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Southern Cross Healthcare
Group PLC

Southern Cross Healthcare

**TOGETHER
WE CARE**

Annual Report and Accounts 2010



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COMPANIES HOUSE



A19

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COMPANIES HOUSE

308

Name: Chevaun Varga

Job title: Care Assistant

Our care staff are the frontline troops in achieving our aim to make residents feel comfortable, respected and well cared for at all times – in fact, to make them feel as ‘at home’ as possible and allow them to carry on with normal life. We recognise that the professionalism of our staff is the most important factor in creating a caring environment which meets the needs and expectations of residents and their families alike. We want Southern Cross to be universally recognised for the high quality of our care. More than any other single factor, it is our care staff who will achieve that for us.

Our Services

We provide an extensive range of healthcare services, including:

Nursing Care Homes

Nursing care homes offer an additional level of care to residential care homes. Qualified nurses provide 24 hour specialist nursing care for a range of clinical needs. Such services may involve palliative care, dementia care, post-operative care or respite care, all tailored to the needs of the individual.

Residential Care Homes

Southern Cross offer a number of residential care homes, which are designed specifically to cater for the needs of those who find difficulty caring for themselves at home, but wish to retain their independence. All Southern Cross care homes are staffed 24 hours a day by trained carers whose goal is to maintain the quality of life of those for whom they care.

Specialist Care

Southern Cross offers care for people with a variety of special needs in both residential and nursing care homes. Our aim is to provide a safe and supportive environment which is sensitive to the ever-changing needs of these residents.

Operating Highlights

- Available beds increased to 38,603 at the period end (2009 38,124 beds)
- Number of homes operated increased to 752 at the period end (2009 744)
- Average occupancy 84.8% (2009 87.7%), average occupancy restated for marketable beds of 87.8%
- Average weekly fee increased by 2.2% to £558 (2009 £546)
- Significant progress made towards improving overall service quality, with 82% (CQC suspended ratings nationally in June 2010) judged excellent or good, up from 81% in March 2010, 77% in September 2009 and 71% in May 2009
- Self funding admissions up from 17% of total admissions in March 2010 to 20% in September 2010

Financial Highlights

- Home EBITDAR before central costs decreased by 3.3% to £280.9m (2009 £290.6m)
- Adjusted EBITDA of £53.4m (2009 £72.5m)
- Adjusted earnings per share for the period of 7.65p (2009 17.65p)
- Net debt at period end reduced by £25.8m to £7.3m
- Revision to existing banking arrangements, including an improvement in the fixed charge covenant from 1.23x to 1.1x

Statutory Financial Highlights

- Revenue increased by 2.3% to £958.6m (2009: £937.1m)
- Operating loss £44.1m (2009: loss of £12.7m) after a non-cash charge of £51.3m (2009: £51.8m) for future minimum lease increases under IAS17 and exceptional charges of £6.3m (2009: £Nil). Excluding these charges, operating profit was £13.5m (2009: £39.1m)
- Basic loss per share for the period of 19.51p (2009: 11.75p loss)

Notes

Mature occupancy excludes immature beds, newly developed homes or refurbished homes which have been trading for less than 12 months

Home EBITDA represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets held for sale, onerous contracts and related impairments and rent

Adjusted EBITDA represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets, onerous contracts and related impairments and charges for future minimum rental increases and exceptional central costs

Adjusted earnings per share is defined as earnings before charge for future minimum rental increases, exceptional central costs, onerous contracts and related impairments, loan arrangement fees written off, loss on disposal of property, plant and equipment and subsidiary undertakings and impairment of freehold assets held for sale and the taxation impact thereof, divided by the weighted average number of shares

At the start of the financial period, the Group changed its internal reporting cycles and now reports on a calendar monthly basis (previously the Group reported 13 periods of 4 weeks). The results for the period ended 30 September 2010 are therefore for a period of 368 days (2009: 364 days)

Our Locations

703

Elderly Care Homes

Scotland and Northern Ireland
124 (2 active) homes

**National
Support Centre**
Darlington

North
214 (8 active) homes

Central
199 (21 active) homes

Head Office
Woking
South
166 (18 active) homes

49

Active Care Homes

Southern Cross Healthcare

Continuously striving to provide excellent affordable personalised care at the heart of the communities we serve.

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Chairman's Statement

Ray Miles
Non-Executive Director and Chairman

In common with other sectors, economic uncertainty was prevalent during the period under review. The period started positively before conditions became more difficult as concerns grew about the public deficit and future government policy, including the significant impact of likely cuts in public spending to be announced in the autumn Comprehensive Spending Review. This was always likely to have a substantial impact on a business so reliant on Local Authority funding.

Strategic Focus

During the period, we maintained a clear strategic focus on the Group's New Horizons change programme the aim of which is to create an organisation capable of providing universally trusted levels of care based on the respect and dignity of the individual and delivered in modern, high quality accommodation. To some extent, the operational imperatives underlying this programme – improving the quality of our service delivery, investing in the development of our people and management systems, and capturing efficiency savings – have been given more immediacy by the need to meet the challenges posed by the macro-economic factors impacting the Group.

In common with other sectors, economic uncertainty was prevalent during the period under review. The period started positively before conditions became more difficult as concerns grew about the public deficit and future government policy, including the significant impact of likely cuts in public spending to be announced in the autumn Comprehensive Spending Review. This was always likely to have a substantial impact on a business so reliant on Local Authority funding.

Against this backdrop, the Group experienced lower admissions than seen for some time, resulting in a fall in occupancy rates. In addition, fee negotiations with Local Authorities became more difficult. At the same time, cost pressures continued unabated including the negative effects of rent escalation, rising minimum wage and higher utility costs.

Against this background, the need for delivering the New Horizons programme is clearer than ever. Its main objectives are to

- Enhance care delivery so that we are ultimately recognised as the most trusted care home group in the UK
- Increase the number of self-funding residents, thus reducing our dependence on public funding and improving margins
- Improve efficiency so that everything is done in a better, more effective and lower cost manner
- Reorganise our management structure to create a flatter, more responsive and accountable management team

In all of these we have made substantial progress during the period but there is still much to be done.

As announced on 25 November 2010, the Board has been approached by other parties expressing potential interest in the Group. The approaches are still preliminary in nature, and the Board continues to believe it to be in shareholders' interests to continue to hold exploratory discussions.

Financials

The macro-economic factors described above combined to negatively impact Group results and in March we lowered market expectations for the full year outturn. An adjusted EBITDA of £53.4m was achieved compared with £72.5m in 2009 and £78.1m in 2008. Revenue grew by 2.3% to £958.6m from last year's £937.1m. Home EBITDAR margin before central costs has fallen by 1.7% to 29.3%. Occupancy in our mature homes fell from 88.4% to 86.1%.

Net debt fell further by £25.8m to £7.3m, a significant achievement given the underlying trading environment. The Group continues to pursue its policy of further reducing debt and, therefore, the Board has decided not to propose a final dividend for FY2010.

On 19 May, we announced we had consolidated the Group's banking arrangements into a revised amortising £50m revolving credit facility (RCF). This facility replaced all the Group's existing bank facilities and reduced the number of Syndicate lenders from eight banks to two. I am pleased to report that following recent discussions with the Group's lenders, revisions to the existing banking arrangements were agreed on 6 December 2010. The facility now comprises an amortising £45m RCF repayable in September 2012, with the fixed charge covenant relaxed from 1.23x to 1.1x.

Industry Developments

In July 2010, the Government launched its Commission on the Funding of Care and Support (known as the Dilnot Commission) to examine the future provision and funding of care in the UK. Southern Cross fully supports the work of this important body and made an early initial submission to it.

We look forward to working with the Commission to help it reach a balanced view of how our society can provide affordable and sustainable care capable of meeting the long-term needs of an ageing population. In particular, we believe the Commission should play a critical role in encouraging Local Authorities, the NHS and care providers such as ourselves to work together in developing the services required to meet the future needs of an ageing population. Such collaboration should enhance the care delivered to our elderly population, whilst generating better value for all those who commission care and moving us towards a system which pays providers the true cost of care and alleviates current imbalances in fee rates around the country.

The NHS is changing, with GP consortia about to assume responsibility for commissioning replacing PCTs in this regard. They will be responsible for organising healthcare and deciding which services to buy and from whom. While remaining focused on our core elderly care services, we will continue to respond flexibly to changing market demands and take advantage of the opportunities presented. This will include offering more specialised care – for example, in dementia, palliative and step down care. As people's perception of appropriate personalised care for individuals evolves, this will also involve greater levels of day care provision, outreach care in the community and short-term and respite care as Local Authorities seek to encourage and support people to stay in their own homes, with support, for as long as practicable.

At the Heart of the Local Community

At Southern Cross, we encourage our residents to enjoy as active and independent a lifestyle as possible. Our approach to care is based on treating every resident as an individual, not only with regard to their specific care and nursing requirements, but also with an eye to enabling them to pursue the interests, hobbies and activities they have always enjoyed and gained so much from.

One area where this strategy is particularly appreciated by residents is relations with the local community in which they live. There is no reason why they should not continue to play a valuable role in the life of their local community – just as they have always done. That's why we encourage residents and their families to get involved with a wide number of community related activities. These may include, for example, raising money for the special baby unit at the local hospital, or making a contribution to a local youth sports group or fundraising for local or national charities. The choice is endless – and any funds raised by our individual homes are topped up or matched by a central donation from Southern Cross itself.

We are proud of our residents' record for helping a wide range of deserving causes and see it as a vital part of them remaining an active, motivated and appreciated section of society.

Of course, community engagement is a two-way process. As well as reaching out into local communities, we also encourage others to see our care homes for what they are – vitally important local amenities and vibrant communities in themselves. Residents can benefit enormously from regular visits from, for example, local school children and theatre groups or others such as crafts and pet therapy specialists. In this way, as wide a range of people as possible can see that they have a role to play in the well-being of elderly people in our communities.

Chairman's Statement (continued)

Notwithstanding, we see difficult trading conditions in the short term, we remain as determined as ever to forge ahead with our change programme which we confidently expect to deliver long-term, industry-leading levels of quality and service.

Name: Tom Spence

Job title: Activities Co-ordinator

Enabling our residents to be as physically and mentally active as they want to be is a cornerstone of our holistic approach to care. In each of our regions, we have members of staff, such as Tom, whose role is to ensure that residents have access to a wide range of activities catering to as many tastes, abilities and hobbies as possible. These can range from gardening to fundraising for worthy local causes, from craftwork to musical and theatrical performances, from games such as carpet bowls to outings to local places of interest.

Landlords

During the period, the Group engaged Morgan Stanley to review its lease arrangements with landlords. All leases are subject to escalation clauses. Whilst many are fixed, a significant number of rents are tied to RPI, resulting in rents currently rising faster than the fees we charge. This work is ongoing and the Group has entered into a dialogue with some of its landlords to explore ways in which rents might be restructured to provide greater stability and a stronger covenant.

People

The Group remains a significant employer with a dedicated team of over 43,000 people working in homes across the UK. I never fail to be impressed by the commitment and expertise of our staff, so often displayed in testing circumstances. For most, their job is more than a way of earning a living – it is a vocation. Increasingly, we seek to recognise this in our comprehensive training programmes and remuneration packages. Our people are one of the reasons that I am optimistic about the future. On behalf of the Board, I thank colleagues throughout the business for their outstanding contribution in a difficult year.

In August, Irene Gray joined the company as Director of Care. This is an important milestone. Her appointment is a clear demonstration of the Group's commitment to take the lead in clinical governance and deliver dependable high quality services which are respected by those who commission care as well as by residents and their families.

Notwithstanding, we see difficult trading conditions in the short term, we remain as determined as ever to forge ahead with our change programme which we confidently expect to deliver long-term, industry-leading levels of quality and service. This will put Southern Cross in a strong position to take advantage of the demographic trends that continue to indicate a longer-term increase in average age and demand for elderly care services.

Ray Miles
Chairman

Questions and Answers from Irene Gray – our new Director of Care

Without question, my priority is to develop a Strategy for Care which is enthusiastically adopted and 'owned' by all our staff and which clearly sets out our route towards excellence in providing care services.

Q You recently joined Southern Cross after a career spent in the NHS. What persuaded you to join the company?

A Throughout my career, my primary clinical interest has always been the care of the elderly. After 38 years in the NHS as a registered nurse, including 24 years as an executive, I was looking for an opportunity which would draw on my experience and where I could make a real difference. I was impressed by Southern Cross' challenging journey to put care at the heart of everything they do and to support and influence the national agenda. As we care for some of the most vulnerable people in society, it is critical that care providers have the vision and the ability to deliver the best possible standards. To be able to lead on developments in care is quite clearly a privilege.

Q What do you see as the particular challenges facing the industry?

A With an expanding elderly population and tight Local Authority budgets, the most obvious challenge is how to provide levels of personal care which meet the expectations and needs of current and future generations whilst, at the same time, making sure that care remains affordable and of the highest quality.

Q What are the main priorities facing Southern Cross?

A Last year, we launched our New Horizons change programme which puts quality of care right at the heart of everything we do. The aim is simply to make ours the most trusted and sought after care experience in the country. Southern Cross is aiming to become the industry benchmark for excellence in care provision. That means creating a Strategy for Care which demonstrably meets the needs of all our residents and provides outstanding and affordable personalised care.

Success in delivering our Strategy for Care will lead to Southern Cross becoming a magnet for the highest calibre of staff in the industry. Throughout their career, we aim to offer all our dedicated staff continuous, in-post training and personal development. This approach will serve to improve job satisfaction and reduce staff turnover.

Q What do you see as your own main goal for the coming year?

A Without question, my priority is to develop a Strategy for Care which is enthusiastically adopted and 'owned' by all our staff and which clearly sets out our route towards excellence in providing care services. The Strategy will deliver a framework to strengthen and improve standards in care practices and make significant inroads to redesigning the way we deliver Dementia Care and End of Life Care. A vital part of this – and it is central to the New Horizons programme – will be to invest in the fabric and facilities in each of our homes over a planned period of time, and to improve the quality rating of all homes across the Group.

Q Do you believe that the Group can achieve its objective of becoming the most trusted care provider in the UK?

A Yes, I do. Everything we do is focused on continuously improving the quality of care we offer our residents and their families. The quality of the care we provide depends on the quality and motivation of the staff in our homes. We want the best staff in the profession, so training will continue to be a prime focus. New Horizons is already delivering positive results and I have no doubt that we can achieve our goals. We want our name to be synonymous with the highest levels of care quality available anywhere. This objective is not out of reach – we simply need to recognise the challenges, agree our approach and, week in, week out, focus on delivering continuous improvement. But success will not come overnight and our priority is to ensure that progress is sustainable and therefore delivery must be paced. That is why the New Horizons programme is planned to extend over several years.

Q. How will you know that you have been successful?

A. There are four ways in which we will know. First and foremost, it will be evident in the number of our homes rated as Good and Excellent. Secondly, partnerships will be strengthened with our commissioners and other key stakeholders and they will demonstrably support and engage with us in our future plans. Thirdly, staff turnover, so often a negative factor in maintaining high quality care services, will reduce. And finally, our occupancy levels will improve as our name becomes synonymous with excellence. In addition to that, of course, we will know simply because our residents and their families will tell us how we are doing.

Q What is your vision of future care provision?

A The service of the future will undoubtedly look and feel different. Most importantly, it will be of a uniformly high quality, more responsive to the needs of society and always open to further change in order to meet the needs of future generations. Improvements will come through the profession's responsiveness to the needs of the elderly communities we serve, with greater rehabilitation and domiciliary support allowing elderly people to stay longer in their own homes. One of the highest expectations I have is to see significant improvements in the care of people with dementia.

