technical account		10,994	6,717
Other technical income		729	825
Total technical income		154,709	85,631
Gross claims paid		(71,646)	(39,032)
Reinsurers' share		21,093	259
Net paid claims		(50,553)	(38,773)
Change in claims provision		(74,116)	(34,633)
Reinsurers' share		18,460	16,659
Change in the provision for claims		(55,656)	(17,974)
Net claims incurred		(106,209)	(56,747)
Net operating expenses	4	(28,457)	(15,159)
Change in the equalisation provision		-	72
Total technical charges		(134,666)	(71,834)
Balance on the technical account - general business		20,043	13,797
Attributable to:			
Continuing operations		20,043	16,028
Discontinued operations		-	(2,231)
		20,043	13,797

Non-Technical Account

	Notes	2003 £ 000's	2002 £ 000's
Balance on the general business technical account		20,043	13,797
Investment income	5	8,707	6,028
Unrealised gains on investments	5	3,299	578
Investment expenses and charges	5	(4,804)	(1,037)
Unrealised losses on investments	5	(1,042)	-
Allocated investment return transferred to the general business technical account	5	(10,994)	(6,717)
Other income		31	-
Other charges - expenses		(62)	(160)
Operating profit		15,178	12,489
Operating profit based on longer term investment return		20,012	13,637
Short term fluctuation in investment returns	5	(4,834)	(1,148)
Profit on ordinary activities before taxation		15,178	12,489
Taxation on profit on ordinary activities	6	(4,148)	(3,645)
Retained profit for the financial year	15	11,030	8,844

All activities derive from continuing operations. There are no recognised gains or losses or movements in shareholders' funds other than profit for the financial year. Accordingly, no statement of recognised gains and losses is given.
The movement in shareholder's funds is shown in note 15.

Balance Sheet at 31st December 2003

	Notes	2003 £ 000's	2002 £ 000's
Assets			
Investments			
Other financial investments	8	199,123	140,255
		<hr/>	<hr/>
		199,123	140,255
Reinsurers' share of technical provisions			
Provision for unearned premiums		32,785	3,289
Claims outstanding		37,761	19,300
		<hr/>	<hr/>
		70,546	22,589
Debtors			
Debtors arising out of direct insurance operations - intermediaries		47,873	23,579
Debtors arising out of reinsurance operations		12,097	84
Other debtors - amounts falling due within one year	9	18,301	20,179
Other debtors - amounts falling due after more than one year	10	7,813	10,773
		<hr/>	<hr/>
		86,084	54,615
Other assets			
Tangible assets	7	6,368	5,211
Cash at bank and in hand		35,212	1,188
		<hr/>	<hr/>
		41,580	6,399
Prepayments and accrued income			
Deferred acquisition costs		21,191	12,100
Other prepayments and accrued income		11,676	-
		<hr/>	<hr/>
		32,867	12,100
Total assets			
		<hr/>	<hr/>
		430,200	235,958
		<hr/>	<hr/>

Balance Sheet at 31st December 2003

	Notes	2003 £ 000's	2002 £ 000's
Liabilities			
Capital and reserves			
Called-up share capital	14	75,000	55,000
Profit and loss account	15	27,256	16,226
Equity shareholders funds	15	102,256	71,226
Technical provisions			
Provision for unearned premium		124,863	53,131
Claims outstanding		155,714	81,598
		280,577	134,729
Creditors			
Creditors arising out of direct insurance operations		8,942	10,012
Creditors arising out of reinsurance operations		8,126	2,040
Other creditors amounts falling due within one year	12	24,276	16,129
		41,344	28,181
Accruals and deferred income		6,023	1,822
Total liabilities		430,200	235,958

Approved by the board of directors and signed on its behalf on 24th March 2004 by:



A J Gibson
Director

Notes to the financial statements**1. Accounting policies****Accounting convention**

The audited financial statements have been prepared in accordance with the special provisions relating to insurance companies in Section 255A of, and Schedule 9A to, the Companies Act 1985. The recommendations of the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998 have been adopted.

Cash flow statement

In accordance with Financial Reporting Standard Number 1, Cash Flow Statements, the Company is not required to prepare a cash flow statement because more than 90% of the voting rights of the Company are held within the Group and the Group's consolidated financial statements are publicly available.

