

NORTHERN RAIL HOLDINGS LIMITED

Report and Financial Statements

7 January 2006



NORTHERN RAIL HOLDINGS LIMITED

REPORT AND FINANCIAL STATEMENTS 2006

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NORTHERN RAIL HOLDINGS LIMITED

REPORT AND FINANCIAL STATEMENTS 2006

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS

Nicholas Brown
Andrew Smith
Christiaan Smulders
Matthew Stevens
Antoine Valk
Peter van Toor

REGISTERED OFFICE

Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY

BANKERS

National Westminster Bank
Staines Branch
67 High Street
Staines
Middlesex
TW18 4PU

SOLICITORS

Denton Wilde Sapte
One Fleet Street
London
EC4M 7WS

AUDITORS

Deloitte & Touche LLP
Chartered Accountants
Leeds

NORTHERN RAIL HOLDINGS LIMITED

DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the 52 weeks ended 7 January 2006.

ACTIVITIES

The group's principal activity is the operation of passenger railway services in the North of England under a Franchise agreement awarded by the Strategic Rail Authority. This agreement transferred to the Department for Transport on 22 July 2005. All trading activities are conducted through Northern Rail Limited. Northern Rail Holdings Limited holds 100% of the share capital in this trading company.

REVIEW OF DEVELOPMENTS AND PROSPECTS

The directors believe the performance of the business in the period to be satisfactory and are confident about the future performance of the business.

RESULTS, DIVIDENDS AND TRANSFERS TO RESERVES

The group has adopted FRS 17 Retirement benefits with effect from 8 January 2005. The impact on the Consolidated Profit and Loss Account as a result of adopting FRS 17 in the 53 weeks ended 7 January 2005 was to decrease operating expenditure by £73,000, increase net finance income by £119,000 and increase the tax charge by £58,000.

The group made a profit after taxation of £19,869,000 (53 weeks ended 7 January 2005 (as restated): £380,000).

The directors recommend a final dividend of £16,600,000 (53 weeks ended 7 January 2005: £nil), which was paid on 14 December 2005, together with the interim dividend of £2,000,000 which was paid on 30 June 2005.

DIRECTORS AND THEIR INTERESTS

The directors who served during the period and up to the date of approval of these accounts were as follows:

Nicholas Brown (Appointed 13 December 2005)

Brian Burdsall (Resigned 13 December 2005)

Andrew Smith

Christiaan Smulders (The Netherlands)

Matthew Stevens

Antoine Valk (The Netherlands)

Peter van Toor (The Netherlands)

No directors had any beneficial interest in the issued share capital of the company during the period ended 7 January 2006.

EMPLOYEE INVOLVEMENT AND DISABLED EMPLOYEES

The group gives full and fair consideration to applications for employment from disabled people having regards to their particular aptitudes and abilities. Efforts are made to continue the employment of those who become disabled during their employment, and training, career development and promotion is, as far as possible, identical for all employees in accordance with their skills and abilities.

The group also has a policy of communicating and consulting with its managers and employees to ensure their active involvement.

CHARITABLE CONTRIBUTIONS

The group made charitable donations of £11,080 during the period (53 weeks ended 7 January 2005: £nil).

FINANCIAL INSTRUMENTS

The group operates passenger railway services in the UK and, as such, is exposed to movements in fuel prices and related exchange rates. To protect cash flows, the group enters into forward contracts, currently on a rolling 12 month basis, to hedge a proportion of its exposures to fuel price and related foreign exchange movements.

NORTHERN RAIL HOLDINGS LIMITED

DIRECTORS' REPORT

AUDITORS

A resolution for the reappointment of Deloitte & Touche LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board

A handwritten signature in black ink, appearing to be 'MS', enclosed within a circular loop.

Matthew Stevens

Director

19th September 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES

United Kingdom 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 group and company as at the end of the financial year 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;
- state whether applicable accounting standards have been followed; 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 are also responsible for the system of internal control, safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NORTHERN RAIL HOLDINGS LIMITED

We have audited the group and individual company financial statements (the "financial statements") of Northern Rail Holdings Limited for the 52 week period ended 7 January 2006 which comprise the consolidated profit and loss account, the consolidated and individual company balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses, and the related notes 1 to 28. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and 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 regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report for the above year and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the company and the group, 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, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the individual company's affairs as at 7 January 2006 and of the group's profit for the period then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985.