Above all, the service of the future will be based on individualised care. Our ability to deliver the full range of personal care services to the people who need them will be judged on our ability to do so in a way which, at all times, respects and preserves the dignity of the people who rely on what we do.

Chief Executive's Statement

Jamie Buchan
Chief Executive

My priorities for the business are as follows:

- Improve care delivery to our residents in a measurable and sustainable way.
- Grow our share of dementia, end of life and 'step down' care markets.
- Increase the number of self funding and co-paying residents.
- Achieve real reductions in cost to serve.
- Invest in our care homes and in the staff who deliver care.

Overview

During the period, we have made significant progress towards transforming the business such that, by 2015, we become recognised as providing the most trusted and sought after care experience in the UK. In pursuit of this aim we successfully completed the first phase of our internal change programme, New Horizons, which I introduced in last year's report and for which the following objectives (end calendar year 2011) have been communicated

- Improving service quality such that at least 85% of our homes are externally judged good or excellent
- Adding 1,200 self funding residents, thereby raising their proportion of total residents to 22%
- Reducing Home Manager turnover to 22% per annum
- Re-engineering the Group's cost structure to achieve savings of at least 1% of revenue

Overall we believe that the New Horizons programme will generate between £15-£20m of annualised value to the business by the end of 2011 together with a transformed operational capability

Name: Harry Carson

Job title: Catering Manager

If an army marches on its stomach, then the same can be said of residents in care homes! A balanced, healthy diet is absolutely vital for people who are perhaps no longer as active as they once were. Behind the scenes, an army of catering managers such as Harry ensure that our residents up and down the country receive three good square meals every day. Catering as far as possible to individual preferences and requirements, Harry works closely with Southern Cross' dedicated experts to ensure that the meals we serve are nutritious, appetising and well cooked

Chief Executive's Statement (continued)

New Horizons

1 Organisation Structure

In order to enable the business to meet its objectives, between February and July of this year, we undertook a major re-organisation of our field operations and central functions. We de-layered our operations function from seven to four management levels, exiting 38% of operations staff above Home Manager level and invested the savings in:

- Decentralising operations to four P&L accountable regions
- Establishing a care function
- Establishing a full human resources function
- Establishing a sales capability

Whilst the reorganisation has not been without its challenges, it is already clear that the new structure has led to improved care quality (lower number of embargoed homes) and a better sales mix (more self funders) whilst empowering Home Managers to develop their businesses for the benefit of the communities which they serve.

Regional Business Units

Our four new Regional Directors have fully established their regional teams in which 33 Area Managers, each with a team of c21 Home Managers, play the central role. Within each area, Home Managers are further supported by a local team of subject matter experts covering people management, training, sales development and business analysis. In addition, each Area Manager team is supported by a dedicated Care Quality Advisor responsible for raising standards of care.

Care Function

Our overriding obligation and commitment is to deliver excellent, affordable, personalised care to our residents and we have made strong progress in the creation of a care function within the Group. In February we created over sixty new, field-based, roles including a national team of Service Quality Inspectors who inspect every one of the Group's homes on a risk-assessed frequency against a set of demanding standards based on individual resident outcomes. In August, the Group announced the appointment of Professor Irene Gray to lead the function as Director of Care. Irene's job is to raise standards of care and clinical governance across the portfolio and to act as a champion for the development of the nursing and care profession within Southern Cross.

A revised Clinical Governance system has also been introduced to provide assurance over standards. New systems are being deployed to analyse key care data with the objective of establishing a set of indicators which will allow the Group to predict homes which are failing and, consequently, to adopt an early intervention approach.

We have continued to make good progress against our target for improving the quality of care delivered in our homes. The table below shows that the number of homes in England judged by the external regulator as Good or Excellent had risen 5% to 82% by Q3 of 2010. Full year figures are not available as the Care Quality Commission discontinued their star rating system in June. The Group is confident however that its internal quality inspection process will continue to drive standards up whilst reducing the number of poor and adequate homes.

	SCH 2010 Q3 (Actual)	SCH 2009 Full (Actual)
CQC Scoring ^{*1}		
Good/Excellent	82%	77%
Poor/Adequate	18%	23%

^{*1} CQC no longer update their quality scores following the implementation of the new standards under the Health and Social Care Act 2008.

People Management

Ours is a people business and I am very pleased indeed with the progress which has been made in delivering a comprehensive set of people management services to our care homes.

During the period, the Group introduced a full suite of processes covering staff recruitment, induction, performance appraisal and training. A national HR support hub was created to act as a one stop shop for all internal people processes and enquiries covering our 43,000 staff. In addition, a national training organisation, embedded within our Regional Business Units, has been created to act as the delivery vehicle for statutory, clinical and management training across all staff groups. In particular, our Home Managers have received training in business management and finance, people management and sales which has already paid dividends in reducing staff turnover by 3% and in increasing the numbers of self funding residents within our homes. Overall I am confident that an improved level of staff engagement has been achieved.

We are committed to further developing and refining training opportunities for everybody in the business. Having the best trained staff in the sector is not only the right and responsible thing to do for our people, it is absolutely central to our business model. High job satisfaction and motivation levels will lead directly to better quality service delivery which will enhance our reputation.

During the period the Group invested in the creation of a human resources database which will go live in early 2011 and which will capture all staff records, thereby enabling a wide range of people management and efficiency programmes to be undertaken

A Time and Attendance rostering system is being rolled out across all homes. Indications from the first 60 homes to use this system are that labour costs are reduced by more than 1% as a result of greater control and accuracy of rostering. The system will also enable the set up of internal staff bank groups which the Group believes will lead to a reduction in agency costs

Sales

One of the priorities we have set ourselves is to improve the Group's penetration of the self funding market. During the period, the average weekly fee for self funding residents was £668 versus £534 for residents whose care was funded by Local Authorities. The Group has developed a new sales process supported by an on-line enquiry management system and a small national sales call centre. Following a successful pilot in the South of England, which showed an increase in self funder admissions of up to 50%, 250 Home Managers across the UK have been fully trained in our new sales process. In order to support Home Managers in achieving sales targets we recruited experienced sales development professionals within each Regional Business Unit. In addition, the Group's website has been updated with improved functionality and an enhanced ability to drive sales enquiries.

2 Segmentation and Cost Management

During the period we introduced an internal business segmentation model in order to help drive performance, simplify management communication and inform capital investment decisions.

Each home has been classified within one of five segments according to its sales opportunity and cost structure. Each segment has distinct operating characteristics and margin potential.

- **'Premium'** capable of over 60% of self funder penetration at premium prices
- **'Plus'** capable of over 30% self funder penetration
- **'LA Major'**: large, cost efficient homes focused on local authority provision
- **'LA Minor'**: less efficient homes focused on local authority provision
- **'Cosy'** small (less than 35 bed) homes

In turn, homes are also accorded the following status:

- **'Mover'** capable of moving into a more attractive segment
- **'Improver'** capable of improvement within the existing segment
- **'Trend'** operating at an acceptable level within the existing segment

The Group believes that approximately 200 homes can be positioned in the 'premium' and 'plus' segments and that over 300 homes have 'mover' or 'improver' potential.

In May of this year, each Area Manager used the segmentation model in preparing area business plans collaboratively with Home Managers. This process has further enabled the development of simple, focused plans for each home and improved stewardship.

During the period the Group invested £30.3m in maintaining and improving the portfolio, more than meeting its commitment from last year. A Director of Property Services was hired to lead the investment programme and to ensure that its execution optimised returns according to the segmentation methodology.

Progress has been made in re-engineering the cost base. The Group began a comprehensive review of central procurement and this work is two thirds complete with approximately £2m of annualised savings already captured in telecommunications, utility supply and food. A review has also been undertaken in repairs, renewals and improvements where the group spends approximately £70m per annum (labour and materials). As a result I am very pleased to announce the appointment of Bovis Lend Lease as our strategic partner for the provision of maintenance and refurbishment services across our national network of 752 homes. We believe the partnership with Bovis Lend Lease will lead to improved standards of service to our home management teams and therefore our residents, greater operational integrity and a more efficient use of the Group's cash resources. The Group is also in the process of reviewing its catering arrangements where it spends c£80m per annum (labour and materials) in order to improve both the quality and cost effectiveness of this important service.

Industry

During the period, the increase in fees paid by local authority commissioners fell materially below the rate of inflation. In addition, older people placed into the Group's care are increasingly frail on admission and have increasingly acute needs, often involving dementia, which require higher levels of personal attention by our nurses and carers.

The care industry is largely dependent on state funding through either Local Authorities or the National Health Service. It is our view that this funding model is not sustainable in the future as the proportion of elderly people with acute care needs continues to increase. The Group has recognised this in its twin objectives of improving standards of care and in attracting a higher proportion of self-funding and co-paying residents. That said, the provision of services to public commissioners will remain our key market for some considerable time and consequently we have actively raised our industry profile during the lead in to the Government's Comprehensive Spending Review (CSR).

Chief Executive's Statement (continued)

The Group welcomes the setting up of the Dilnot Commission into the funding of long-term care.

Name: Clare Macpherson

Job title: Dining Room Assistant

For people of all ages, a good meal can often be the highlight of the day. Clare and her colleagues know this and aim to ensure that for the residents in their care, meal times are something to be looked forward to. Whether it's assisting people in need of a helping hand or just making sure that meals are well presented and nicely served, our dining room assistants play a vital role in the happiness of our homes and in the health of all of our residents.

Our objective in engaging with government was to gain recognition of the proper economic and social value of care services, such as those delivered by the Group. To that end, the Group highlighted:

- The value for money provided by residential care versus the true cost of providing other forms of care, for example 'extra care' and domiciliary care
- Continued inefficient local authority provision and commissioning conflict
- The opportunity for care homes to provide a wider range of services to the NHS at significantly lower cost

The outcome of the CSR was disappointing. Local Authorities face reductions in their budgets of 26% over the four years commencing April 2011 and Social Care is not ring fenced. We remain deeply concerned that Local Authorities will reduce expenditure on care for older people by increasing eligibility criteria, thereby leaving vulnerable people without the access to appropriate forms of care, and by depressing fees to increasingly unsustainable levels.

The Group welcomes the setting up of the Dilnot Commission into the funding of long term care. This development gives the industry in general the opportunity to influence the future funding of appropriate elderly care provision in the UK and to debate the benefits of different models of care provision with a clear understanding of the true costs of each model. We will continue to work closely with the Commission which will report next summer.

Portfolio

Southern Cross operates 752 homes across the UK. During the period the Group added 479 new beds. At the beginning of FY2011, the Group took the decision to re-categorise 1,303 rooms, previously marketed as twin bedded rooms, for single occupancy at premium rates. This will reduce the number of available beds being marketed across the Group to 37,300, representing a 10.2% share of the UK market for independently provided residential care. (Source: Laing & Buisson)

Caring for Older People

Historically, the Group has operated under two brands, Southern Cross Healthcare and Ashbourne. Following the work done on internal business segmentation and the classification of homes into five segments (Premium, Plus, LA Major, LA Minor, and Cosy) the historical classification under Southern Cross and Ashbourne has been discontinued.

The Group is currently undertaking a major review of its elderly care marketing proposition and branding.

Specialist Services

Active Care

Active Care is one of the country's largest independent mental health and learning disability care providers, operating 49 homes and 930 beds. In the period under review, Active Care generated revenue of £41.9m (2009: £43.8m) a decrease of 4.3%, due primarily to the closure of Abbeydale. It attracted average weekly fees of £1,086 (2009: £1,097).

Chief Executive's Statement (continued)

Operating Performance

During the period, the macro-economic climate has materially worsened leading directly to a like for like decline in mature occupancy of 2.3%. In particular, the Group experienced a reduction in Local Authority admissions in the second half of the period in contrast to the recovery normally seen over the summer months.

The average Local Authority settlement during the period was 1.3% versus RPI of 4.4%. We continued to see restrictions on eligibility criteria and movement towards the provision of domiciliary care to elderly people with acute social needs.

Overall average weekly fees increased by a net 2.2%, while home payroll costs increased by 3.4% (excluding the additional 4 days in the current period of account) and home running costs increased by 5.2%. The results were negatively impacted by falling occupancy. Average occupancy in mature homes fell by 2.3% to 86.1%, although the market generally also fell. The net effect was that operating margin reduced by 1.7% to 29.3%.

The operating performance is summarised below:

	H1 2010 £m	H2 2010 £m	Total 2010 £m
Revenue	480.7	477.9	958.6
Home EBITDAR before central costs	140.6	140.3	280.9
Margin %	29.2%	29.4%	29.3%
Rent - charge for amounts currently payable	97.7	99.3	197.0
Rent cover - times	1.44	1.41	1.43
Adjusted EBITDA	28.0	25.4	53.4
Adjusted EBITDA profile	52.4%	47.6%	100%
Average mature occupancy %	86.9%	85.3%	86.1%

Fee Rates

In the period under review, the Group achieved a net increase in average weekly fee rates of 2.2% to £558 (2009: £546). Fees charged to private clients were reviewed and an overall increase of 3.7% was agreed, effective from February 2010. Over the period, Local Authority fee rate increases differed from Authority to Authority. In England, an average increase of 1.0% was achieved, while in Scotland and Northern Ireland the increase was 2% while for Wales it was 1.6%, resulting in an overall average increase of 1.3%.

People

As I wrote last year in my first report as Chief Executive, I am constantly struck as I go round the business by the professionalism, enthusiasm and dedication of colleagues throughout the country. Our people - Home Managers, Carers, Nurses, Chefs, Housekeepers, Administrators and Maintenance Staff - take the lead in fostering relationships with our residents, their families and the local community. Along with regional and head office staff, they are our route to achieving our ambition to deliver the highest levels of care in the UK. They are vital to our success. Once again, I am delighted to express my thanks to all of them for the contribution they make to the business.

Outlook

The long term demographics for our business remain positive and we are clear that significant opportunities exist for the Group in the provision of dementia and end of life services. In addition we are developing a range of step down and re-ablement services which we believe will be attractive to NHS commissioners.

In the short term however, we will face continued pressure on occupancy levels and on margin as a direct consequence of Local Authority budget reductions and the lack of current definition from central government on long term funding for the care of older people.

Despite these challenges, the Group enters 2011 with a very clear sense of purpose. In its first year, the achievement of the New Horizons Programme has been to lay the foundations for turning Southern Cross into a significantly improved national operator of care homes. As we enter the second year of the programme we now have the management capability to create benefit in the following three areas:

- Further improvement in care standards
- Capture of a higher margin resident mix
- Achievement of further cost efficiencies

To that extent I believe that we are creating a valuable operating brand which will stand the company in very good stead for the future.

Jamie Buchan
Chief Executive

Name: Betty Hannah

Job title: Domestic Supervisor

More often than not it's the front line nursing staff who steal the limelight in care homes. But without the behind-the-scenes work carried out by dedicated staff like Betty, every care home in the country would very soon grind to a halt. We have them to thank for the cleanliness and hygiene of residents' private rooms as well as all the public spaces inside our homes. And with almost 33,000 residents in 752 homes the length and breadth of the country, it is impossible to overstate the scale of the daily laundry operation needed to keep things going smoothly.

Financial Review

Richard Midmer
Group Finance Director

Revenue increased by £21.5m to £958.6m (2009: £937.1m), an increase of 2.3%.

Revenue Statement

At the start of the financial period, the Group changed its internal reporting cycles and now reports on a calendar monthly basis (previously the Group reported 13 periods of 4 weeks). The results for the period ended 30 September 2010 are therefore for a period of 368 days (2009: 364 days).