Premiums

Gross written premiums represent premiums on business incepting during the period together with adjustments to premiums written in previous periods.

The provision for unearned premiums represents that part of gross premiums written which is estimated to be earned after the balance sheet date.

Outward reinsurance premiums are accounted for in the same accounting period as the gross premiums to which they relate.

Claims

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

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

Technical provisions - claims outstanding

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

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

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

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

Unexpired risk provision

A provision for unexpired risks is made when it is anticipated that unearned premiums will be insufficient to meet future claims and claims settlement expenses of business in force at the end of the period.

The provision for unexpired risks is calculated after taking into account the relevant investment return.

Notes to the financial statements (continued)**Depreciation**

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

Computer software	10 years
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The computer and other equipment costs relate to the expenditure incurred in the development and implementation of the GIOS system, this system represents the core operating platform of the business going forward. The company holds a 10-year licence for the system which is expected to have a useful economic life of at least 10 years.

Acquisition costs

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

Investment return

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

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

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

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

Investments

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

Taxation

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

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 have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax.

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

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

Notes to the financial statements (continued)

2. Segmental analysis

The Company's business has all been underwritten in the EU which has been treated as one geographical segment. Segmental information in the format required by the Companies Act 1985, so far as available, is as follows:

	Gross premiums earned		Gross claims incurred	
	2003 £ 000's	2002 £ 000's	2003 £ 000's	2002 £ 000's
Motor - third party liability	79,096	49,105	61,870	43,315
Motor - other classes	101,363	33,398	85,748	29,641
Property	4	1,543	(1,856)	709
Total	180,463	84,046	145,762	73,665
	Net operating expenses		Reinsurance balance	
	2003 £ 000's	2002 £ 000's	2003 £ 000's	2002 £ 000's
Motor - third party liability	12,280	8,684	(434)	6,699
Motor - other classes	16,177	5,915	2,585	4,374
Property		560	(75)	(112)
Total	28,457	15,159	2,076	10,961

3. Directors and employees

The Company has no employees.

Directors fees were as follows:

Fees

2003	2002
£ 000's	£ 000's
52	73

The emoluments of the highest paid director were as follows:

Emoluments excluding pension contributions

£ 000's	£ 000's
20	20

4. Net operating expenses - technical account

	2003 £ 000's	2002 £ 000's
Acquisition costs	34,283	14,424
Movement in deferred acquisition costs	(11,993)	(2,981)
Administrative expenses	6,167	3,716
Total	28,457	15,159
	2003 £ 000's	2002 £ 000's
Operating profit is stated after charging the following items:		
Depreciation - after recharges to syndicates	1,684	286
Auditors' remuneration:		
Audit fees	45	46
Other services	-	45

Notes to the financial statements (continued)

5. Investment return

	2003 £ 000's	2002 £ 000's
Investment income	8,600	3,897
Realised gains on investments	107	578
Unrealised gains on investments	3,299	2,131
	<u>12,006</u>	<u>6,606</u>
Investment expenses and charges	(5,846)	(1,037)
Total investment return	<u>6,160</u>	<u>5,569</u>
	2003 £ 000's	2002 £ 000's
Underwriting investment income on a long term rate of return basis transferred to technical account	10,994	6,717
Short term fluctuation in investment returns	(4,834)	(1,148)
	<u>6,160</u>	<u>5,569</u>

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

6. Taxation on profit on ordinary activities

a) UK corporation tax:

	2003 £ 000's	2002 £ 000's
UK Corporation tax at 30% (2002- 30%):		
Current tax on profits for the year	(2,298)	(5,918)
Adjustments in respect of prior years	1,110	(8,500)
Total current tax charge	<u>(1,188)</u>	<u>(14,418)</u>
Deferred tax		
Current year	(2,269)	10,773
Adjustments in respect of prior years	(691)	-
Total deferred tax charge	<u>(2,960)</u>	<u>10,773</u>
Tax on profits on ordinary activities	<u>(4,148)</u>	<u>(3,645)</u>

b) Factors affecting tax charge for the current period:

	2003 £ 000's	2002 £ 000's
Profit on ordinary activities before tax	15,178	12,489
Current tax @30% (2002: 30%)	(4,553)	(3,747)
Effects of:		
Adjustments relating to disallowable expenses	(289)	(6)
Non-taxable income	-	23
Adjustment for disclaimer of reserves	2,544	(2,188)
Adjustments in respect of prior years	1,110	(8,500)
Total current tax charge	<u>(1,188)</u>	<u>(14,418)</u>

Notes to the financial statements (continued)

7. Tangible assets

	£ 000's
Company Cost	
At 1st January 2003	5,880
Additions	2,038
At 31st December 2003	<u>7,918</u>
Accumulated depreciation	
At 1st January 2003	669
Charge for the year	881
At 31st December 2003	<u>1,550</u>
Net book value	
At 31st December 2003	<u>6,368</u>
At 31st December 2002	5,211

8. Investments

	2003 £ 000's	2002 £ 000's
Shares and other variable-yield securities	39,478	-
Debt securities and other fixed income securities	77,946	61,631
Deposits with credit institutions	80,027	78,624
Other	1,672	-
	<u>199,123</u>	<u>140,255</u>
Listed investments at market value	88,387	61,631

9. Debtors - amounts falling due within one year

	2003 £ 000's	2002 £ 000's
Amounts due from group undertakings	15,988	-
Amounts due from syndicates	-	18,579
Amounts due from co-insurer	1,554	825
Tax recoverable	-	383
Other debtors	759	392
	<u>18,301</u>	<u>20,179</u>

10. Debtors - amounts falling due after more than one year

	2003 £ 000's	2002 £ 000's
Deferred tax	7,813	10,773
	<u>7,813</u>	<u>10,773</u>

11. Deferred tax asset

	2003 £ 000's	2002 £ 000's
Accelerated capital allowances	311	32
Trading losses available for carry forward	7,502	10,741
	<u>7,813</u>	<u>10,773</u>
		£ 000's
At 1 January 2003		10,773
Deferred tax credit in the profit and loss account		(2,960)
At 31 December 2003		<u>7,813</u>

The Company has no unprovided deferred tax liabilities

Notes to the financial statements (continued)

12. Creditors - amounts falling due within one year

	2003 £ 000's	2002 £ 000's
Insurance premium tax	3,123	1,449
Corporation tax	2,298	5,369
Amounts due to group undertakings	-	1,723
Amounts due to subsidiary undertakings	13,610	7,588
Amounts due to syndicates	4,689	-
Other creditors	556	-
	<u>24,276</u>	<u>16,129</u>

13. Claims outstanding

Included within claims incurred in the technical account is an amount of £4,560,000 (2002: £3,583,000) being the difference between the provision for claims outstanding at the beginning of the year less payments made during the year on account of claims incurred in previous years and the provision for claims outstanding at the end of the year for such claims.

14. Called-up share capital

	2003 £ 000's	2002 £ 000's
<i>Authorised:</i>		
Ordinary shares of £1 each	<u>75,000</u>	<u>75,000</u>
<i>Allotted, issued and fully paid:</i>		
Ordinary shares of £1 each		
At 1st January	55,000	45,000
On 16th July 2002	-	10,000
On 16th January 2003	<u>20,000</u>	-
At 31st December	<u>75,000</u>	<u>55,000</u>

15. Reconciliation of movements in shareholder's funds

	Share Capital £ 000's	Profit and loss account £ 000's	Total £ 000's
At 1st January 2003	55,000	16,226	71,226
Retained profit for the financial year	-	11,030	11,030
Issue of share capital	20,000	-	20,000
At 31st December 2003	<u>75,000</u>	<u>27,256</u>	<u>102,256</u>

16. Related party transactions

The Company has taken advantage of the exemption in Financial Reporting Standard 8(3) from disclosure of related party transactions with other entities included in the consolidated financial statements of Highway Insurance Holdings Plc.

17. Ultimate and immediate parent undertakings

The Company's immediate parent undertaking is Highway Group Services PLC.

The ultimate holding company, and the largest holding company for which group accounts are prepared, is Highway Insurance Holdings Plc, a company registered in England and Wales. Copies of that company's financial statements may be obtained from Highway House, 171 Kings Road, Brentwood, Essex CM14 4EJ.