Preferred Group Limited

Report and Financial Statements

30 November 2006

Registered No 4192432

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COMPANIES HOUSE

Registered No 4192432

Directors
R Taylor
P Chambers
A Mehr
L Weir
S Staid
A Attia

Secretary
Clifford Chance Secretaries (CCA) Limited
10 Upper Bank Street
London E14 5JJ

Auditors
Ernst & Young LLP
1 More London Place
London SE1 2AF

Bankers
Barclays Bank plc
54 Lombard Street
London EC3V 9EX

Registered Office
First Floor
No 6 Broadgate
London
EC2M 2QS

Directors' report

The directors present their report and financial statements for the year ended 30 November 2006

Principal activities

The Company acts as an investment holding company This activity commenced with the acquisition of Preferred Mortgages Limited on 25 May 2001, of which it owns the entire issued share capital The principal activity of Preferred Mortgages Limited is the provision of loans secured on properties in the United Kingdom

Business review

The Company has not traded during the year In the year ended 30 November 2006 the Company's expenses were paid by a subsidiary company, Preferred Mortgages Limited

The Company received dividends of £25,000,000 from Preferred Mortgages Limited on 27 November 2006

Events after balance sheet date

On 2 April 2008, the mortgage lending business of the Company's subsidiary, Preferred Mortgage Limited, announced a suspension in their mortgage origination activities

It is not possible to quantify the financial impact on the Company at this stage

Results

The results for the year are shown in the profit and loss account on page 7

Directors

The directors who held office during the year, or after the year end, were as follows

J Webster (resigned 15 December 2005)
A Attia (resigned 18 May 2006 and reappointed 17 March 2008)
W Bilsborough (resigned 27 March 2008)
D Gibb (appointed 17 May 2006 and resigned 25 July 2007)
W Hinshelwood (appointed 17 May 2006 and resigned 17 March 2008)
N Ingram (resigned 27 April 2007)
C Rupp (appointed 9 February 2006 and resigned 17 March 2008)
R Taylor
P Chambers (appointed 25 July 2007)
A Mehr (appointed 17 March 2008)
L Weir (appointed 17 March 2008)
S Staid (appointed 17 March 2008)

Dividend

The directors have declared a dividend of £25,000,000 for the year (2005 – £nil)

Going concern

The directors believe that the Company is a going concern and accordingly have prepared the financial statements on this basis

Directors' report

Policy and practice on payment of creditors

The Company does not follow any stated code on payment practice It is the Company's policy to agree terms of payment with suppliers when agreeing the terms of each transaction and to abide by those terms Standard terms provide for payment of all invoices within 30 days after the date of the invoice, except where different terms have been agreed with supplier at the outset It is the policy of the Company to abide by the agreed terms of payment There are no creditor days of suppliers' invoices outstanding at the year-end (2005 – nil days)

Principal risks and uncertainties

Financial instrument risks

The financial instruments held by the Company comprise borrowings, cash and various other items (such as trade debtors, trade creditors, etc) that arise directly from its operations

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken

The main risks arising from the Company's financial instruments are credit risk, interest rate risk and liquidity risk The directors review and agree policies for managing each of these risks and they are summarised below

Credit risk

Credit risk is the risk that borrowers will not be able to meet their obligations as they fall due All loan facilities provided to group companies during the year by the Company were secured on the relevant Company's assets The ongoing credit risk of these loans is closely monitored by the directors

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under different bases or which reset at different times The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar Where this is not possible the Company considers the use of derivative financial instruments to mitigate any residual interest rate risk

Liquidity risk

Liquidity risk is the risk that investment income receivable by the Company will not arise on a timely manner to meet the Company's obligations as they fall due The ongoing liquidity risk is closely monitored by the directors

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware Having made enquiries of fellow directors and the group's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the next Annual General Meeting

On behalf of the Board

Director
Date 12/04/08

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK 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 that 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 safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