The Group's operating performance is summarised in the following table:

	2010 £'m	2009 £'m
Revenue	958.6	937.1
Home EBITDAR before central costs	280.9	290.6
Home EBITDAR margin (%)	29.3	31.0
Adjusted EBITDA before exceptional central costs and charge for future minimum rental increases	53.4	72.5
Operating loss	(44.1)	(12.7)
Loss before taxation	(47.4)	(19.8)
Average number of available beds	38,531	37,664
Cash generated from operating activities	33.4	87.5

Revenue

As at the period end, the Group had increased the number of available beds by 479 (1.3%) to 38,603 (2009: 38,124). The growth was attributable to the completion of two in-house developments (156 beds), an extension to an existing home (23 beds) and the acquisitions of four leasehold homes (300 beds).

The average number of available beds increased by 867 (2.3%) during the period, to 38,531 (2009: 37,664).

Revenue increased by £21.5m to £958.6m (2009: £937.1m), an increase of 2.3%. Excluding the additional 4 days in the current period of account, revenue increased by £11.2m. The increase in revenue is due to the net impact of fee increases, being 2.5% during the period and contributing additional revenue of £23.8m, the impact of acquisitions made in the prior and current period which contributed £12.7m, offset by a reduction in average occupancy of £22.4m and mix effects of £2.9m. Overall the average weekly fee rate increased by a net 2.2%.

Home Operating Costs

Home payroll costs increased £24.1m from £533.7m to £557.8m, of which £5.9m was due to the additional 4 days in the current period of account and £8.8m was attributable to acquisitions made in the current and prior period. Excluding these, home payroll costs increased by £9.4m, driven primarily by wage increases of 1.7% effective in October 2009.

Home running costs for the current period were 12.5% of revenue (2009: 12.0%), in absolute terms, excluding the additional 4 days in the current period of account, home running costs increased by £5.9m (5.2%). The increase was driven by cost of inflation of 3% (£3.4m) and increases in planned repairs and maintenance (£2.5m).

Rent

The rent charge for the period, including the non-cash charge of £51.3m (2009: £51.8m) under IAS17, was £248.3m (2009: £239.1m). Excluding the non-cash charge and the additional 4 days in the current period of account, the rental charge increased by £7.7m. The increase was driven by new leases entered into (£3.3m), leases with average fixed increases of 2.7% (£3.0m), leases with RPI linked average increases of 2.5% (£1.0m) and leases subject to 5 yearly increases (£0.4m).

Central Costs

Total central costs, including £6.3m in respect of exceptional central costs, were £36.8m. Excluding exceptional central costs and costs for the 4 additional days in the current period of account, central costs decreased by £0.7m. As a percentage of revenue, central costs (excluding exceptional central costs) equated to 3.2% (2009: 3.3%).

Exceptional Central Costs

Exceptional central costs relate to the internal change programme 'New Horizons' and other exceptional costs. During the period £5.3m was incurred in respect of New Horizons. The total costs of the programme are expected to be £6m with the majority of the remaining costs anticipated to be incurred during the first half of FY2011. Other exceptional central costs totalled £1.0m, the majority of which related to costs incurred in respect of a review of the Group's operating lease portfolio.

Segmental Results

The Group continued to have two distinct segments within its operations, namely **Elderly Care** (which incorporates Southern Cross Healthcare and Ashbourne Senior Living) and **Specialist** (being the Active Care Partnership business).

Elderly Care

Average available beds within the Elderly Care portfolio increased by 867 to 37,601 (2009: 36,734). The total number of available beds within the Elderly Care portfolio at the period end was 37,673 (2009: 37,195).

Fee revenue in the Elderly Care segment increased by £23.4m (2.6%) to £916.7m, excluding the additional 4 days in the current period of account, revenue increased by £13.5m. The key driver of revenue growth was the increase in average weekly fee (£23.3m) and acquisitions completed in the prior and current period (£12.7m). These increases were offset by a reduction in occupancy (£20.4m) and mix effects (£2.1m).

Total Home EBITDAR before central costs decreased by £9.7m (3.5%) to £269.6m. Home EBITDAR margin before central costs for Elderly Care reduced to 29.4% (2009: 31.3%).

Specialist Care

Available beds in the specialist segment remained at 930 and included 53 beds in respect of Abbeydale, a centre that was closed during the period and which will re-open during FY2011 under the Elderly Care segment.

During the period, revenues in the Specialist segment decreased by £1.9m (4.3%) to £41.9m (2009: £43.8m) due primarily to the closure of Abbeydale.

Home EBITDAR before central costs for the period remained at £11.3m with Home EBITDAR margin before central costs increasing from 25.8% to 27.0%.

EBITDA

Loss before interest, tax, depreciation and amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, onerous contracts and related impairments, and impairment of freehold assets held for sale ('EBITDA') for the Group decreased by £24.9m to a £4.2m loss (2009: £20.7m profit). Excluding the impact of future minimum rental increases under IAS 17 and exceptional central costs, adjusted EBITDA decreased by £19.1m (26.3%) to £53.4m.

Depreciation

Depreciation has increased from £21.6m in 2009 to £27.1m in the current period, reflecting the higher spend incurred during the prior period.

Disposal of Freehold Assets

During the period, the Group disposed of freehold assets for a net cash consideration totalling £31.2m. The related assets had a net book value of £31.4m, resulting in a loss on disposal of £0.2m. Further freehold assets were sold for deferred consideration of £0.6m, being equal to the book value of the assets.

During the period, the Directors reviewed the carrying value of the Group's freehold properties. Following this review, a number of properties were found to have fair values lower than their carrying value. As a result, the carrying value of the related freeholds has been written down by £1.1m.

Onerous Contracts and Related Impairments

During the period, management took the decision to close two of the Group's homes. As previously reported, Abbeydale, an independent hospital located in North London, was closed in the first half of the financial period. Ferngrove, a home located in Lancashire, was closed in September 2010 due to the building not meeting the standard required by the Group. As a result of these decisions an onerous contract charge of £11.5m has been recognised in the period and included £0.9m of related impairment charges.

Financial Review

(continued)

Net Finance Costs

The net financing costs for the period amounted to £3.3m (2009: £7.1m), representing a decrease of £3.8m due to lower levels of debt across the period.

Included within net finance costs are interest charges of £2.2m (2009: £6.0m) in relation to interest payable on bank borrowings and amortisation of loan arrangement fees of £1.1m (2009: £0.7m). The lower interest charge was due to lower levels of debt held by the Group, with net debt at 30 September 2010 of £7.3m (2009: £33.1m). Amortisation of loan arrangement fees increased as a result of costs associated with the consolidation of the Group's banking facilities, which was completed on 18 May 2010.

Taxation

The tax credit on earnings before taxation of £10.7m (2009: £2.3m charge), consists of a current tax credit of £0.3m and a deferred tax credit of £10.4m, and represents a headline rate of 22.6% (2009: 11.6% negative). The deferred tax credit includes a current period credit of £8.2m, a prior period credit of £3.1m and a charge of £0.9m attributable to a change in the rate of taxation. The current period deferred tax credit is significantly impacted by £8.0m of trading losses arising in the period which cannot be recognised due to the uncertainty of their future economic benefit. This is offset by a £5.3m credit (of which £2.5m relates to prior periods).

Furthermore, the current period tax credit is impacted by future minimum rental increases, onerous contracts and related impairments, impairment charges of freehold assets held for sale, losses on disposal of property, plant and equipment and subsidiary undertakings and the rate change on the recognition of deferred tax assets from 28% to 27%. The corporation tax rate change is effective from April 2011 and it is anticipated that all deferred tax assets will reverse after this date.

The reconciliation below shows the effective rate of tax after consideration of the above items.

	£'m	Taxation credit/(charge) £'m
Loss before taxation	(47.4)	10.7
Future minimum rental increases	51.3	(14.3)
Onerous contracts and related impairments	11.5	(3.2)
Impairment of freehold assets held for sale	1.1	-
Loss on disposal of property, plant and equipment and subsidiary undertakings	0.2	-
Trading losses arising not recognised	-	8.0
Impact of prior period items	-	(3.4)
Other	-	(2.8)
Rate change on deferred tax assets	-	0.9
Total	16.7	(4.1)

After consideration of the above items, the current tax charge of £4.1m represents an effective tax rate of 24.6% (2009: 25.8%) before charges for future minimum rental increases, onerous contracts and related impairments, losses on disposal and impairment charges.

The Group expects the effective future tax rate to remain at or slightly below the standard rate of corporation tax in future periods.

Dividends

Total dividends paid during the period amounted to £Nil (2009: £Nil) and the Directors have decided not to recommend a final dividend for the period ended 30 September 2010.

Loss per Share

The loss per share for the period was 19.51p (2009: loss of 11.75p). Earnings per share for the period before future minimum rental increase charges, exceptional central costs and the taxation impact thereof, was 2.55p (2009: 8.08p), a decrease of 68%. Excluding the impact of losses recognised in respect of freehold properties, impairment charges and charges in respect of onerous contracts and related impairments, adjusted earnings per share was 7.65p (2009: 17.65p).

Balance Sheet

Non-current Assets

Property, Plant and Equipment

Property, plant and equipment increased from £111.4m to £118.4m due to the net impact of additions to property, plant and equipment of £35.8m, offset by depreciation charges of £27.1m, and other asset disposals and impairments of £1.7m.

Deferred Tax

Deferred tax assets have increased by £10.5m from £14.7m to £25.2m. The movement is primarily due to the increase in capital allowances available to the Group.

Property Assets Held for Sale

At the start of the current period, the Group held 20 freehold property assets for resale with a value totalling £46.5m. During the period, 6 were disposed of with a value of £31.4m. Following a review by the Directors of the carrying values of the remaining 14 freehold property assets held for sale, an impairment charge of £1.1m was made.

The property assets held for sale at the period end relate to 14 freehold properties amounting to £14.0m, all of which are being actively marketed.

Cash Flow

	2010 £'m	2009 £'m
Cash flows from operations	33.4	87.5
Net interest and taxation	(3.7)	3.3
Investing activities	(3.9)	(25.6)
Financing activities	(56.4)	(35.6)
Net (decrease)/increase in cash	(30.6)	29.6

Net decrease in cash during the period was £30.6m (2009 £29.6m increase), with cash inflow from operations of £33.4m (2009 £87.5m). Cash inflow from operations represents a cash conversion ratio of Adjusted EBITDA, after exceptional items, of 74.3% (2009 120.7%). The current period cash conversion ratio has been reduced due to the impact of 5 quarterly rent payments (£14.6m) being made as a result of the extended period. Excluding the impact of these items, the cash conversion ratio, after exceptional items, was 102%.

Finance charges paid during the period amounted to £3.7m (2009 £13.1m) and included £1.1m relating to loan arrangement fees and costs in respect of the consolidation of the Group's banking facilities in May. The remaining payments relate to standard charges incurred in accordance with the Group's banking facilities. Tax payments during the period totalled £0.2m (2009 £15.6m repayment) and related to prior periods.

Net cash outflow from investing activities amounted to £3.9m (2009 £25.6m). Included within net cash outflow from investing activities are purchase of property, plant and equipment of £35.1m and receipts from the sale of subsidiary undertakings and the sale of property, plant and equipment and other assets of £25.5m and £5.7m respectively.

Purchase of property, plant and equipment totalled £35.1m and included £2.1m of development expenditure, £30.3m of maintenance and improvement capex on the Group's homes and other capital expenditure of £2.7m.

The net cash used in financing activities for the period amounted to £56.4m (2009 £35.6m) and included net repayment of bank borrowings totalling £55.8m.

Net Debt and Financing

During the period, the Group's net debt reduced by £25.8m to £73m (2009 £33.1m) with bank borrowings reducing by a net £55.8m. On 18 May 2010 the Group consolidated its existing banking arrangements into a revised £50m revolving credit facility. Interest on drawn amounts is charged at margins between 2.75% and 3.25% above LIBOR. At 30 September 2010, the Group had loans of £7.5m drawn on the facility.

As at the period end, the Group had committed bank facilities of £50m, against which it had loans drawn of £7.5m, finance lease obligations of £1.0m and guarantees issued of £11.8m, leaving £29.7m of undrawn facilities.

The Group holds agreements to limit its exposure to interest rate movements. At the period end, the Group had £13.6m of interest rate caps outstanding at 4.62% and £21.0m of interest rate collars outstanding with cap rates of 4.50% and floors of 2.57%. The notional amount hedged under these agreements reduces over their term and both expire on 30 June 2011.

Following recent discussions with the Group's lenders, revisions to the existing banking arrangements were agreed on 6 December 2010. The Group's facility now comprises an amortising £45m RCF repayable in September 2012, with the fixed charge covenant relaxed from 1.23x to 1.1x. The first amortisation, of £3.3m, takes place on 1 October 2011.

Available Beds

Following a review of double occupancy rooms, the Group has reclassified 1,303 rooms as single occupancy. As at the beginning of FY11, this will have the net impact of reducing the number of available beds across the Group by 1,303 beds to 37,300. For FY10, this amendment to available beds would have had the effect of increasing average occupancy for the Group from 84.8% to 87.8%.

Richard Midmer
Group Finance Director

Corporate Social Responsibility

The Group's CSR objective remains unchanged. We want to deliver sustainable improvements in our business in a way that aligns, as far as is possible, our core business needs with the wider interests and concerns of our stakeholders. We understand that alongside the business's economic drivers we have a responsibility for improving the lives of our residents, their families, our staff and the wider local community.

Marketplace

Care Standards and Quality of Care

Southern Cross is committed to becoming the most trusted and sought after care experience in the UK. To this end in 2010 we recruited Irene Gray, a highly experienced Director of Care, to ensure leadership of the highest quality in this area.

Each region of the UK has its own regulatory body that undertakes its own inspection process and the Group monitors these inspections closely. We are pleased to report that the percentage of homes rated good and excellent improved by 5.4% to 82.2%.

Until June of this year, the regulator in England, where most of our homes are based, operated a star rating system. This rating scheme was predicated upon care standards contained in previous legislation and, consequent on new standards being introduced by the Health and Social Care Act 2008, this system was discontinued. The ratings shown below have not been updated since June, when the star rating system was frozen. It is planned to introduce a new system in 2011 but, as yet, there is no clarity about that system.

Inspection Rating	2008/9	2009/10
Excellent (blue)	14.6%	14.6%
Good (green)	62.2%	67.6%
Adequate (amber)	21.0%	14.8%
Poor (red)	2.2%	3.0%

The figures above are based on the external inspection scores of our homes in England, which represent 79% of our total estate. Homes in Scotland, Wales and Northern Ireland are graded on a different basis by their respective inspection agencies and therefore direct comparison is not possible. However, in addition to external inspections we apply a thorough inspection process to our own homes and, based on this inspection, we would expect our homes in the remainder of the UK to achieve scores similar to our English homes.

Sometimes, homes can experience temporary problems slipping to a lower status. While the quality of our homes overall improved in the year an additional 2 homes were judged as Poor at the period end. During the year the Group upgraded its internal inspection system in a drive to eliminate poorly performing homes and raise the standards of all homes to a consistent and sustainable level. As this new system becomes more embedded we will be able to identify the signs that a home's care quality is slipping thereby allowing for early intervention to prevent, for example, an admissions embargo (voluntary or otherwise) from being placed upon it.

It is our vision and wish that our inspection regime will become so trusted that the regulatory bodies will feel able to rely upon it.

The Board continues to review the status of inspection quality scores at each of its meetings.