Deloitte + Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Leeds
31 October 2006

NORTHERN RAIL HOLDINGS LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

52 weeks ended 7 January 2006

		52 weeks ended 7 January 2006	53 weeks ended 7 January 2005 (as restated)
	Note	£'000	£'000
TURNOVER	2	467,606	34,986
Operating expenditure			
- Exceptional redundancy cost	3	(3,550)	(397)
- Other operating expenditure		(436,858)	(34,043)
Total operating expenditure	4	(440,408)	(34,440)
OPERATING PROFIT	4	27,198	546
Net finance income/(expense)	5	2,740	(3)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		29,938	543
Tax on profit on ordinary activities	7	(10,069)	(163)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION FOR THE FINANCIAL PERIOD		19,869	380
Dividends	8	(18,600)	-
RETAINED PROFIT FOR THE FINANCIAL PERIOD TRANSFERRED TO RESERVES	19	1,269	380

All amounts relate to continuing operations.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Note	52 weeks ended 7 January 2006	53 weeks ended 7 January 2005 (as restated)
Profit for the financial period		1,269	380
Actuarial gain/(loss) relating to pension scheme	22	13,698	(718)
UK deferred tax attributable to actuarial gain/(loss)		(4,109)	215
Total recognised gains and losses relating to the period		10,858	(123)
Prior period adjustment (as explained in note 25)		(369)	
Total gains and losses recognised since last financial statements		10,489	

NORTHERN RAIL HOLDINGS LIMITED

CONSOLIDATED BALANCE SHEET

As at 7 January 2006

	Note	7 January 2006 £'000	7 January 2005 (as restated) £'000
FIXED ASSETS			
Intangible assets	9	17,569	20,893
Tangible assets	10	3,293	2,162
Investments	12	-	-
		<u>20,862</u>	<u>23,055</u>
CURRENT ASSETS			
Stocks	13	3,137	3,168
Debtors	14	38,983	18,413
Cash at bank and in hand		<u>30,473</u>	<u>27,726</u>
		72,593	49,307
CREDITORS: amounts falling due within one year	16	<u>(74,719)</u>	<u>(42,990)</u>
NET CURRENT ASSETS		(2,126)	6,317
TOTAL ASSETS LESS CURRENT LIABILITIES		18,736	29,372
CREDITORS: amounts falling due after one year	17	<u>(294)</u>	<u>(12,020)</u>
NET ASSETS EXCLUDING PENSION LIABILITY		18,442	17,352
PENSION LIABILITY	22	<u>(7,707)</u>	<u>(17,475)</u>
NET ASSETS INCLUDING PENSION LIABILITY		<u>10,735</u>	<u>(123)</u>
CAPITAL AND RESERVES			
Called up share capital	18	-	-
Profit and loss account	19	<u>10,735</u>	<u>(123)</u>
TOTAL EQUITY SHAREHOLDERS' FUNDS	20	<u>10,735</u>	<u>(123)</u>

These financial statements were approved by the Board of Directors on 19th September 2006

Signed on behalf of the Board of Directors



Matthew Stevens

Director

NORTHERN RAIL HOLDINGS LIMITED

COMPANY BALANCE SHEET

As at 7 January 2006

	Note	7 January 2006 £	7 January 2005 £
FIXED ASSETS			
Investments	11	4	4
CREDITORS: amounts falling due within one year	16	(2)	(2)
NET CURRENT LIABILITIES		(2)	(2)
TOTAL ASSETS LESS CURRENT LIABILITIES		2	2
NET ASSETS		2	2
CAPITAL AND RESERVES			
Called up share capital	18	2	2
Profit and loss account	19	-	-
TOTAL EQUITY SHAREHOLDERS' FUNDS		2	2

These financial statements were approved by the Board of Directors on 19 September 2006.