ERNST & YOUNG

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Independent auditors' report

to the members of Preferred Group Limited

We have audited the Company's financial statements for the year ended 30 November 2006 which comprise the Profit and Loss Account, Balance Sheet and the related notes 1 to 11 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 United Kingdom law and 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 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 and are properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements

In addition we report to you if, in our opinion, 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 and consider the implications for our report if we become aware of any apparent misstatements within it

Basis of audit 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 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

INVESTOR IN PEOPLE

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited A list of members' names is available for inspection at 1 More London Place London SE1 2AF the firm s principal place of business and registered office

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 Company's affairs as at 30 November 2006 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London
Date 21 April 2008

Profit and loss account

for the year ended 30 November 2006

	Notes	2006 £000	2005 £000
Other operating income – dividends receivable		25,000	–
Operating expenses		–	–
Profit on operating activities before interest		25,000	–
Interest payable and similar charges		–	–
Profit on ordinary activities before taxation		25,000	–
Taxation	2	–	–
Profit on ordinary activities after taxation	9	25,000	–

All of the activities are continuing activities and there are no other gains or losses recognised in the current financial statements other than those stated in the profit and loss account

The notes on pages 9 to 13 form part of these financial statements

Balance sheet

at 30 November 2006

	Notes	2006 £'000	2005 £'000
Fixed assets			
Fixed asset investments	4	15,704	15,704
Current assets			
Debtors receivable within one year	5	34,323	9,323
Total current assets		34,323	9,323
Creditors. amounts falling due within one year	6	(25,373)	(373)
Net current assets		8,950	8,950
Total assets less current liabilities		24,654	24,654
Creditors amounts falling due after more than one year	7	(24,287)	(24,287)
		367	367
Capital and reserves			
Called up share capital	8	–	–
Profit and loss account	9	367	367
Total equity shareholders' funds		367	367

The notes on pages 9 to 13 form part of these financial statements

These financial statements were approved by the Board of Directors and signed on its behalf by

Director

Date 18/04/08

Notes to the financial statements

at 30 November 2006

1. Accounting policies

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

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and have been drawn upon the historical cost convention The financial statements have been prepared on a going concern basis

Fixed asset investments

Investments in subsidiary undertakings are stated at cost less any provision for permanent diminution in value

Taxation

The charge for taxation is based on the profit 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 transaction 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 the directors consider it is more likely than not that there will be suitable taxable profits from which the reversal of the underlying timing differences can be deducted Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Cash flow statement

Under Financial Reporting Standard No 1 (Revised) the Company is exempt from the requirement to prepare a cash flow statement on the grounds that the parent undertaking includes the Company in its own consolidated financial statements, which are publicly available

Group accounts

The Company has taken advantage of the exemption from preparing consolidated financial statements afforded by section 228 of the Companies Act 1985

Notes to the financial statements

at 30 November 2006

2. Tax on profit on ordinary activities

(a) Analysis of tax charge in the period

	Year ended 30 November 2006 £ 000	*Year ended 30 November 2005 £ 000*
Current tax		
UK corporation tax on profits in the period	–	–
Total current tax (note 2 (b))	–	–

(b) Factors affecting the tax charge in the period

The tax assessed for the period is lower than the Standard rate for Current Corporation tax in the UK of 30% (2005 30%) The factors affecting the tax charge are explained below

	Year ended 30 November 2006 £ 000	*Year ended 30 November 2005 £ 000*
Profit on ordinary activities before tax	25,000	–
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2005 30%)	7,500	–
Effects of		
UK dividends received non-taxable	(7,500)	
	–	–

There is a deferred tax asset of £11,851 (2005 £11,851) arising from losses brought forward From 1 April 2008 the Standard rate of corporation tax in the UK will decrease to 28% The impact of this would be for the deferred tax to decrease by £790 to £11,061 Due to the uncertainty of when this asset will reverse, this asset has not been recognised