The Group also continues to maintain ISO 9001 accreditation at many of its homes. As a result of the effort that went into the Group's operational restructure, progress in this area was slower this year. However, we now have 225 homes accredited.

Customers

Obtaining feedback from residents, families and professionals associated with the Group's homes is very important to us. Each of the homes has in place measures to gather and act upon this feedback. This includes resident and family meetings, open days and surveys.

For most of the year the Group operated a 'stand alone' customer satisfaction unit which sat outside the operational structure and conducted satisfaction surveys amongst residents, their families and professionals. Following the closure of the Group's Glasgow office where this unit was based the Group has taken the opportunity to develop a new methodology for canvassing and reporting on the views of all stakeholders and this will be rolled out during the course of 2011.

The Group recognises that it has a duty to deliver its services to its residents in a safe and responsible manner – a duty of care that we take extremely seriously. It is true to say that as an organisation individually and collectively we have a zero tolerance to any form of abuse. We continue to work with the charity Action on Elder Abuse (Registered Charity Number 1048397) who provide a confidential whistle blowing helpline. This helpline is manned by the charity and is available to anyone associated with a Southern Cross home who suspects any form of abuse or inappropriateness in the delivery of a service. Calls to this helpline are assessed by the charity and, if necessary, appropriate action is taken by them to resolve the situation.

We also continue to promote the government's 'Dignity in Care Campaign'. We employ more than 800 registered 'Dignity Champions' whose role is to ensure that the rights of individuals in our homes are respected at all times.

Workplace

People continue to be the Group's most valuable asset. Their performance is critical if we are to deliver the Group's demanding objectives. Considerable progress has been made this year to create the framework, structure and support required to enable our people to both fulfil their potential and deliver a high quality service to our residents.

To enable this, during 2010 we expanded the Human Resources function so that it, and therefore the Group, is better placed to address all aspects of the employee lifecycle.

Key Staff Information

Measure	2007/2008	2008/2009	2009/2010
Staff numbers	42,845	44,711	43,099
% of workforce female	83.9	82.5	82
% of senior management female	68	67	75
% of workforce from non-EU countries	8.5	9.7	6.8
Average age of employees	40	40	40

This year approval was given to implement a new HR and Payroll system, which will go live during 2010/2011. A new Time and Attendance system that will transform rostering (which to-date has been an immensely time-consuming rota for Home Managers), improve payroll cost control and save administration time is currently being rolled out to all homes. These systems will be key in supporting people management, providing information for decision making and identifying opportunities for improvement in such areas as staff retention, turnover and absence.

Staff Engagement

The results of our staff survey last year gave us insight into how engagement with the Group's objectives relate to our team's daily experience. This insight was re-enforced with the findings of workshops and site visits.

One of the key findings was that staff told us that they needed to know what is expected of them at work. They needed greater role clarity and definition. In addition, Home Managers wanted to be given additional tools and support to enable them to develop the full potential of their team.

During the year we created a HR Hub to provide the additional HR support that our people were looking for.

In the current year we intend to launch a new People Management Framework which will provide:

- a framework to guide our decisions around policies, processes and approach,
- consistency in how we manage our people processes,
- a foundation to enable us to become an 'Employer of Choice',
- an expression of our corporate values and business ethos, and
- a basis for engendering respect amongst every employee in the organisation.

We believe this People Management Framework will help us to reduce staff turnover and manage our recruitment more effectively whilst creating an engaged and motivated workforce.

We will continue actively to seek feedback from our staff and ensure that all initiatives address and reflect staff input and feedback.

Staff Recognition and Reward

We believe it is important that staff feel recognised and rewarded for the work that they do.

We ensure our staff are appropriately remunerated for the work that they do. We benchmark our salaries and benefits against our key competitors and the local market. In difficult economic conditions, the Group intends to use such funds as are available to address attraction and retention issues within business critical roles.

We will continue to investigate ways of rewarding employees who successfully complete our in-house education programs, offering attractive career progression and raising the capability of our organisation.

We estimate that 25% of our staff are members of a trade union or similar type of organisation. A recognition agreement is in place between Southern Cross and the GMB Union and both parties are committed to working in partnership. The Group will continue to consult with employee representatives on major issues and developments within the organisation.

This year we will relaunch our employee benefits package and employee assistance program and a new occupational health service for our staff.

People who contribute through their skills, talents and experience will in return benefit from development opportunities and financial rewards.

The Southern Cross Care Awards are held every two years, where excellence across the country is celebrated. In November 2009 each of the regions held local events to recognise their regional winners with the grand final being held in March 2010. These awards are about recognising the work that people do, day in, day out, in the Group's homes.

The Group is proud of the fact that our staff are often honoured in the local, regional and national Care Awards.

Staff Training

	Carers with NVQ level 2	Managers with Registered Manager Award
2006/2007	55%	52%
2007/2008	74%	62%
2008/2009	73%	91%
2009/2010	82%	84%

Our emphasis remains on developing the skills of our care workers to enable them to gain relevant work based qualifications. It is of great credit to our carers that 82% now have the level 2 NVQ qualification. Our in-house training staff delivered courses in core subjects covering everything from infection control to customer care. More specialist training such as the Alzheimer's Society's 'Tomorrow is Another Day' training was delivered in our homes specialising in dementia care as well as a general dementia awareness course in all other homes.

Corporate Social Responsibility (continued)

During the year just ended, more than 700 staff went through the Group's apprenticeship scheme. We are working with our training partners to extend this scheme to 16-18 year olds.

To support all our staff training activity, a new Learning and Development function was created during the year to provide a more centralised approach to development for all staff and put in place key programmes of development to drive up the capability of our staff. Regional based training teams were created and are responsible for ensuring that each home has access to appropriate and timely training.

Values

Underlying all these HR activities is a set of Group values. These values shape how we do business and how we treat our colleagues, our residents, their relatives and our partners.

These values are the Southern Cross Way 'in action', and influence behaviours and corporate culture, and contribute towards optimum business delivery.

We are continuing to develop the way we articulate our values and intend to consult further with our people to redefine, refocus and agree a set of values that is in keeping with our business ethos and will support the Group in meeting its objectives in the years ahead.

Health and Safety

It is critically important from both a moral and reputational perspective that we provide an injury-free working environment for our staff, residents and their guests.

The Board continues to lead and is committed to the Health and Safety agenda. While our Chief Executive has overall responsibility for Health and Safety, policy development and monitoring of performance is undertaken by the Group's Health and Safety Committee which is chaired by Irene Gray, Director of Care. The Board recognises that there are three main strands to its responsibility namely to its residents (through the care function), to its staff (through the HR function) and to all stakeholders (through its estates function).

The Health and Safety Committee, which meets at least quarterly, reports to the Group's Executive Committee. The Board receives reports on health and safety issues at each board meeting. The Committee is charged with ensuring that Group policy is implemented and it does this by monitoring performance by way of a series of Key Performance Indicators. The Committee's minutes are cascaded down through the operational structure to each home. These minutes form part of each home's Health and Safety Group agenda. Any issues arising for the attention of the Group Health and Safety Committee are passed back up the operational structure. This enables a full circle of clear communication within the Group.

Further communication channels include 'The Weekly Briefing', which includes Hazard Alerts, guidance on areas of best practice and changes to policy. Hazard Alerts are also emailed directly to the homes. A quarterly newsletter summarises recent initiatives to ensure staff are well informed.

The Group recognises that an effective risk management system is crucial to it meeting its health and safety objectives. The Group is currently working to further develop its risk management system and has recently appointed a Head of Governance to lead the Group in all aspects of risk management.

This year, 129 Home Managers completed the Level 3, Health and Safety Training programme. This programme is based on Southern Cross Health and Safety policies and procedures and is validated by the Chartered Institute of Environmental Health.

Community

One of our key objectives is to ensure that our homes play a part in the life of the communities they serve. We believe it is important that we bring people of all generations together as each has something to learn from the other. It is for this reason that we organise various events both in the homes and out in the community that facilitate the meeting of people.

The Group has a number of programmes in place to help the homes bolster this position. As in previous years, the Group supported local youth teams through its kit sponsorship programme, which donates kit to a variety of sports. In exchange, the teams are encouraged to work closely with their local home. The young people make regular visits and spend time in the Group's homes. This has enormous benefits in terms of greater understanding and learning between the generations in those communities.

The Group also has a fund matching programme whereby the homes are encouraged to raise funds for the benefit of their residents, which the Group will then match. Homes also raise money for local charities and again the Group matches those donations. The total committed by Southern Cross on kit sponsorship and matching funds in the last year was £135,267.

Programme	No of teams/ homes supported	
	2008/ 2009	2009/ 2010
Kit sponsorship	78	43
Fund Matching	280	341

We remain totally committed to our partnership with Action on Elder Abuse, the principal charity we supported in 2009/2010. This year, we donated £22,620 to the charity.

Environment Energy Consumption

Source of Energy	CO ₂ tonnes produced 2008/2009	CO ₂ tonnes produced 2009/2010
Electricity	76,720	76,243
Natural Gas	62,345	59,609
Oil	5,610	5,373
LPG	1,196	1,166
Total	145,871	142,391
Per bed equivalent figure	3.87	3.69

We remain committed to reducing the Group's energy consumption, while maintaining a consistent service for our residents.

We have increased our emphasis on identifying and improving our environmental impact. This work has been controlled and directed by the newly formed Property Services Department, which has reviewed our policies for procurement of products and services, design of new properties, and operation of homes.

We plan to provide environmental and energy/carbon reduction training and awareness at all our locations, to ensure we receive committed and informed staff engagement.

The Carbon Reduction Commitment Energy Efficiency Scheme (CRC) began on 1 April 2010 and we have had in place since late 2009 a detailed plan to manage the impact of this. Changes to the scheme, announced in October 2010, which may increase utility costs by some 6-9%, heighten our need to reduce our qualifying emissions. We continue to install additional metering that complies with CIBSE TM 39 guidelines to allow the careful monitoring of performance. Acting upon the information gathered remains key to reducing our carbon footprint.

A large proportion of our energy is consumed by lighting and we have conducted a series of trials on energy saving fittings to replace low efficacy systems. Once the results of the savings and their suitability are confirmed, we plan to roll out a replacement programme.

Waste Management continues to be important for the Group.

Absolute Figures

Type of Waste	2006/2007 Tonnes	2007/2008 Tonnes	2008/2009 Tonnes	2009/2010 Tonnes
Landfill	13,313	10,543	7,685	8,082
Recycling	-	-	1,579	892
Clinical	12,562	13,677	11,384	12,611

Per Bed Equivalent Figures

Type of Waste	2006/2007 Tonnes	2007/2008 Tonnes	2008/2009 Tonnes	2009/2010 Tonnes
Landfill	0.39	0.28	0.20	0.21
Recycling	-	-	0.04	0.02
Clinical	0.37	0.37	0.29	0.33

Clinical waste presents particular challenges. The Group continues to seek ways to deal with this waste in an environmentally efficient way while ensuring all sites are managed in line with statutory requirements.

Suppliers

At Southern Cross we value our supplier relationships. While we look to obtain products and services at a competitive price, balanced with good service, we recognise that this is only sustainable when our suppliers also make a fair return. Equally, it is important that we honour our agreed terms of business with them. When awarding new contracts or reviewing existing supplier arrangements we seek, through our due diligence process, to understand our suppliers' environmental policies and ensure these are aligned with our own commitment to environmental best practice.

Our high volume suppliers use our eProcurement system (e-HIPO) though work continues to find ways of further streamlining the number of suppliers we use and hence the volume of paper generated.

Priorities for the Year Ahead

While the general backdrop to trading remains challenging we anticipate that our efforts to develop our CSR programme may be constrained. Our key priorities are to develop our staff engagement for the benefit of all stakeholders and reduce our carbon emissions while remaining firm on our commitment to our chosen principal charity, Action on Elder Abuse.

Directors and Officers

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Committees

Audit Committee

Nancy Hollendoner (Chairman)
Baroness Morgan of Huyton
Christopher Fisher

Nomination Committee

Ray Miles (Chairman)
Christopher Fisher
Nancy Hollendoner
Baroness Morgan of Huyton
Jamie Buchan

Remuneration Committee

Christopher Fisher (Chairman)
Baroness Morgan of Huyton
Nancy Hollendoner
Ray Miles

Quality Assurance Committee

Baroness Morgan of Huyton
(Chairman)
Nancy Hollendoner
Jamie Buchan

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1. Ray Miles (66)

Non-Executive Director and Chairman

Ray Miles became a Non-Executive Director of the Company in June 2006 and served as the Senior Independent Director until he was appointed Chairman on 1 January 2008. Mr Miles has spent most of his career in the shipping industry. From 1988 until December 2005, he was Chief Executive Officer of CP Ships Limited. He was also the Senior Independent Director of Stelmar Shipping Limited from 2004 to 2005 and Deputy Chairman of International Personal Finance PLC from July 2007, when it demerged from Provident Financial PLC, until May 2010. Mr Miles joined the advisory board of Stena AB in 2006. He is a Trustee of Country Holidays for Inner City Kids.

2. Jamie Buchan (51)

Chief Executive

Jamie Buchan was appointed as an Executive Director of the Company on 1 January 2009. Between 2002 and May 2008, Mr Buchan, backed by a Malaysian private fund, led the successful turnaround and subsequent sale of the ExCeL Exhibition and Conference Centre in London. Prior to that, Mr Buchan held leading roles in hospitality at Whitbread, in customer service and brand development at Centrica, in logistics at Ocean Group, and, for 14 years, retail service station operations in Esso, which he joined as a graduate trainee in 1981.

3. Richard Midmer (56)

Group Finance Director

Richard Midmer joined the Company as Group Finance Director on 1 July 2008. He previously worked in the oil and gas sector as Finance Director of British-Borneo Oil & Gas PLC. He joined NHP PLC, a quoted care home company, as Group Finance Director in November 2000, where he worked until its acquisition by private equity in February 2005.

4. Christopher Fisher (57)

Senior Independent Non-Executive Director

Christopher Fisher joined the Board in June 2006 and became the Senior Independent Non-Executive Director in January 2008. He is a partner in Penfida, a firm providing independent financial advice to pension fund trustees, a director of Bank of Ireland (UK) PLC and is also President of the Council of Reading University. He spent most of his career at Lazard, the investment bank, where he was a Managing Director, and has also served as Vice Chairman, Corporate Finance, at KPMG, and as a Non-Executive Director of Kelda/Yorkshire Water.

5. Baroness Morgan of Huyton (51)

Non-Executive Director

Baroness Morgan of Huyton became a Non-Executive Director of the Company in June 2006. A former teacher, Baroness Morgan worked as a senior aide to the British Prime Minister from 1997 to 2005. In 2001, she was made a peer and served as a Minister in the Cabinet Office. From 2001 to 2005, she was Director of Government Relations, Downing Street, working closely with the Prime Minister. Baroness Morgan is now working as an adviser to a children's charity, serving on the Board of the Olympic Delivery Authority, a member of the advisory committee to the Board of Virgin Group Holdings Limited and is a Non-Executive Director of Carphone Warehouse PLC.

6. Nancy Hollendonner (55)

Non-Executive Director

Nancy Hollendonner joined the Board in January 2008. Ms Hollendonner is a senior adviser on the healthcare market to Hawkpoint Partners Limited. She previously worked as an equities analyst specialising in the healthcare market and was employed by UBS Investment Bank resigning from that position in 2002. Ms Hollendonner served as a Non-Executive Director of NHP PLC between 2003 and 2005.

Company Secretary

William McLeish was appointed as Company Secretary on 25 May 2006 and is a chartered accountant. On 1 August 2007, he was elected an associate of the Institute of Chartered Secretaries and Administrators.