Signed on behalf of the Board of Directors

Name

Director



NORTHERN RAIL HOLDINGS LIMITED

CONSOLIDATED CASH FLOW STATEMENT

52 weeks ended 7 January 2006

		52 weeks ended 7 January 2006	53 weeks ended 7 January 2005
	Note	£'000	£'000
Net cash inflow from operating activities	26	38,770	23,273
Returns on investments and servicing of finance			
Interest received		1,313	24
Interest paid		(701)	(8)
Net cash inflow from returns on investments and servicing of finance		612	16
Taxation			
UK Corporation tax paid		(4,487)	-
Capital expenditure			
Purchase of tangible fixed assets		(1,548)	(65)
Franchise bid costs		-	(3,712)
Net cash outflow for capital expenditure		(1,548)	(3,777)
Acquisitions			
Acquisition of franchise assets and liabilities		-	(3,909)
Net cash acquired		-	123
Net cash outflow for acquisitions		-	(3,786)
Equity dividends paid		(18,600)	-
Net cash inflow before financing		14,747	15,726
Financing			
New loan		-	12,000
Repayment of loan		(12,000)	-
Net cash (outflow)/inflow from financing		(12,000)	12,000
Increase in cash	27	2,747	27,726

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

1. ACCOUNTING POLICIES

The principal accounting policies are summarised below. They have been applied consistently throughout the current period and preceding period with the exception of the adoption of FRS 17 Retirement benefits, as explained in note 25.

Basis of accounting

The financial statements are prepared under the historical cost convention in accordance with applicable United Kingdom accounting standards.

Basis of consolidation

The group financial statements consolidate the financial statements of the company and its subsidiary undertakings drawn up to the accounting reference date. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

Turnover

Passenger income represents agreed amounts attributed to the company by the income allocation systems of the Railway Settlement Plan Limited, mainly in respect of passenger receipts. Grant income relates to rail support from the Strategic Rail Authority / Department for Transport in respect of passenger services and amounts received from Passenger Transport Executives. Grant income is recognised in the profit and loss account in the period to which it relates. Other income arises from the provision of ancillary services to external parties.

Intangible fixed assets

Franchise goodwill arises on transition of a rail franchise, representing the fair value of the proportion of the pension scheme deficit the company is expected to fund over the franchise term and any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired. Franchise goodwill is capitalised and written off on a straight line basis over the life of the franchise of 6 ¾ years. Franchise bid costs are capitalised and amortised over the life of the franchise of 6 ¾ years. Provision is made for any impairment.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment.

Depreciation is provided to write off the cost less residual value of tangible fixed assets on a straight line basis over their useful economic lives or the franchise period of 6¾ years as appropriate.

The useful economic lives are as follows:

Buildings	10 - 20 years
Plant and machinery, motor vehicles and fixtures and fittings	5 - 10 years
Computer and IT equipment	3 years

Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on 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 tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

1. ACCOUNTING POLICIES (continued)

Taxation (continued)

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Leases

Operating lease rentals are charged to the profit and loss account in equal annual amounts over the lease term.

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost is purchase cost on an average cost basis. Net realisable value is the value at which the stock can be realised in the normal course of business. Provision is made for slow moving and obsolete items.

Change in accounting policy for pension costs

The group has adopted FRS 17 Retirement benefits in these financial statements with effect from 8 January 2005. The adoption of this standard represents a change in accounting policy and the comparative figures have been restated to remove the pension costs under SSAP 24, as previously reported, and to include the cost and pension liability under FRS 17 and related intangible asset. Details of the effect of adopting FRS 17 are given in the related prior year adjustment note 25.

The Railways Pension Scheme provides pension benefits to the substantial majority of current employees on a defined benefit basis. The group's main obligation in respect of the Railway Pension Scheme is to pay contributions as agreed with the scheme actuary and trustees over the franchise term.

The deficit reflected in the balance sheet reflects only that portion of the deficit that is expected to be funded over the franchise term, net of deferred tax. A "franchise adjustment" is made to the deficit on this basis. The franchise adjustment is the projected deficit at the end of the franchise term which the group will not be required to fund, discounted back to present value. On transition of a rail franchise an intangible asset is recognised, which exactly offsets the initial recognition of the portion of the deficit the group is expected to fund, net of deferred tax. This intangible asset is subsequently amortised on a straight line basis over the franchise term.

The current service cost is charged to operating profit. The finance cost of liabilities and expected return on assets are shown as a net amount of other finance charges or credits on the face of the Consolidated Profit and Loss account. The service cost is included as part of staff costs in note 6. The actuarial gain/loss is charged through the Consolidated Statement of Total Recognised Gains and Losses.

The pension scheme assets are measured using fair values whilst the pension scheme liabilities are measured using a projected unit method and discounted using an appropriate discount rate.

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

2. TURNOVER

The group has one principal class of business being the operation of passenger railway services.