3. Directors and employees

The Company has no employees (2005 none) The directors received no remuneration from the Company during the year (2005 nil)

Notes to the financial statements

at 30 November 2006

4. Fixed asset investments

	2006	*2005*
	£000	*£000*
Investment in subsidiary	15,704	15,704

Details of investments in which the company holds 20% or more of the nominal value of any class of share capital are as follows

Subsidiary undertakings	*Country of incorporation*	*Principal Activity*	*Class*	*Class and percentage of ordinary shares held*
Preferred Mortgages Limited	England and Wales	Provision of loans secured on properties	Ordinary £1	100%
Preferred Funding Three Limited*	England and Wales	Investment company	Ordinary £1	100%
Preferred Funding Five Limited*	England and Wales	Investment company	Ordinary £1	100%
Preferred Mortgages Residuals One Limited*	England and Wales	Investment company	Ordinary £1	100%
Preferred Mortgages Residuals 2 Limited*	England and Wales	Investment company	Ordinary £1	100%
Mortgage Funding II Limited*	England and Wales	Dormant	Ordinary £1	100%
Yellow Brick Road Direct Mortgages Limited*	England and Wales	Dormant	Ordinary £1	100%
Preferred Home Loans Limited*	England and Wales	Dormant	Ordinary £1	100%

*held indirectly

5. Debtors: amounts falling due within one year

		2006	*2005*
		£000	*£000*
Amounts owed by other group companies	- Dividend	28,443	3,443
	- Other	5,880	5,880
		34,323	9,323

6 Creditors. amounts falling due within one year

		2006	*2005*
		£000	*£000*
Amounts owed by other group companies	- Dividend	25,000	–
	- Other	368	368
Accruals		5	5
		25,373	373

Notes to the financial statements

at 30 November 2006

7. Creditors: amounts falling due after more than one year

	2006	*2005*
	£000	*£000*
Parent company loan	24,287	24,287

8. Called up share capital

	2006	*2005*
	£	*£*
Authorised		
1,000 ordinary shares of £1 each	1,000	1,000
Allotted, called up and fully paid		
1 ordinary share of £1	1	1

The initial share capital of the Company of 1 ordinary share was issued on 2 April 2001

Each ordinary share carries the right to one vote at general meetings of the Company and ranks pari passu for all other purposes regardless of the price they were issued

9. Profit and loss account

	2006	*2005*
	£000	*£000*
Profit and loss account at 30 November	367	367
Retained profit for the year	25,000	–
Dividends declared	(25,000)	–
Profit and loss account at 30 November	367	367

10. Post balance sheet events

On 2 April 2008, the mortgage lending business of the Company's subsidiary, Preferred Mortgage Limited, announced a suspension in their mortgage origination activities.

It is not possible to quantify the financial impact on the Company at this stage

Notes to the financial statements

at 30 November 2006

11. Control

The Company is controlled by its parent undertaking Preferred Holdings Limited, which is registered and operates in the United Kingdom

The ultimate parent company of Preferred Holdings Limited is Lehman Brothers Holdings Inc which is incorporated in the state of Delaware in the United States of America

The Company has taken advantage of the exemption in paragraph 3(c) of Financial Reporting Standard 8 from disclosing transactions with related parties that are part of Lehman Brothers Holdings Inc

The largest Group in which the results of the Company are consolidated is that headed by Lehman Brothers Holdings Inc, incorporated in the United States of America As at 30 November 2006 the smallest group in which they are consolidated is that headed by Lehman Brothers Spain Holdings Limited, registered in England and Wales Subsequent to this, on 25 October 2007 the smallest group in which they are now consolidated is Lehman Brothers Bancorp UK Holdings Limited, registered in England and Wales The consolidated financial statements of these groups are available from 745 Seventh Avenue, New York, USA and First Floor, No 6 Broadgate, London EC2M 2QS