Notes

Kamma Foulkes resigned as an Executive Director on 31 December 2009.

Executive Committee

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1. Mark Cash (51)

Regional Director – South

Mark Cash joined the Group in September 2009. From 2004 to 2009 he was UK Operations Director for Sunrise Senior Living Ltd, overseeing its organic growth in the premium private pay assisted living and care home sector. Prior to that, he held a variety of management roles within ExxonMobil, which he joined as a graduate trainee in 1981. Until 2004 he led Exxon's company owned UK and Ireland service station network.

2. Pam Finnis (41)

Regional Director – Central

Pam Finnis joined the Executive Committee following her appointment as Regional Director in September 2009. Prior to that Mrs Finnis was the Managing Director of the Midlands Division. She has 27 years experience within the independent care sector. She is a Registered General Nurse and previously held senior management positions with Ashbourne Healthcare and Highfield Care before joining Southern Cross in 2004.

3. Irene Gray (56)

Director of Care

Having trained as a nurse in the early 1970's, Irene subsequently spent 7 years working as a ward sister in elderly care. Irene has held a number of executive roles, including Senior Civil Servant, within the NHS over a period of 24 years and joined the Company from the University Hospitals Bristol NHS Foundation Trust where she was Chief Operating Officer. In 1997 she was awarded a MSc from Nottingham University and currently holds honorary Chairs in Nursing at three universities. A 'change leader', Irene has been involved in policy development and delivery at a national level and therefore brings significant experience to her role.

4. Michael MacIntosh (36)

Regional Director – Scotland and Northern Ireland

Michael MacIntosh joined the Group in March 2009 as Managing Director of the Scottish Division, and subsequently joined the Executive Committee. Mr MacIntosh joined from Four Seasons Health Care as Director of Public Private Partnerships. Previously, he has worked for Barchester Healthcare, Westminster Health Care, the NHS and Highlands and Islands Enterprise.

5. David Smith (36)

Director of Finance and Support Services

David Smith joined the Group as Group Finance Manager in March 2006, was appointed Group Financial Controller in March 2008 and Director of Finance and Support Services on 1 September 2010. He previously spent 10 years at PwC working in various roles including secondments to Riyadh, Saudi Arabia and the United States.

6. Phil Whitaker (48)

Regional Director – North

Prior to his appointment to the Executive Committee Phil Whitaker was responsible for Southern Cross' North Eastern division having joined the Group in June 2007. Mr Whitaker has over 15 years experience in the independent health and social care sector and has previously held senior positions within BUPA and Takare PLC. Prior to this he managed services at the Department of Employment.

7. Patricia Williamson (57)

Group Human Resources Director

Patricia Williamson was appointed as Group HR Director on 1 July 2009. Patricia previously worked at Trader Media Group, part of the Guardian Media Group, as Group HR Director. Ms Williamson has considerable experience in leading and delivering business transformation gained across banking and services industries. She has held many senior positions including Chief Operating Officer for Barclays Asset & Sales Finance.

Notes

Executive Directors Jamie Buchan and Richard Midmer are also members of the Executive Committee, their biographies can be seen on page 25.

Directors' Report

The Directors present their report and the audited financial statements for the period ended 30 September 2010

Activities of the Group

The Group's principal activity is the operation of care homes for the elderly. It is also involved in the development of new homes and the provision of specialist services for people with physical and/or learning disabilities. The principal activity of the Company is a holding company.

A detailed review of the Group's activities, development of its business and future plans is provided in the Chief Executive's report and in the financial review.

Results and Dividends

The consolidated income statement, showing the results for the period, is set out on page 45. A detailed review of the Group's results is provided in the financial review.

The Directors recommend that no final dividend (2009: £Nil) be paid. The Company did not pay an interim dividend during the year (2009: £Nil).

Directors

The names of the Directors who held office during the year and up to the date of signing of the financial statements together with the biographical details of the current Directors are given on page 25.

The beneficial interests of Directors in the shares of the Company, details of service contracts and remuneration are shown in the report of the Remuneration Committee on pages 37 to 43.

Employment

The Group seeks to recruit, develop and employ throughout the organisation, suitably qualified, capable and experienced people, irrespective of age, race, religion or sexual orientation. Employee involvement in the business is encouraged. The Group communicates with its employees through the use of the Group's intranet, its regular newsletter and conferences and seminars for home and regional managers. It obtains employee feedback through employee surveys and formal focus groups. Full and fair consideration is given to applications for employment from disabled persons, having regard to their particular aptitudes and abilities. Efforts are made to continue the employment of those who become disabled during their employment. Retraining of newly disabled employees is provided where appropriate and fair consideration is given to all employees in terms of their career development and promotion prospects.

Supplier Payment Policy

It is Group policy to pay suppliers in accordance with agreed terms and conditions, provided that suppliers also comply with all relevant terms and conditions. At 30 September 2010 the Group's supplier payment period was 43 days (2009: 46 days). The Company is a holding company and does not have trade suppliers.

Financial Instruments

Information on the Group's financial risk management objectives, policies and on the exposure of the Group to relevant risks in respect of financial instruments is set out in note 22 to the consolidated financial statements.

Key Performance Indicators

The key performance indicators (KPIs) that are regularly used by the Group to monitor progress against its strategy are shown below and discussed in the Highlights section and the financial review on page 16 of the report.

KPI	Description
Quality outcome	The number of homes judged to be either good or excellent expressed as a percentage of total homes
Average occupancy	The average occupancy of available beds expressed as a percentage
Average weekly fee	The average weekly fee achieved per occupied bed
Home EBITDAR before central costs	Home EBITDAR (Earnings before interest, tax, depreciation, amortisation, rent and loss on disposal of property, plant and equipment and subsidiary undertakings, onerous contracts and related impairments, impairment of property assets held for resale and exceptional central costs) before central costs
Adjusted EBITDA	EBITDA (Earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, onerous contracts and related impairments, impairment of freehold assets held for resale and exceptional central costs) after adding back the charge for future minimum rental increases
EBITDAR margin	Home EBITDAR before central costs expressed as a percentage of revenue
Rent cover	Home EBITDAR before central costs divided by the cash rent cost

Principal Risks and Uncertainties

Southern Cross, like all businesses, faces a number of operating risks and uncertainties

There are a number of risks that could impact the Group's long-term performance and steps are taken to understand and evaluate these in order to achieve our objective of creating long-term, sustainable returns for shareholders

The Group has a risk management process in place which is designed to identify, manage and mitigate business risk. Regular reporting of these risks and the monitoring of actions and controls is conducted by the Audit Committee, which reports its findings to the Board. This process is described in the corporate governance section.

The most fundamental risks faced by the Group are

- failure to comply with regulation, possibly leading in extreme cases to the revocation of a care home's registration,
- failure to achieve quality standards, possibly leading to the suspension of admissions to our homes,
- generating severe negative publicity were a serious incident to occur at one of the Group's care homes,
- budgeted occupancy levels not being achieved with negative effects on profit,
- average weekly fees do not rise, at least in line with costs, putting profit margins under pressure,
- failure to meet bank covenants, and
- failure to attract, retain and motivate nursing and other qualified staff, adversely impacting admissions

Takeover Directive

The Company has one class of share capital, ordinary shares. There are no special control rights in relation to the Company's shares. The rules governing the appointment and replacement of Board members and changes to the Articles of Association accord with usual English company law provisions. The Board has power to purchase its own shares and is seeking renewal of that power at the forthcoming AGM within the limits set out in the notice of that meeting. There are no significant agreements to which the Company is party, which take effect, alter or terminate in the event of change of control of the Company. There are no agreements providing for compensation for Directors or employees on change of control.

Events After the Balance Sheet Date

Events which happened after the balance sheet date are set out in note 33 to the financial statements.

Substantial Shareholdings

At 3 December 2010, the Company had been notified of the following interests which exceed 3% of the Company's issued share capital

		%
Legal and General Group PLC	22,920,058	12.19
J O Hambro Capital Management Group Limited	17,300,000	9.20
Deutsche Bank AG	16,797,232	8.93
UBS Investment Bank	15,182,728	8.07
Lloyds Banking Group PLC	9,325,487	4.96
Breeden European Ventures LLC	8,250,244	4.39
JP Morgan Asset Management	6,422,964	3.42
ING Bank NV	6,310,483	3.36
Standard Life Investments Limited	6,289,756	3.34
Credit Suisse SEC (Europe) Limited	6,221,178	3.31

Charitable and Political Donations

During the period the Group made donations to charities totalling £85,464 (2009: £156,300). No political donations were made. Further information on the Group's charitable donations is disclosed in the corporate social responsibility report on pages 22 and 23.

Directors' Indemnities

The Company maintains liability insurance for its Directors and Officers. The Company also provides an indemnity for its Directors and the Secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

Annual General Meeting

The notice convening the Annual General Meeting of the Company together with explanatory resolutions is included in a separate document sent to shareholders.

Directors' Report (continued)

Statement of Directors' Responsibilities in Respect of the Annual Report, the Directors' Remuneration Report and the Financial Statements

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable IFRSs as adopted by the European Union 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 adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed in the Directors and Officers section confirm that, to the best of their knowledge

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and loss of the Group, and
- the Directors Report together with the Chief Executive's Report and Financial Review include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

Disclosure of information to Auditors

Each person who is a Director at the date of approval of this report confirms that

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware, and
- he has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

By order of the Board



William McLeish
Company Secretary
7 December 2010

Corporate Governance

Southern Cross is committed to achieving the highest standards of corporate governance possible. The Board's Code of Ethics, which is subscribed to by all Directors, sets the tone for corporate behaviour. The principles of corporate governance set out in the Combined Code on Corporate Governance issued by the Financial Reporting Standards Council in June 2008 ('the Combined Code') are fully supported by the Board.

This statement describes how the principles of the Combined Code have been applied to the Group in the current financial year.

The Board

The Board currently comprises three Non-Executive and two Executive Directors, in addition to the Non-Executive Chairman. Biographical details of the current Directors are given on page 25.

The roles of the Chairman and Chief Executive are clearly defined, approved by the Board and separate. The Chairman's primary responsibility is for leading the Board and ensuring its effectiveness. The Chief Executive is responsible for the executive management of the Group's operations and day-to-day business activities.

The Board of Southern Cross Healthcare Group PLC is collectively responsible for the success of the Group.

Its role is to

- provide entrepreneurial leadership of the Group within a framework of prudent and effective controls which enables risk to be continually assessed and managed,
- set the Group's strategic aims, and to ensure that the necessary financial and human resources are in place for the Group to meet its objectives,
- continually review the processes in place for monitoring and evaluating risk and the effectiveness of the Group's system of internal control, risk management and operational effectiveness, keeping in mind the importance of the Group's reputation and public image,
- ensure that appropriate operating budgets and longer term plans are in place and monitor management's performance against these,
- set the Group's values and standards and ensure that its obligations to its shareholders and other stakeholders are understood and met, including reporting to shareholders on the Board's stewardship,
- establish a culture, based on integrity, openness, trust and robust and constructive challenge, which motivates management to be successful, and
- ensure that the Group meets its objectives and consequently increases shareholder value.

Specific responsibilities are reserved to the Board, certain of which may be delegated in the first instance to Board Committees. The policies and procedures adopted by the Board are documented in a manual, which sets out the roles and delegated authorities applying to the Board. This manual is reviewed and updated whenever necessary.

To assist the Board in the stewardship of the Group, a comprehensive set of documents, which detail financial and operational performance tracked against budgets and key performance indicators, together with reports on personnel, developments, acquisitions, risk management and compliance matters, are provided to the Board. The Board has a formal schedule of matters reserved for its approval, these matters include approval of

- the annual strategic plan and budgets,
- the Group's risk management and treasury policies,
- major operating and capital expenditure proposals,
- substantial contracts,
- changes to the structure, size and composition of the Board,
- Group policies including the health and safety policy, and
- Corporate communications.

The Company Secretary is responsible for ensuring Board procedures are complied with. The removal from office of the Company Secretary is a matter reserved for the whole Board.

The Board meets, formally, bi-monthly, and additional meetings are arranged as necessary to consider urgent business. The Chairman also meets with the Non-Executive Directors when no Executive Directors are present. The table below summarises the total number of formal Board, Audit Committee, Nomination Committee, Remuneration Committee, Quality Assurance and Executive Committee meetings held during the year and the attendance by each Director at those meetings.

Corporate Governance (continued)

	Board	Audit	Nomination	Remuneration	Quality	Executive
Total number of meetings**	7	3	1	2	2	12
Attendance at meetings						
Roy Miles	7	–	1	2	–	–
Jamie Buchan	7	1*	1	2*	2	12
Richard Midmer	7	3*	–	–	–	11
Kamma Foulkes (resigned 31 December 2009)	1	–	–	–	–	3
Baroness Morgan of Huyton	7	3	1	2	2	–
Christopher Fisher	7	3	1	2	–	–
Nancy Hollendoner	7	3	1	2	2	–

* By invitation

** Due to diary constraints, The Board, and the Audit and Remuneration Committees met in early October 2010 rather than September as they had done previously

In addition to the above meetings, a number of meetings were held by telephone to deal with urgent business which arose between the formal meeting dates

On 2 October 2009, the Company announced that Kamma Foulkes planned to retire from the Company with effect from 31 December 2009

The induction process for new Directors is the responsibility of the Chairman. The process includes industry specific presentations from third parties and management presentations as well as visits to the Group's operations. The process is supported with a Board induction pack which is designed to provide new Directors with background documentation about the Group. It contains information on its history, operations, policies and procedures and details their duties under the Companies Act as well as explaining the additional dealing and disclosure obligations arising from the Company's stock exchange listing. Directors can take independent advice on matters relating to their duties, at the expense of the Company, and have access to the advice and services of the Company Secretary.

The Board considers Baroness Morgan of Huyton, Christopher Fisher and Nancy Hollendoner to be independent Non-Executive Directors. In the view of the Board they are independent of management and free from any relationship, business or otherwise, which could materially interfere with the exercise of their independent judgement.

Currently one third of the Directors are subject to retirement from the Board at the Company's Annual General Meeting. Details of the retiring Directors and of those individuals nominated for office are set out in the Notice calling that Meeting. The Board has resolved to adopt the recommendation contained in the UK Corporate Governance Code that all directors stand for re-election annually.

Each year, the Board carries out a formal evaluation of its own performance and of individual Directors. The evaluation covers all aspects of Board behaviours and processes including its composition, the performance of its Committees, Directors and Secretary and its interaction with its stakeholders. External advisers on corporate governance, Linstock Limited, facilitate the evaluations. This year's evaluation process is underway. The results of the last evaluation were considered by the Board at its meeting in February. The issues identified included the need:

- to improve board access to management beyond the Executive Directors,
- to expand the Group's corporate strategy,
- to adopt a consistent approach to risk management across the whole business,
- to develop an integrated human resources strategy.

The Board considers that it has made significant progress in all these areas in the course of the year.

The Non-Executive Directors, led by the Senior Independent Non-Executive Director, are responsible for evaluating the performance of the Chairman and the Executive Directors. Resources are available to support Directors in addressing any identified training needs that arise out of performance evaluations.

Conflicts of Interest

Under the Companies Act 2006, a Director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the Company's interests. The requirement is very broad and could apply, for example, if a Director becomes a Director of another company or a trustee of another organisation. The Companies Act 2006 allows Directors of public companies to authorise conflicts and potential conflicts where appropriate. The Company's Articles contain provisions which allow the Board to authorise Directors' conflicts of interest. At each Board meeting, Directors are invited to:

- declare the nature and extent of their interests (direct or indirect) in any proposed or existing transaction or arrangement with the Company, and
- update any declaration of interests which has become inaccurate or incomplete.