Turnover is analysed as follows:

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Passenger income	129,126	7,535
Grant	297,110	24,958
Other	41,370	2,493
	<u>467,606</u>	<u>34,986</u>

3. EXCEPTIONAL COSTS

Exceptional redundancy costs of £3,550,000 (2005: £397,000) were incurred by the group's trading entity, Northern Rail Limited, as a result of restructuring necessary when the Northern Rail Franchise was acquired.

4. OPERATING PROFIT

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Operating profit is stated after charging/(crediting):		
Depreciation of tangible fixed assets	417	35
Amortisation of intangible fixed assets	3,324	-
Auditors' remuneration		
- audit fees	63	55
- tax services	10	-
- other	31	-
Rental income receivable	(748)	(66)
Access and related charges payable to Network Rail	78,056	8,825
Operating lease rentals payable		
- Rolling Stock	33,355	2,561
- Property leases	25,980	1,968
- Other	209	28
	<u></u>	<u></u>
Analysis of operating expenditure in the period:		
Raw Materials and Consumables	34,983	2,232
Staff Costs:		
- Wages and Salaries	122,344	9,562
- Social Security Costs	9,359	711
- Other pension costs	12,667	570
Other external Charges	253,764	20,933
Depreciation and other amounts written off tangible and intangible fixed assets	3,741	35
Exceptional redundancy	3,550	397
	<u>440,408</u>	<u>34,440</u>

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

5. NET FINANCE INCOME/ (EXPENSE)

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Interest payable and similar charges	(650)	(146)
Less: interest receivable and similar income	1,313	24
Net return on pension scheme (see note 22)	2,077	119
	<u>2,740</u>	<u>(3)</u>
<i>Interest payable and similar charges:</i>		
Interest payable to joint venture partners	560	139
Bond costs	90	7
	<u>650</u>	<u>146</u>

6. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Directors' remuneration		
Total directors emoluments for the period (excluding pension)	-	11
Total directors pension contribution	-	1
	<u>-</u>	<u>12</u>
	Number	Number
Number of directors who are members of a defined benefit scheme	<u>2</u>	<u>2</u>
	Number	Number
Average number of persons employed (including directors)		
Operational	3,442	264
Engineering and maintenance	729	56
Administration and support	405	30
	<u>4,576</u>	<u>350</u>

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

6. INFORMATION REGARDING DIRECTORS AND EMPLOYEES (continued)

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Staff costs during the period (including directors)		
Wages and salaries	122,344	9,562
Social security costs	9,359	711
Pension costs	12,790	819
	<u>144,493</u>	<u>11,092</u>

Antoine Valk was remunerated through NedRailways BV. Peter van Toor and Christiaan Smulders were remunerated through NS Groep NV. Brian Burdsall, Nicholas Brown, Andrew Smith and Matthew Stevens were remunerated through Serco Limited. It is not practicable to ascertain what proportion of their emoluments relates to the group.

7. TAX ON PROFIT ON ORDINARY ACTIVITIES

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
The tax charge comprises:		
Current tax		
United Kingdom corporation tax	10,190	73
Adjustment in respect of prior periods	94	-
Total current tax	<u>10,284</u>	<u>73</u>
Deferred tax charge		
Origination and reversal of timing differences	(241)	-
Movement in pension provision	77	90
Adjustment in respect of prior periods	(51)	-
Total deferred tax charge	<u>(215)</u>	<u>90</u>
Total tax charge on profit on ordinary activities	<u>10,069</u>	<u>163</u>

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

7. TAX ON PROFIT ON ORDINARY ACTIVITIES (continued)

The differences between the total current tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Profit on ordinary activities before tax	29,938	543
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (53 weeks ended 7 January 2005: 30%)	8,981	163
Effects of:		
Expenses not deductible for tax purposes	968	(90)
Capital allowances in excess of depreciation	(66)	-
Movement in short term timing differences	307	-
Adjustment in respect of prior periods	94	-
Current tax charge for the period	10,284	73

8. DIVIDENDS

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Paid - £9,300 per ordinary share (53 weeks ended 7 January 2005: £nil per ordinary share)	18,600	-

The directors recommended a final dividend of £16,600,000 (53 weeks ended 7 January 2005: £nil), which was paid on 14 December 2005, together with the interim dividend of £2,000,000 which was paid on 30 June 2005.