Board minutes evidence any conflicts that are authorised.

Committees of the Board

The Board has constituted a number of committees, specifically Audit, Remuneration, Nomination, Quality Assurance and Executive Committees. The roles and terms of reference of each committee are summarised below.

Audit Committee

The Audit Committee is comprised of the three independent Non-Executive Directors. Nancy Hollendoner, the committee's chairman, was previously an equity analyst specialising in the healthcare market with the investment bank UBS and is currently a senior adviser on the healthcare market to Hawkpoint Partners Limited. The other members of the Committee are Christopher Fisher and Baroness Morgan of Huyton. In the view of the Board both Nancy Hollendoner and Christopher Fisher bring recent and relevant financial expertise to the committee.

The Committee meets formally at least four times a year and otherwise as required. The External Auditors, Group Finance Director, Director of Finance and Support Services and Head of Internal Audit are invited to attend Audit Committee meetings. At each meeting, an opportunity is given for the Non-Executive Directors and the External Auditors to meet in private. As a matter of course the Chair of the Audit Committee communicates with the audit partner outwith formal committee meetings.

The Committee has clearly defined terms of reference, these are set out on the Group's website. Its responsibilities include assisting the Board in the effective discharge of its duties in respect of corporate governance, financial reporting, risk management, and internal control.

The Committee is responsible for making recommendations to the Board in relation to the appointment, reappointment, any matters relating to the resignation or dismissal of the External Auditors as well as the approval of External Auditor's fees. Consideration is given to the desirability of rotating both the audit firm and partner.

The independence and objectivity of the External Auditors is reviewed by the Audit Committee, with specific consideration given to the level of non-audit fees. Information on non-audit fees is given in note 6 to the consolidated financial statements. In general, non-audit fees paid to the External Auditors are not allowed to exceed the audit fee. The Committee approves each appointment and does not consider the non-audit fees paid to the External Auditors to have affected their independence or objectivity.

The Committee receives an annual independence confirmation from the External Auditors.

The Board, through its Audit Committee, receives regular reports from the Internal Audit department. Deloitte LLP provided support to the Internal Audit Department during the year. The work of that department, presented during the course of the year, was summarised in its annual report to the Committee. The Audit Committee also receives regular reports from the Group Risk Management Committee on the policies and processes in place to control and mitigate risks. These risks are continually reassessed. The findings of the Internal Audit department and the Committee's assessment of the risks facing the Group were used to create the Group's 2011 internal audit plan which has been agreed by the Audit Committee. The Committee will monitor progress against the plan.

The Chair of the Audit Committee is in regular communication with the Head of Internal Audit outwith formal committee meetings. In addition, during the year the Chair of the Audit Committee attended 4 out of 5 Group Risk Management Committee meetings as an observer.

Other work of the Committee includes evaluating the performance and effectiveness of both the external and internal audit functions. This year, Lintstock Limited, a corporate advisory firm, assisted with the review of the internal audit function.

The Committee also has responsibility for reviewing the Group's procedures by which employees may, in confidence, raise concerns about improprieties in matters of financial reporting, matters affecting the day-to-day care of residents, or other matters, and for ensuring these arrangements allow for independent investigation and appropriate follow up. In particular, the Committee approved arrangements with two external agencies for telephone 'hotlines' that staff can use to report concerns.

During the year the work undertaken by the Committee included the review of

- the appropriateness of accounting policies, estimates and judgements used in the financial statements,
- the annual and half year financial reports and quarterly management statements prior to recommending same for Board approval,
- Internal Audit reports and significant findings,
- financial risks and internal controls,
- Director and Officer expenses and related party transactions,
- external and internal auditor performance,
- external and internal audit plans and the scope of audit work,
- the impact of potential new or anticipated legislation, including, but not limited to, changes affecting accounting policies and to pensions,
- whistle-blowing arrangements,
- business continuity plans,
- treasury functions, and
- the approval of audit fees and terms of engagement.

The Committee's terms of reference are set out on the Group's website.

Corporate Governance (continued)

Remuneration Committee

The composition and role of the Remuneration Committee is described in the remuneration report on pages 37 to 43. Full details of Directors' remuneration and shareholdings are also given in that report.

Nomination Committee

The Nomination Committee comprises Ray Miles, Christopher Fisher, Baroness Morgan of Huyton, Nancy Hollendoner and Jamie Buchan. The chairman of the Committee is Ray Miles. The Committee meets formally as required.

The Committee assists the Board in discharging its responsibilities relating to the composition and make up of the Board. It is responsible for evaluating the balance of skills, knowledge and experience on the Board, identifying potential candidates to be appointed as Directors, as the need may arise, and determining succession planning for the Chairman and Chief Executive. During the year the committee met once.

The Committee's terms of reference are set out on the Group's website.

Quality Assurance Committee

The Quality Assurance Committee assists the Board in its desire to deliver the highest possible quality of care to its residents. The Quality Assurance Committee's responsibilities include monitoring the Group's compliance in relation to the obligations imposed on it by statute and by the various regulatory authorities, assessing the effectiveness of internal quality reporting and of applicable internal controls, identifying any patterns or trends evident from its review of inspection reports received from regulators, monitoring staff turnover, reviewing feedback obtained from internal surveys of residents, regulators and staff and identifying appropriate corrective actions when required.

The Committee comprises Baroness Morgan of Huyton, Nancy Hollendoner and Jamie Buchan as well as senior management and is chaired by Baroness Morgan. The Committee met twice this year.

The Committee's terms of reference are set out on the Group's website.

Executive Committee

In 2009 the Board established an Executive Committee. As well as the Executive Directors, the Committee comprises Irene Gray, Director of Care, David Smith, Director of Finance and Support Services, Patricia Williamson, Group Human Resources Director, and the four Regional Directors, namely, Phil Whitaker, Pam Finnis, Michael MacIntosh and Mark Cash.

Terms of reference for the Committee have been agreed and these are set out on the Group's website. The duties of the Committee include monitoring Group performance in all areas and directing improvements in efficiency, quality, and profitability. The Committee also monitors and influences Group strategy and is responsible for business planning processes. In summary, its role is to support the strategy of the Board and direct the day-to-day business of the Group.

Meetings are held monthly.

Internal Control and Risk Management

The Board has overall responsibility for the Group's system of internal control and risk management. The system includes an ongoing process for identifying, evaluating and managing significant risks faced by the Group. The process is designed to manage rather than eliminate the risk of failure to achieve business objectives. As with any system of internal control it can only provide reasonable, but not absolute, assurance against material misstatement or loss.

The Board has reviewed the key risks faced by the Group and the effectiveness of the Group's internal control system for the year under review and up to the date of approval of the Annual Report and Accounts.

The Group's Risk Management system is described below.

Risk Management

The Board has put in place a documented organisational structure with clearly defined and understood roles and responsibilities. Documented policies and procedures, at both home and head office level, have been established. The Board remains responsible for the Company's system of internal control and for reviewing its effectiveness. However, it has delegated day-to-day responsibility for risk management to its Group Risk Management Committee ('GRMC'). The GRMC meets every three months or more frequently if circumstances dictate.

The GRMC is chaired by the Group Finance Director and comprises representatives of the major functions of the Group, namely Finance, Operations, Human Resources, Estates, Health and Safety and Information Technology.

The GRMC is responsible for setting Group policy and strategy for risk management, identifying, assessing and managing risks facing the Group and communicating, educating and training employees on the risks facing the Group. A Risk Manager is assigned to each category of risk identified within the business.

The Risk Management Policy provides the framework for managing risk and aims to meet the requirements of good corporate governance. The management of the risks identified in our business in an appropriate way is fundamental to our approach.

The following definitions are included within the policy:

Risk: Events that may prevent the achievement of the strategic objectives of the Group,

Risk management: The process of identification and treatment of risks facing the Group so that strategic objectives may be met, and

Risk assessment: The systematic process of analysing risk.

Policy Objectives

Southern Cross is committed to effective risk management; the objectives in respect of risk management are as follows:

- to set Group policy and strategy for risk management,
- to identify threats to the achievement of the Group's business objectives,
- to assess, manage and control the Group's exposure to risk,
- to educate and train Risk Managers in risk management,
- to ensure risk management culture is embedded within the organisation, and
- to ensure timely communication of risks to both internal and external sources.

Reporting

It is the responsibility of Risk Managers to report any newly identified risks which are then considered by the GRMC at its next meeting. Reports will include findings from the self-audit tools, issues identified by Internal Audit and risks identified as a result of specific incidents that occur unexpectedly in the normal course of business. The GRMC filters these as appropriate and reports on them to the main Board through the Audit Committee. A Group Risk Register is maintained in respect of all major risks.

Internal Audit

Throughout the year, the Internal Audit Department carried out a number of audits at the Group's homes and of head office functions. Deloitte LLP were also engaged to carry out audits of head office functions. The results of these audits were reported to the Audit Committee, which communicated any significant concerns to the Board. Operational Management also performed regular audits of the homes which considered compliance with regulations and Group policies, health and safety legislation and other operational matters. To help ensure compliance, the Group has a Quality Assurance Department that assists in training operational management on internal compliance techniques and ensures that a uniform approach is adopted across the Group.

Management Information Systems

The Group has a comprehensive management information system for regular and timely reporting into the Board. Every month the financial reporting system produces reports on the results for the year and the period to date, together with key performance indicators (comparing them against budgeted performance), working capital movements, and detailed cash flow information. The management reporting system also includes information on internal, external, regulatory and compliance audits, health and safety and other operational matters. The Board reviews this information at each of its meetings.

Effectiveness of Internal Controls

An assessment is made of the financial, operational, compliance and risk management controls. Internal Audit assisted the Board in its review. In addition to its other work, Internal Audit tests the mitigating controls identified by the GRMC in relation to the Group's key risks in order to give assurance as to their effectiveness. The Committee also requires Risk Managers to certify the effectiveness of the controls identified as mitigating the risks they are responsible for.

There were no significant control failures during the year.

The Board confirms that it has reviewed the effectiveness of the system of internal controls, in accordance with the guidance 'Internal Control: Revised Guidance for Directors on the Combined Code', and is satisfied that the Group complies with that guidance.

Corporate Governance (continued)

Investor Relations

The Board supports the view that effective communications with its shareholders, the 'sell side' research analysts and the wider investment community is a critical element of corporate governance. The Chairman has overall responsibility for ensuring effective communication with the Group's shareholders and to ensure the Board develops an understanding of the views of major shareholders.

The Group's Annual and Interim Reports are the primary method by which information is communicated to our shareholders. In addition there is also regular dialogue with individual institutional shareholders. In accordance with the EU Transparency Directive the Group issues quarterly Interim Management Statements, and presentations for analysts and institutional shareholders are held after the announcement of interim and preliminary results. These presentations are recorded and can be accessed via the Group's website. All Non-Executive Directors are given the opportunity to attend these meetings and receive copies of any briefings on the Group produced by analysts or brokers. The Chairman and the Senior Independent Director are available to meet with major shareholders at any time and a number of such meetings took place during the year.

The Group's Annual General Meeting is used as an opportunity to communicate with private investors and to give all ordinary Shareholders the opportunity to ask questions of the Directors.

In an effort to communicate more readily with its Shareholders, the Group's website has been developed to incorporate an investor relations section. A profile of the Group, statutory financial statements, all announcements and the corporate calendar are included.

Going Concern

After making enquiries, the Directors have a reasonable expectation that the Group and Company have adequate resources to continue operations for the foreseeable future. For this reason the financial statements continue to be prepared on the going concern basis.

Compliance Statement

The Board confirms that for the year under review the Company has been in compliance with the provisions set out in Section 1 of the 2008 Combined Code.

By order of the Board

William McLeish
Company Secretary
7 December 2010

Remuneration Report

Introduction

The Remuneration Committee presents its annual report which is unaudited except for those parts which are stated as being audited

The following principles were applied by the Committee in setting remuneration policy

Our remuneration packages should be

Competitive The Remuneration packages should be sufficiently competitive to recruit and retain the correct calibre of individual while endeavouring to balance total reward towards performance-linked elements

Linked to Performance A significant proportion of senior management rewards are determined by the Group's success over the medium to long-term

Aligned to Shareholders A large part of the total reward package is to be paid in shares and is related to share price performance

Key Elements of Remuneration (Executive Directors)

Element	Objective	How much	Conditions
Base salary	To reflect status and responsibilities	Benchmarked to peer group	None
Benefits	To support Executives' well-being	Car allowance and insurance benefits	None
Annual bonus	To align Executives with business objectives	Up to a maximum of 100% of salary	70% based on Group performance, 30% based on personal objectives
Pension (DC)	To provide for retirement	15% of salary	None
Long-term incentives			
Share options	To align total reward with shareholder objectives	Current awards are disclosed below Future awards up to a maximum of 100% of salary will be made under the approved PSP/CSOP scheme	Various, as disclosed below

Assessing what is 'Competitive'

In order to understand the marketplace for senior executives, the Group regularly asks its remuneration advisers to benchmark Directors' remuneration packages against those of a peer group. As the peer group is small, packages are also benchmarked against FTSE 250 constituent companies. When considering the appropriate cohort for comparison purposes the Committee considers both the size and complexity of the business and thus comparison against companies in the lower half of the FTSE 250 is considered appropriate.

Balance of Remuneration

In setting remuneration policy the Committee also considered the need to balance reward for short-term performance with the objective of delivering shareholder value over the medium term and the Board's desire to see sustainable improvements in results over the medium to long-term.

Other Senior Executives

The Committee also recognises that the top executives below Board level have an important influence in the Group's ability to achieve its objectives. Accordingly the Committee also reviews the remuneration packages for the Executive Committee to ensure that they remain competitive and that, in relative terms, the correct balance is struck between the Board and the rest of the employees.

The Committee believes that appropriate rewards are available to those below board level to recognise and retain our best employees.

Linking Reward to Group Performance

The Group's strategy is described by the Chairman and by the Chief Executive in their reports on pages 2 and 8. The Board measures its progress towards achievement of its business objectives by identifying key performance indicators (KPIs), which are detailed on page 28, setting targets for these and monitoring their achievement. The Executive Directors bonuses are designed to reflect their personal accountability for achievement of objectives within their area of responsibility.

Long Term Incentives

At its AGM in February 2009, shareholders approved share option agreements for Jamie Buchan and Richard Midmer. These, one-off, agreements were proposed to address the particular circumstances faced by the Group following its refinancing in 2008. Otherwise, awards have been made to Executive Directors under the Group's approved PSP plan combined with awards under the approved Company Share Option Plan (CSOP).

Remuneration Report (continued)

Environmental, Social and Governance Issues

The Committee is able to consider environmental, social and governance issues in setting performance targets for Executive Directors although no direct link between these issues and Directors' remuneration has been made to date. Notwithstanding this the Committee believes that the current incentive structure does not present any risk in these areas.

Share Ownership

The Group believes that the awards granted to Executive Directors help ensure considerable alignment of interest between the Directors and Shareholders. The Group maintains a policy under which Executive Directors should acquire (and hold) shares in the Company equal in value to one and a half times their basic salary (two times in the case of the Chief Executive) – this shareholding to be built up over a period of time not longer than five years. Other Executive Committee members should acquire shares in the Company equal in value to one times their basic salary.

The Remuneration Committee and its Role

During the year, the Remuneration Committee comprised four Non-Executive Directors (namely, Christopher Fisher, Baroness Morgan of Huyton, Nancy Hollendoner and Ray Miles).

The Committee has clearly defined terms of reference, these are set out on the Group's website. Its responsibilities include:

- making recommendations to the Board on the Group's framework of remuneration for executive management,
- reviewing the ongoing appropriateness and relevance of the remuneration policy, and
- determining, on behalf of the Board, specific remuneration packages for each of the Executive Directors and the Chairman of the Board.

The Committee meets formally at least twice a year and otherwise as required. During the year the Committee's work included the following items:

- reviewing the competitiveness of Executive Director reward structures. The Committee takes advice from Hewitt New Bridge Street (HNBS),
- reviewing Executive Directors' and Senior Executives' salaries,
- determining awards under Share Option plans,
- determining awards under the Performance Share Plan,
- reviewing the style and content of the remuneration report to shareholders,
- setting targets for the executive bonus plan and determining outcomes, and
- determining and agreeing the Group's executive shareholding policy.

Remuneration Policy

The Group's overall policy on remuneration is to attract, develop, motivate and retain individuals at all levels, pay competitive salaries and align remuneration arrangements with the Group's strategy and objectives.

Basic Salary and Benefits

The Committee reviews basic salary and benefits each year, taking into consideration Group financial performance, individual responsibilities, skills and experience. Consideration is also given to the salaries and benefits paid to executives by other companies of similar size and standing. The last such review took place during 2009. Directors' salaries for the 2011 financial year remain unchanged since the dates of their appointments.

Annual Performance-related Bonus

Subject to attainment of certain performance targets (based on Adjusted EBITDA), Executive Directors are entitled to receive a bonus of up to 70% of basic salary. The Directors are also eligible to receive a further bonus equal to 30% of basic salary, subject to achievement of agreed personal objectives.

In respect of the 2010 financial year, the committee determined that no bonuses were payable to Executive Directors.

A bonus plan for the 2011 financial year has been agreed and personal objectives have been set and agreed with the Executive Directors.

Performance Share Plan

The Southern Cross Healthcare Group 2006 Performance Share Plan ('the PSP') was adopted by the Company in June 2006. Awards under the plan are generally made annually, based on an allocation of notional ordinary shares – equivalent in value to a maximum of 100% of annual basic salary as at the award date. However, if the Remuneration Committee decides that exceptional circumstances exist in relation to the recruitment or retention of an employee, then the maximum award will be equivalent to 200% of annual basic salary. On 24 March 2009, the Committee approved an amendment to the plan which had the effect of adding an HMRC approved section to the plan. The approved (CSOP) section allows parallel awards to be made which can benefit from beneficial tax treatment to the extent that the Group's share price at the time of exercise has increased by comparison to the price at the date of award. The gross value of awards under the amended plan is the same as it would have been under the original plan.

2008 Awards (under original PSP plan)

On 17 January 2008, 3,719,808 awards were granted with an exercise price of £Nil. A further grant of 370,970 awards with an exercise price of £Nil was made on 14 May 2008.

The Company failed to achieve the performance conditions applicable to these awards and consequently the awards under this grant have now lapsed.

2009 Awards (under combined PSP/CSOP plan)

On 29 May 2009, options over 2,365,000 shares were granted with an exercise price of £Nil. Further options over 150,000 and 130,000 shares both with an exercise price of £Nil were made on 1 July 2009 and 5 October 2009 respectively. On like dates, parallel awards were made under the approved section of the plan (being respectively, 732,282, 21,897 and 23,622). The exercise price for these CSOP options is 127p, 137p and 127p respectively.

A summary of the vesting conditions for these options follows.

Options can be exercised under the plan at the expiry of the three-year period following the date of the grant and are subject to attainment of agreed performance targets which, for these awards, will be tested at the end of the 2011 financial year.

100% of the options can be exercised on attainment of a performance target based on Adjusted EBITDA. Specifically the condition is that Adjusted EBITDA (as defined on page 28) for the 2011 financial year is required to be £90.4m for full vesting to occur. At Adjusted EBITDA of £81.4m, 10% of the award will vest. There is straight-line vesting between these points. In terms of the approved option, the option can be exercised to the extent that the share price on the exercise date exceeds the option price. At the time of vesting, to the extent that there is a gain on the option granted under the Approved Section, PSP options will be forfeited to the same value, thus maintaining the gross value of the award at the same level as it would have been had no CSOP award been made.

2010 Awards (under combined PSP/CSOP plan)

On 18 January 2010, options over 1,735,903 shares were granted with an exercise price of £Nil. Parallel awards over 375,398 shares were also made under the approved section of the plan. The exercise price for the CSOP options is 152p.

A summary of the vesting conditions for these options follows.

Options can be exercised under the plan at the expiry of the three-year period following the date of the grant and are subject to attainment of agreed performance targets which, for these awards, will be tested at the end of the 2012 financial year.

100% of the options can be exercised on attainment of a performance target based on Adjusted EPS. Specifically the condition is that Adjusted EPS (as defined) for the 2012 financial year is required to be 24.13p for full vesting to occur. At Adjusted EPS of 22.23p, 20% of the award will vest. There is straight-line vesting between these points. In terms of the approved option, the option can be exercised to the extent that the share price on the exercise date exceeds the option price. At the time of vesting, to the extent that there is a gain on the option granted under the Approved Section, PSP options will be forfeited to the same value, thus maintaining the gross value of the award at the same level as it would have been had no CSOP award been made.

General

In the event of a takeover, the normal position is that shares would vest on a pro-rata basis, subject to application of the performance conditions. However, the rules allow the Remuneration Committee to increase the number of shares to such higher number as it decides, provided that such number does not exceed the number of shares determined by reference to the performance conditions.

The Remuneration Committee considered the targets for each award to be appropriate at the date of award. Targets for future awards will be considered in the context of the Group's performance at the time of the award.

Share Option Plans

At the AGM on 16 February 2009 shareholders approved Share Option Plans for both the Chief Executive and the Group Finance Director. The options were granted on 17 February 2009.

The plans are similar in design but differ in specific clauses relating to the exercise date, number of shares under option, exercise prices and performance conditions, reflecting the different timing and circumstances of each Director's appointment. No payment is required for the grant of the options. The options are not transferable, except on death, and they are not pensionable.

The Committee can decide to satisfy the options by the payment of a cash amount or the transfer of shares equal in value to the gain made on the exercise of the option. The Chief Executive's options will lapse on 1 January 2019 while the Group Finance Director's options will lapse on 1 July 2018, both to the extent that they have not been exercised.

In both cases the options are exercisable three years after the date of appointment, other than Option 4 of the Group Finance Director's plan, which is not exercisable until after 1 January 2012.

Remuneration Report (continued)

The Chief Executive's share options are subject to the following performance conditions. The options will only be exercisable provided the share price is in excess of 130p at the time of exercise and adjusted EPS has grown by 5% compound between the 2008 financial year (adjusted EPS 19.60p) and the financial year ending on 30 September 2011. This EPS performance condition also applies to Option 4 of the Finance Director's share option award. If the EPS performance condition is not satisfied, the Committee may allow up to one third of the options affected to be exercised in the period up to 31 March 2012 if it is their opinion, acting fairly and reasonably, that the underlying financial performance of the Group satisfies allowing such exercise.

In the event of a takeover, to the extent that the Performance Conditions are satisfied, the Options may be exercised within one month (or such longer period as the Committee may permit).

SAYE

At its 2009 AGM, Shareholders approved an all employee Sharesave plan. No invitations to participate in the plan were issued in the year under review.

Amendment of Share Plans

No share plan can be amended unless shareholder approval is obtained, except for minor alterations to benefit the administration of the Plan, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for Participants or any Group Member.

Pension Benefits

Executive Directors are entitled to money purchase benefits equal to 15% of annual salary. Bonuses and awards made under any share plans are not pensionable.

Service Contracts

The Executive Directors' service agreements provide that the notice required to terminate their employment is 12 months given either by the Director or the Company. In the event of termination, Directors are expected to seek to mitigate their loss and the Committee looks to apply this principle as rigorously as possible.

The Company also has the right to terminate the employment of an Executive Director without notice or with less than 12 months' notice by making a payment in lieu of notice equal to the base salary and contractual benefits the Executive Director would be entitled to receive during any un-expired part of the notice period.

Under the current terms of the Executive Directors' service agreements, Jamie Buchan is entitled to receive a basic salary of £430,000 per annum, whilst Richard Midmer is entitled to receive a basic salary of £385,000 per annum. Richard Midmer is also entitled to a car allowance. All Executive Directors are entitled to life and healthcare insurance.

Kamma Foulkes left the Company and resigned from the Board on 31 December 2009. In compensation for the unexpired portion of her service agreement she received a cash payment of £393,000 under the terms of her compromise agreement. The Committee also agreed, within the rules of the PSP plan, to consider her a 'good leaver' in respect of her 2008 PSP award.

A summary of the specific terms of the Executive Directors' service agreements is included in the table below.

Director	Effective date	Un-expired term	Notice period
J Buchan	1 January 2009	Indefinite	12 months
R Midmer	1 July 2008	Indefinite	12 months

Outside Appointments

Executive Directors are permitted to accept or retain (pre-existing) a non-executive appointment outside the Group, subject to permission from the Committee and provided there are no conflicts of interest. Such appointments can enhance Directors' experience and add value to the Group. Fees for such appointments are normally retained by the individual Director. In the period to 30 September 2010, Jamie Buchan and Richard Midmer retained £30,000 and £62,834 respectively in respect of non-executive appointments. Kamma Foulkes did not receive any fees for non-executive appointments.

Non-Executives

The Non-Executive Directors have letters of appointment with the Company. The terms of the letters of appointment for the Non-Executive Directors are subject to the provisions of the Articles. All such appointments are for an initial term of three years from the date of the first AGM following appointment. Following recommendations from the Nomination Committee the Board resolved to re-appoint Ray Miles, Christopher Fisher and Baroness Morgan of Huyton to serve for a further three years from 31 January 2010.

The Remuneration Committee makes recommendations on the level of fees payable to the Non-Executive Directors which are set by the Board as a whole. Under his letter of appointment, the Chairman receives an annual fee of £125,000. The other Non-Executive Directors receive an annual fee of £45,000. In addition, the chairmen of the Audit, Remuneration and Quality Committees receive an annual fee of £7,500. All Non-Executive Directors receive reimbursement of business expenses incurred in the proper performance of their duties. Fees for the Chairman and other Non-Executive Directors remain at the level set at the time of the flotation in 2006.

The appointment of each of the Non-Executive Directors is terminable on one month's notice, is subject to the retirement by rotation provisions in the Articles and does not give rise to any entitlement to compensation in respect of their termination

Directors' Remuneration (audited)

	Salary or fees £'000	Annual bonus £'000	Benefits in kind £'000	Compensation for loss of office £'000	Total emoluments 2010 £'000	2009 £'000	Pension contributions 2010 £'000	2009 £'000
Executive								
J Buchan*	430	-	2	-	432	539	64	48
R Midmer	385	-	15	-	400	585	58	58
Non-Executive								
R Miles	125	-	-	-	125	170	-	-
C Fisher	53	-	-	-	53	53	-	-
Baroness Morgan of Huyton	53	-	-	-	53	53	-	-
N Hollendoner	53	-	-	-	53	53	-	-
Previous Directors								
B Colvin	-	-	-	-	-	22	-	-
J Murphy	-	-	-	-	-	128	-	52
K Foulkes**	85	-	4	393	482	448	-	41
	1,184	-	21	393	1,598	2,051	122	199

* Appointed 1 January 2009

** Kamma Foulkes salary comprises £75,000 in respect of salary and £10,000 taken in lieu of pension

Directors' Interests

The Directors of the Company had the following shareholdings in the Company at each of the balance sheet dates

	2010 Number of ordinary shares of 1p each	2009 Number of ordinary shares of 1p each
J Buchan	200,307	135,579
R Midmer	80,344	59,173
R Miles	163,837	163,837
C Fisher	100,000	70,000
Baroness Morgan of Huyton	2,222	2,222
N Hollendoner	15,919	15,919

Share Plans (audited)

As at 30 September 2010 the interests of Directors in share plans are

	Opening	Lapsed	Vested	Granted	Closing	Exercise Price	Earliest vesting date	Expiry date
PSP								
K Foulkes	39,130	39,130	-	-	-	Nil	N/A	N/A
Share Options								
R Midmer	1,000,000	-	-	-	1,000,000	£0 84	1/07/11	1/07/18
R Midmer	500,000	-	-	-	500,000	£1 26	1/07/11	1/07/18
R Midmer	500,000	-	-	-	500,000	£1 68	1/07/11	1/07/18
R Midmer	500,000	-	-	-	500,000	£2 50	1/01/12	1/01/19
J Buchan	1,800,000	-	-	-	1,800,000	£1 00	1/01/12	1/01/19
J Buchan	600,000	-	-	-	600,000	£1 50	1/01/12	1/01/19
J Buchan	600,000	-	-	-	600,000	£2 00	1/01/12	1/01/19

The Company's closing share price on 30 September 2010 was 31p, whilst the highest and lowest, during the period, was 155p and 17p, respectively

Remuneration Report (continued)

Executive Committee Remuneration

In 2009 as part of the restructuring of management responsibilities associated with the New Horizons programme, an Executive Committee comprising the Group's senior management team was formed. It has been progressively strengthened over the last financial year and now comprises four regional directors and three functional directors responsible for care, HR and finance and other central services, as well as the two Executive Directors.

The remuneration of the Executive Committee (in aggregate) excluding Executive Directors is shown in the table below.

	Salary or fees £'000	Annual bonus £'000	Benefits in kind £'000	Compensation for loss of office £'000	Total emoluments 2010 £'000	2009 £'000	Pension contributions 2010 £'000	2009 £'000
Executive Committee (Excl. Executive Directors)	1,007	63	65	144	1,279	882	131	51

As at 30 September 2010 the interests of Executive Committee members excluding executive directors in share plans are:

	Opening	Lapsed	Vested	Granted	Closing	Exercise price	Earliest vesting date	Expiry date
PSP								
2008 Award	94,363	94,363	-			Nil	N/A	N/A
2009 Award	1,120,000	119,270			1,000,730			
2010 Award		74,103		497,566	423,463			
Executive Committee (Excl. Executive Directors)	1,214,363	287,736		497,566	1,424,193			

Dilution

The current intention is to use newly issued shares to satisfy the exercise of all employee awards and executive options.

In accordance with ABI guidelines, the Company can issue a maximum of 10% of its issued share capital in a rolling 10 year period to employees under share plans. An additional guideline of 5% applies to discretionary or executive plans. As the major awards to Executive Directors were specifically approved by shareholders, the Committee may not observe this guideline in future. The table below shows the potential dilution if shares were issued to satisfy all current commitments.

Share dilution	Current total dilution	Additional dilution during year
All share plans (maximum 10%)	4.88%	(1.56%)
Discretionary share plans (maximum 5%)	4.88%	0.12%

TSR Chart of Southern Cross Healthcare Group PLC

The above chart shows the Group's relative TSR performance compared against the TSR performance of the FTSE Small Cap index constituents, excluding Investment Trusts

Christopher Fisher
Chairman of the Remuneration Committee
7 December 2010

Independent Auditors' Report to the Members of Southern Cross Healthcare Group PLC

We have audited the group financial statements of Southern Cross Healthcare Group PLC for the period ended 30 September 2010 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of changes in shareholders' equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 30, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the group financial statements

- give a true and fair view of the state of the group's affairs as at 30 September 2010 and of its loss and cash flows for the period then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion

- the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements, and
- the information given in the Corporate Governance Statement set out on pages 31 to 36 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following

- under the Companies Act 2006 we are required to report to you if, in our opinion
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit, or
- a corporate governance statement has not been prepared by the parent company.