NOTES TO THE FINANCIAL STATEMENTS
52 weeks ended 7 January 2006

9. INTANGIBLE FIXED ASSETS

Group	Franchise bid costs £'000	Franchise Goodwill (as restated) £'000	Total £'000
Cost			
At 8 January 2005 and 7 January 2006	3,712	17,181	20,893
Amortisation			
At 8 January 2005	-	-	-
Charge for the period	591	2,733	3,324
At 7 January 2006	591	2,733	3,324
Net book value			
At 7 January 2006	3,121	14,448	17,569
At 7 January 2005	3,712	17,181	20,893

10. TANGIBLE FIXED ASSETS

Group	Short leasehold buildings £'000	Plant and machinery £'000	Assets under construction £'000	Total £'000
Cost				
At 8 January 2005	1,012	1,053	132	2,197
Additions	-	315	1,233	1,548
Transfer	-	132	(132)	-
At 7 January 2006	1,012	1,500	1,233	3,745
Accumulated depreciation				
At 8 January 2005	11	24	-	35
Charge for the period	136	281	-	417
At 7 January 2006	147	305	-	452
Net book value				
At 7 January 2006	865	1,195	1,233	3,293
At 7 January 2005	1,001	1,029	132	2,162

Assets under construction relate to various ongoing station and other capital improvement projects.

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

11. INVESTMENTS IN SUBSIDIARY UNDERTAKING

Cost	£
Shares in subsidiary undertaking:	
At 8 January 2005 and 7 January 2006	<u>4</u>

The parent company's wholly owned subsidiary undertaking, Northern Rail Limited, a company incorporated in England, operates passenger railway services.

12. INVESTMENTS HELD AS FIXED ASSETS

One share in each of the following companies is held by the group and were all acquired for nil consideration.

	Number of shares
ATOC Limited (4p share)	1
Rail Staff Travel Limited (4p share)	1
Rail Settlement Plan Limited (4p share)	1
NRES Limited (£1 share)	1

ATOC Limited is the contracting arm of ATOC, the Association of Train Operating Companies. Rail Settlement Plan Limited operates the income allocation and settlement routines on behalf of ATOC. Rail Staff Travel Limited manages staff travel arrangements in the industry on behalf of ATOC. NRES Limited provides rail related information to the public.

13. STOCKS

	Group	
	2006	2005
	£'000	£'000
Raw materials and consumables	<u>3,137</u>	<u>3,168</u>

14. DEBTORS

	Group	
	2006	2005
	£'000	£'000
Trade debtors	14,660	9,377
Other debtors	10,703	3,780
Prepayments and accrued income	13,328	5,256
Deferred taxation (see note 15)	292	-
Called up share capital not paid	-	-
	<u>38,983</u>	<u>18,413</u>

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

15. DEFERRED TAXATION

The amounts of deferred tax asset recognised are as follows:

	Group £'000
At 8 January 2005	-
Credit to the profit and loss account	292
	<hr/>
At 7 January 2006	292
	<hr/> <hr/>

The analysis of the deferred tax asset is as follows :

	2006 £'000	2005 £'000
Capital allowances in excess of depreciation	(54)	-
Short term timing differences	346	-
	<hr/>	<hr/>
	292	-
	<hr/> <hr/>	<hr/> <hr/>

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group 2006 £'000	2005 £'000	Company 2006 £	2005 £
Trade creditors	30,381	19,780	-	-
Amounts owed to group undertakings	-	3,712	2	2
Corporation tax	5,870	73	-	-
Other creditors	4,419	2,113	-	-
Taxation and social security	6,307	2,843	-	-
Accruals and deferred income	27,742	14,469	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
	74,719	42,990	2	2
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group 2006 £'000	2005 £'000
Amounts owed to group undertakings	-	12,000
Grants not yet credited to the profit and loss account	274	-
Other Creditors	20	20
	<hr/>	<hr/>
	294	12,020
	<hr/> <hr/>	<hr/> <hr/>
Amounts owed to group undertakings are repayable as follows:		
- between one and two years	-	-
- between two and five years	-	12,000
	<hr/>	<hr/>
	-	12,000
	<hr/> <hr/>	<hr/> <hr/>

The £12m loan consisted of £6m owed to NV Nederlandse Spoorwegen and a further £6m owed to Serco Group plc. Each loan agreement is a short term single currency (sterling) term loan facility. Both loans were repaid during the year. The ownership structure of Northern Rail Holdings Limited is shown in note 28.

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

18. CALLED UP SHARE CAPITAL

	2006 £	2005 £
Authorised:		
50 'A' ordinary shares of £1 each	50	50
50 'B' ordinary shares of £1 each	50	50
	<hr/>	<hr/>
Called up, allotted and unpaid:		
1 'A' ordinary shares of £1 each	1	1
1 'B' ordinary shares of £1 each	1	1
	<hr/>	<hr/>
	2	2
	<hr/>	<hr/>

'A' ordinary shares of £1 each and 'B' ordinary shares of £1 each carry equal voting rights and rank pari passu in all respects.

19. RESERVES

	Group profit and loss account £'000	Company profit and loss account £
At 8 January 2005	246	-
Prior period adjustment (see note 25)	(369)	-
	<hr/>	<hr/>
At 8 January 2005 as restated	(123)	-
Retained profit for the financial period	1,269	-
Amount relating to defined benefit pension scheme liability, net of related deferred tax	9,589	-
	<hr/>	<hr/>
At 7 January 2006	10,735	-
	<hr/>	<hr/>

The profit for the financial period of the parent company was £18,600,000 (2005: £nil). The company has taken advantage of Section 230 of the Companies Act 1985 not to present its own profit and loss account.

20. RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS' FUNDS

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Profit for the financial period	19,869	380
Other recognised gains and losses (net)	9,589	(503)
Dividends	(18,600)	-
	<hr/>	<hr/>
Net increase/(reduction) in shareholders' funds	10,858	(123)
Opening equity shareholders' funds as previously stated	246	-
Prior period adjustment	(369)	-
	<hr/>	<hr/>
Closing equity shareholders' funds	10,735	(123)
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

21. CONTINGENT LIABILITIES

The group's trading entity, Northern Rail Limited, as the Northern franchise holder, has procured two performance bonds in favour of the Strategic Rail Authority. These bonds took effect from 18 October 2004 for the franchise term and for a period of 7 reporting periods after the end of the franchise.

The initial expiry date of the franchise is 18 September 2011. However, this can be extended subject to meeting certain performance criteria to 15 September 2013. The performance bond amount as at 7 January 2006 was £13,483,634 (2005: £5,769,932).

In addition, Northern Rail Limited, as the Northern franchise holder, has procured two season ticket bonds in favour of the Strategic Rail Authority. The bonds are dated 3 December 2004 and take effect from the franchise commencement date of 12 December 2004. The total season ticket bond value as at 7 January 2006 was £1,527,610 (2005: £1,290,172).

22. PENSION LIABILITY

The group's trading entity, Northern Rail Limited, operates two sections of the Railways Pension Scheme ("the RPS"). This provides benefits for employees based on final pensionable pay. The members are expected to meet 40% of the cost of the emerging benefits. One section of the Railways Pension scheme relates to the Eastern division (ex Arriva Trains Northern Limited), and the other section relates to the Western division (ex North Western Trains Company Limited). The two sections are described separately below.

The group's main obligation in respect of the two sections of the RPS is to pay contributions as agreed with the scheme actuary and trustees.

The deficit reflected in the consolidated balance sheet reflects only that portion of the deficit that is expected to be funded over the franchise term, net of deferred tax. A "franchise adjustment" is made to the deficit on this basis. The franchise adjustment is the projected deficit at the end of the franchise term which the group will not be required to fund, discounted back to present value. On transition of a rail franchise, an intangible asset is recognised, which exactly offsets the initial recognition of the portion of the deficit the group is expected to fund, net of deferred tax. This intangible asset is subsequently amortised on a straight line basis over the franchise term.

Combined Divisions

The most recent full actuarial valuation of both sections was at 31 December 2004. This was updated to 7 January 2006 by Mercer Human Resources. The following assumptions have been used for both divisions:

	7 January 2006	7 January 2005	12 December 2004
Discount rate	4.80%	5.25%	5.25%
Rate of increase in salaries	4.20%	4.20%	4.20%
Rate of increase in deferred pensions	2.70%	2.75%	2.75%
Rate of increase in pensions in payment	2.70%	2.75%	2.75%
Inflation assumption	2.70%	2.75%	2.75%

The assets in the scheme and the expected rates of return have been calculated separately for each division.

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

22. PENSION LIABILITY (continued)

The assets in the scheme and the expected rates of return were:

Eastern Division:

	Expected rate of return at 7 January 2006	7 January 2006 £'000	Expected rate of return at 7 January 2005	7 January 2005 £'000	Expected rate of return at 12 December 2004	12 December 2004 £'000
Equities	7.	127,300	8.0%	103,900	8.0%	102,000
Bonds	4.	26,100	5.0%	21,300	5.0%	21,000
Property	5.	24,000	6.5%	19,600	6.5%	21,700
Total market value of assets		177,400		144,800		144,700
Present value of scheme liabilities		(222,100)		(176,100)		(175,400)
Deficit in the scheme		(44,700)		(31,300)		(30,700)
Members' share of deficit		16,820		10,800		10,593
Franchise adjustment		20,169		4,136		3,122
Group's share of deficit		(7,711)		(16,364)		(16,985)
Related deferred tax asset		2,313		4,909		5,096
Net pension liability		(5,398)		(11,455)		(11,889)

Western Division:

	Expected rate of return at 7 January 2006	7 January 2006 £'000	Expected rate of return at 7 January 2005	7 January 2005 £'000	Expected rate of return at 12 December 2004	12 December 2004 £'000
Equities	7.	121,700	8.0%	98,800	8.0%	97,100
Bonds	4.	15,400	5.0%	12,700	5.0%	12,500
Property	5.	21,550	6.5%	17,700	6.5%	20,400
Total market value of assets		158,650		129,200		130,000
Present value of scheme liabilities		(173,800)		(143,500)		(142,600)
Deficit in the scheme		(15,150)		(14,300)		(12,600)
Members' share of deficit		6,060		5,700		5,040
Franchise adjustment		5,791		-		-
Group's share of deficit		(3,299)		(8,600)		(7,560)
Related deferred tax asset		990		2,580		2,268
Net pension liability		(2,309)		(6,020)		(5,292)

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS 52 weeks ended 7 January 2006

22. PENSION LIABILITY (continued)

AMOUNTS INCLUDED WITHIN OPERATING PROFIT

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Combined divisions		
Current service cost	12,667	570
Total included within operating profit	<u>12,667</u>	<u>570</u>

AMOUNTS INCLUDED IN NET FINANCE INCOME

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Combined divisions		
Expected return on scheme assets	12,160	633
Interest cost on scheme liabilities	(10,300)	(522)
Interest on franchise adjustment	217	8
Net finance return	<u>2,077</u>	<u>119</u>

ANALYSIS OF AMOUNT RECOGNISED IN CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Combined divisions		
Actual return less expected return on assets	24,464	(1,317)
Experience gains and losses on liabilities	(32,373)	(407)
Experience gains and losses on franchise adjustment	21,607	1,006
Actuarial gain/(loss) recognised	<u>13,698</u>	<u>(718)</u>

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

22. PENSION LIABILITY (continued)

HISTORY OF THE EXPERIENCE GAINS AND LOSSES RECOGNISED IN CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Combined divisions		
Difference between expected and actual returns on scheme assets	24,464	(1,317)
Percentage of scheme assets	7%	0%
Experience gains and losses on scheme liabilities	(32,373)	(407)
Percentage of scheme liabilities	8%	1%
Total actuarial gain or loss recognised in the consolidated statement of total recognised gains and losses excluding experience gains and losses on franchise adjustment	(7,909)	(1,724)
Percentage of scheme liabilities	2%	1%
Total amount recognised in consolidated statement of total recognised gains and losses including experience gains and losses on franchise adjustment	13,698	(718)

ANALYSIS OF THE MOVEMENT IN THE SCHEME DEFICIT DURING THE PERIOD

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Combined divisions		
Opening share of deficit	(24,964)	(24,545)
Current service cost	(12,667)	(570)
Contributions	9,928	750
Additional contributions - brass matching	918	-
Other finance income/(costs)	2,077	119
Actuarial gains	13,698	(718)
Closing share of deficit	(11,010)	(24,964)
Related deferred tax asset	3,303	7,489
	<u>(7,707)</u>	<u>(17,475)</u>

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

23. OPERATING LEASE COMMITMENTS

On 4 February 2005, the group signed an agreement with Network Rail Infrastructure Ltd for access to the railway infrastructure. The agreement, which consists of fixed and variable charges, expires in 2009. The variable charges cover track usage, traction, and are primarily depending on train miles run.

The company has contracts which commit it to lease rolling stock from Angel Trains Contracts Limited, First/Keolis Transpennine Limited and Porterbrook Leasing Company Limited.

At 7 January 2006 the company was committed to making the following payments during the next year in respect of operating leases:

	Property £'000	Rolling stock £'000	Other £'000
Leases which expire:			
Within one year	317	1,157	110
Within two to five years	35	-	151
After five years	26,239	32,198	48
	<u>26,591</u>	<u>33,355</u>	<u>309</u>

24. RELATED PARTY TRANSACTIONS

The group's related parties, as defined by Financial Reporting Standard 8, the nature of the relationship and the effect of the transactions with them are summarised below:

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Mobilisation costs	-	1,859
Executive salaries and expense recharges	5,098	3
Loan	6,000	(6,000)
Interest	277	69
	<u> </u>	<u> </u>

All of the above expenses were payable to Serco Group plc and its subsidiaries which are related parties by virtue of Serco Group plc owning 50% of the issued share capital of the company. At 7 January 2006, amounts due to Serco Group plc amounted to £41,000 (2005: £7,931,000).

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Mobilisation costs	-	1,853
Executive salaries and expense recharges	287	-
Loan	6,000	(6,000)
Interest	277	69
	<u> </u>	<u> </u>

All of the above expenses were payable to NV Nederlandse Spoorwegen and its subsidiaries which are related parties by virtue of NV Nederlandse Spoorwegen owning 50% of the issued share capital of the company. At 7 January 2006, amounts due to NV Nederlandse Spoorwegen amounted to £63,000 (2005: £7,922,000).

NOTES TO THE FINANCIAL STATEMENTS
52 weeks ended 7 January 2006

25. PRIOR PERIOD ADJUSTMENT

The group has adopted FRS 17 Retirement benefits with effect from 8 January 2005, as highlighted in the accounting policies. As a result, the 7 January 2005 Consolidated Balance Sheet has been restated as follows:

	Intangible assets £'000	Pension liability £'000	Equity shareholders funds £'000
8 January 2005 as previously reported	11,979	(8,192)	246
Adoption of FRS 17	8,914	(9,283)	(369)
8 January 2005 restated	<u>20,893</u>	<u>(17,475)</u>	<u>(123)</u>

The impact on the Consolidated Profit and Loss Account as a result of adopting FRS 17 in the 53 weeks ended 7 January 2005 was to decrease operating expenditure by £73,000, increase net finance income by £119,000 and increase the tax charge by £58,000.

The estimated impact in the 52 weeks ended 7 January 2006 of adopting FRS 17 was to increase net finance income by £2,908,000, increase operating expenditure by £287,000 and increase the tax charge by £77,000.

26. RECONCILIATION OF OPERATING PROFIT TO OPERATING CASH FLOWS

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 (as restated) £'000
Operating profit	27,198	546
Depreciation of tangible fixed assets	417	35
Amortisation of intangible fixed assets	3,324	-
Decrease in stocks	31	26
Increase in debtors	(20,278)	(17,453)
Increase in creditors	26,257	40,299
Adjustment for pension funding	1,821	(180)
Net cash inflow from operating activities	<u>38,770</u>	<u>23,273</u>

27. ANALYSIS AND RECONCILIATION OF NET FUNDS

	At 8 January 2005 £'000	Cash flows £'000	Non-cash flows £'000	At 7 January 2006 £'000
Cash in hand, at bank	27,726	2,747	-	30,473
Debts due after one year	(12,000)	12,000	-	-
Net funds	<u>15,726</u>	<u>14,747</u>	<u>-</u>	<u>30,473</u>

NORTHERN RAIL HOLDINGS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

52 weeks ended 7 January 2006

27. ANALYSIS AND RECONCILIATION OF NET FUNDS (continued)

	52 weeks ended 7 January 2006 £'000	53 weeks ended 7 January 2005 £'000
Increase in cash in the period	2,747	27,726
Cash outflow/(inflow) from decrease/(increase) in debt	12,000	(12,000)
Change in net funds resulting from cash flows	14,747	15,726
Net funds at 7 January 2005	15,726	-
Net funds at 7 January 2006	30,473	15,726

28. ULTIMATE CONTROLLING PARTIES

The ultimate controlling parties of Northern Rail Holdings Limited are NV Nederlandse Spoorwegen and Serco Group plc. Copies of the financial statements of NV Nederlandse Spoorwegen are available from Laan Van Puntenburg 100, 3511 ER, Utrecht, Netherlands. Copies of the financial statements of Serco Group plc are available from Dolphin House, Windmill Road, Sunbury-on-Thames, Middlesex, TW16 7HT.