Under the Listing Rules we are required to review

- the directors' statement, set out on pages 28 to 30, in relation to going concern, and
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Other matter

We have reported separately on the parent company financial statements of Southern Cross Healthcare Group PLC for the period ended 30 September 2010 and on the information in the Directors' Remuneration Report that is described as having been audited.



Randal Casson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
7 December 2010

Consolidated Income Statement

For the period ended 30 September 2010

	Note	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Revenue	3	958 6	937 1
Home payroll costs	3	(557 8)	(533 7)
Home running costs	3	(119 9)	(112 8)
Home EBITDAR ¹ before central costs	3	280 9	290 6
Rent			
Charge for rental amounts currently payable		(197 0)	(187 3)
Charge for future minimum rental increases		(51 3)	(51 8)
Total rent	3	(248 3)	(239 1)
Home EBITDA ² before central costs		32 6	51 5
Central costs		(36 8)	(30 8)
Adjusted EBITDA ³ before exceptional central costs and charge for future minimum rental increases		53 4	72 5
Exceptional central costs	4	(6 3)	-
Charge for future minimum rental increases	21	(51 3)	(51 8)
EBITDA		(4 2)	20 7
Loss on disposal of property, plant and equipment and subsidiary undertakings	5	(0 2)	(4 1)
Impairment of freehold assets held for sale	5	(1 1)	(7 7)
Onerous contracts and related impairments	5	(11 5)	-
Depreciation	11	(27 1)	(21 6)
Operating loss	3,6	(44 1)	(12 7)
Finance costs	7	(3 7)	(7 9)
Finance income	7	0 4	0 8
Loss before taxation		(47 4)	(19 8)
Taxation credit/(charge)	8	10 7	(2 3)
Loss attributable to ordinary shareholders of the company		(36 7)	(22 1)
	Note	Pence per share	Pence per share
Loss per share attributable to equity shareholders of the company			
Basic	10	(19 51)	(11 75)
Diluted	10	(19 51)	(11 75)

All of the above activities relate to continuing operations

The Consolidated Income Statement above represents all the gains and losses incurred by the Group during the periods presented and therefore no separate Consolidated Statement of Comprehensive Income has been presented

- 1 EBITDAR represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets held for sale, onerous contracts and related impairments, and rent
- 2 EBITDA represents earnings before interest, tax depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets held for sale and onerous contracts and related impairments
- 3 Adjusted EBITDA represents EBITDA after adding back exceptional central costs and the charge for future minimum rental increases

Consolidated Balance Sheet

As at 30 September 2010

	Note	30 Sept 2010 £'m	27 Sept 2009 £'m
ASSETS			
Non-current assets			
Property, plant and equipment	11	118 4	111 4
Goodwill	12	219 2	219 2
Deferred tax assets	23	25 2	14 7
Other non-current assets	14	3 4	3 4
Total non-current assets		366 2	348 7
Current assets			
Cash and cash equivalents	15	1 2	31 8
Trade receivables	16	32 6	37 7
Inventories	17	1 1	1 1
Property assets held for sale	13	14 0	46 5
Other current assets	16	21 3	8 9
Total current assets		70 2	126 0
Total assets	3	436 4	474 7
LIABILITIES			
Current liabilities			
Short-term financial liabilities	19	(0 6)	(21 5)
Trade and other payables	18	(93 7)	(97 9)
Provisions and similar obligations	20	(2 3)	(0 6)
Total current liabilities		(96 6)	(120 0)
Non-current liabilities			
Long-term financial liabilities	19	(6 0)	(41 7)
Provisions and similar obligations	20	(18 7)	(12 3)
Deferred government grants		(2 4)	(2 9)
Future minimum rental increase accrual	21	(260 8)	(209 5)
Total non-current liabilities		(287 9)	(266 4)
Total liabilities	3	(384 5)	(386 4)
Net assets	3	51 9	88 3
Equity			
Share capital	24	1 9	1 9
Share premium		161 5	161 5
Accumulated deficit		(111 5)	(75 1)
Total equity		51 9	88 3

The financial statements on pages 45 to 77 were approved by the Board of Directors on 7 December 2010


J Buchan
Chief Executive


R Midmer
Finance Director

Registered Number 05328138

Consolidated Cash Flow Statement

For the period ended 30 September 2010

	Note	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Cash flows from operations			
Cash generated from operations	25	33 4	87 5
Interest received		0 2	0 8
Interest and bank loan arrangement fees paid		(3 7)	(13 1)
Tax (paid)/received		(0 2)	15 6
Net cash generated from operations		29 7	90 8
Cash flows from investing activities			
Purchase of subsidiary undertakings net of cash acquired		-	(0 7)
Sales of subsidiary undertakings	5	25 5	-
Purchase of property, plant and equipment		(35 1)	(45 3)
Receipts from the sale of property, plant, equipment and other assets	5	5 7	20 4
Net cash used in investing activities		(3 9)	(25 6)
Cash flows from financing activities			
Repayment of borrowings		(88 8)	(75 9)
New borrowings		33 0	41 1
Capital element of finance leases	27	(0 6)	(0 8)
Net cash used in financing activities		(56 4)	(35 6)
Net (decrease)/increase in cash and cash equivalents		(30 6)	29 6
Opening cash and cash equivalents		31 8	2 2
Closing cash and cash equivalents	15	1 2	31 8

Note: Included within the purchase of property, plant and equipment is development expenditure on new properties totalling £2.3m (2009: £18.1m)

Consolidated Statement of Changes in Shareholders' Equity

For the period ended 30 September 2010

	Share capital £'m	Share premium £'m	Accumulated deficit £'m	Total equity £'m
At 28 September 2008	1 9	161 5	(53 3)	110 1
Loss attributable to ordinary shareholders	-	-	(22 1)	(22 1)
Share-based payments (including deferred tax of £0 1m)	-	-	0 3	0 3
At 27 September 2009	1 9	161 5	(75 1)	88 3
Loss attributable to ordinary shareholders	-	-	(36 7)	(36 7)
Share-based payments (including deferred tax of £0 1m) (note 31)	-	-	0 3	0 3
At 30 September 2010	1 9	161 5	(111 5)	51 9

Notes to the Consolidated Financial Statements

For the period ended 30 September 2010

1 General Information

Southern Cross Healthcare Group PLC ('the Company') and its subsidiaries (together 'the Group') are engaged in the operation of care homes for the elderly and the provision of specialist services for people with physical and/or learning disabilities

The Company is a public limited company incorporated and domiciled in the United Kingdom whose shares are listed and traded on the London Stock Exchange (Registered number 05328138). The address of its registered office is Southgate House, Archer Street, Darlington, County Durham DL3 6AH

The Group prepares its financial information for the financial year ending on 30 September of a given calendar year

The consolidated financial statements of the Group represent the following

Period ended 30 September 2010

The consolidated financial information of Southern Cross Healthcare Group PLC, including

- the consolidated financial information of Southern Cross Healthcare Group PLC and its subsidiaries for the period from 28 September 2009 to 30 September 2010

52 weeks ended 27 September 2009

The consolidated financial information of Southern Cross Healthcare Group PLC, including

- the consolidated financial information of Southern Cross Healthcare Group PLC and its subsidiaries for the period from 29 September 2008 to 27 September 2009

The principal subsidiaries within the Group are disclosed in note 34

2 Accounting Policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated

2.1 Basis of Preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union, and International Financial Reporting Interpretations Committee ('IFRIC') interpretations and the Companies Act 2006, as applicable to Companies reporting under IFRS

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss

At the start of the financial period, the Group changed its internal reporting cycles and now reports on a calendar monthly basis (previously the Group reported 13 periods of 4 weeks). The results for the period ended 30 September 2010 are therefore for a period of 368 days (2009: 364 days)

The following new standards, amendments and interpretations, which are in issue at the balance sheet date but not yet effective, have not been applied in these financial statements

Effective for periods commencing on or after

- IFRS9 'Financial instruments' 1 January 2013
- IAS24 Revised 'Related party disclosures' 1 January 2011
- Amendment to IFRS7 'Financial instruments: Disclosures' 1 July 2011
- Amendment to IFRIC14 'Pre-payments of a Minimum Funding Requirement' 1 January 2011
- IFRIC18 'Transfer of Assets from Customers' 30 October 2009
- IFRIC19 'Extinguishing Financial Liabilities with Equity Instruments' 1 July 2010
- Annual improvements 2010 1 January 2011

It is considered that the above standards, amendments and interpretations will not have a significant effect on the results or net assets of the Group but may increase the level of disclosure to be made in the financial statements

Notes to the Consolidated Financial Statements (continued)

2 Accounting Policies (continued)

From 28 September 2009, the following standards, amendments and interpretations became effective and were adopted by the Group

- IFRS8 'Operating segments'
- IAS1 Revised 'Presentation of financial statements'
- IAS23 Revised 'Borrowing costs'
- IAS27 Revised 'Consolidated and separate financial statements'
- IFRS1 Revised 'First time adoption of IFRS'
- IFRS3 Revised 'Business combinations'
- IFRIC13 'Customer Loyalty Programmes'
- IFRIC14 'The Limit on a Defined Benefit Asset'
- IFRIC15 'Agreements for the Construction of Real Estate'
- IFRIC16 'Hedges of a Net Investment Including Foreign Operations'
- Amendment to IAS39 'Financial instruments: Recognition and measurement', and IFRS7 'Financial instruments: Disclosures' on the reclassification of financial assets
- Amendment to IFRIC9 and IAS39 regarding embedded derivatives
- Amendment to IFRS1 'First time adoption of IFRS' and IAS27 'Consolidated and separate financial statements' on the cost of an investment in a subsidiary, jointly controlled entity or associate
- Annual improvements to IFRSs (2008)
- Amendment to IAS32 'Financial instruments: Presentation' and IAS1 'Presentation of financial statements on puttable financial instruments and obligations arising on liquidation'
- Amendment to IFRS2, 'Share-based payments' on vesting conditions and cancellations
- Annual improvements 2009
- Amendment to IFRS2 'Share-based payments – Group cash-settled share-based payment transactions'
- Amendments to IFRS1 for additional exemptions
- Amendments to IAS32 'Financial instruments: Presentation on classification of rights issues'
- Amendment to IAS39 'Financial instruments: Recognition and measurement' on eligible hedged items
- IFRIC17 'Distribution of Non-Cash Assets to Owners'

The adoption of these standards, amendments and interpretations has not had a significant impact on the Group's result for the year or equity

2.2 Significant Accounting Judgements, Estimates and Assumptions

In order to prepare these consolidated financial statements in accordance with the accounting policies below, management has used estimates and judgements to establish the amounts at which certain items are recorded. Critical accounting estimates and judgements are those which have the greatest impact on the consolidated financial statements and require the most difficult, subjective and complex judgements about matters that are inherently uncertain and are set out below

a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill represents the goodwill for a portfolio of homes, which have been allocated to a group of cash generating units which are split on a segmental basis

The Group determines whether goodwill is impaired on at least an annual basis. This requires an estimation of the value in use of the segment to which the goodwill is allocated. Estimating the value in use amount requires management to make an estimate of the expected future cash flows from the segment and to select a suitable discount rate to calculate the present value of those cash flows. Further details are given in note 12. Impairment losses on goodwill are not reversed.

b) Property Assets Held for Sale

Property assets are freehold properties acquired through acquisitions or developed by the Group that are expected to be sold within one year. All property assets held for resale are measured at the lower of carrying value and fair value, less costs to sell. Determining the fair value of the property assets requires valuation and estimation techniques to be used. When assessing the fair value of each property, management consider a number of factors including estimated sale price, internal valuations and future expected yields. Any impairment charges are recognised in the income statement.

c) Onerous Leases and Contracts

Provisions are made for future operating lease payments of vacant care homes for the full remaining lease term or up to the point at which the lease is expected to be sublet and for amounts in respect of an onerous contract. In calculating provisions for future lease payments of vacant care homes, the Group has estimated future lease payments and other associated costs over the remaining period of the lease, and the best estimate of amounts required to settle the contract. Furthermore, a suitable discount rate to calculate the present value of the future cash flows has been selected.

2 Accounting Policies (continued)

d) Leases

Judgement is required in the initial classification of leases as either operating leases or finance leases. Assets held under finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at inception of the lease, with a corresponding liability being recognised for the value of the leased asset or, if lower, the present value of the minimum lease payments. Assets held under finance leases are depreciated over the shorter of the estimated useful economic life or the lease term.

All other leases are considered to be operating leases. The land and buildings elements of a lease of land and buildings are considered separately for the purpose of lease classification, with the lease of land classified as an operating lease. Operating leases and rentals payable are charged in the income statement on a straight-line basis over the lease term. The total committed cost is determined and amortised on a straight-line basis over the lease term. The charge for rentals currently payable is the actual amount payable, in the period, by the Group for its operating leases. The charge for future minimum rental increases reflects the impact of recognising rental increases on a straight-line basis over the lease term.

Sale and leaseback transactions

When a sale and leaseback results in a finance lease, any gain on the sale is deferred and recognised as income over the lease term. Any loss on the sale is immediately recognised as an impairment loss when the sale occurs.

If the leaseback is classified as an operating lease, any gain is recognised immediately if the sale and leaseback terms are demonstrably at fair value. Otherwise, the sale and leaseback are accounted for as follows:

- if the sale price is below fair value, any profit or loss is recognised immediately except that, if the loss is compensated for by future lease payments at below market price, it is deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used,
- if the sale price is above fair value, the excess over fair value is deferred and amortised over the useful life of the asset,
- if the fair value of the asset is less than the carrying amount of the asset at the date of the transaction, the difference is recognised immediately as a loss on the sale.

2.3 Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 27 September 2009 and 30 September 2010. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Where the fair values of net assets acquired are based on provisional assessments pending final determination of certain assets and liabilities, provisional goodwill is recorded. Intangible assets in acquired companies which concern resident contracts are recognised and amortised over periods of up to three years. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is capitalised as goodwill. Goodwill is not amortised, instead impairment tests are undertaken annually, and any impairment is charged to the income statement. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

The results of subsidiaries acquired or disposed of during the period are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

2.4 Revenue Recognition

Revenue comprises the fair value of fee income relating to the provision of care services, net of price reductions directly related to sales. Fee income comprises care home fees which are recognised when delivery of service is completed.

The Group recognises revenue when the amount of revenue can be reliably measured and it is probable that future economic benefits will flow to the Group.

2.5 Home Payroll Costs

Home payroll costs represent payroll costs directly incurred at home level, including costs incurred in respect of the use of agency labour.

2.6 Home Running Costs

Home running costs represent costs of items directly incurred at home level, including food and kitchen supplies, medical supplies, utilities, maintenance and other running costs of the home.

2.7 Home EBITDAR Before Central Costs

Home EBITDAR before central costs represents profitability at home level after taking account of home payroll and home running costs, but before rental charges on operating leases, central costs and depreciation on home assets.

2.8 Central Costs

Central costs represent costs of head office support functions, including central payroll costs, other costs not directly attributable to homes and certain other payroll costs.

Notes to the Consolidated Financial Statements (continued)

2 Accounting Policies (continued)

2.9 EBITDA and Adjusted EBITDA

EBITDA represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, onerous contracts and related impairments and impairment of freehold assets held for sale. Adjusted EBITDA represents EBITDA after adding back exceptional central costs and the charge for future minimum rental increases.

The Group believes that EBITDA and Adjusted EBITDA (and measures derived therefrom including Home EBITDAR before central costs and Home EBITDA before central costs) facilitate operating performance comparisons from period to period and company to company by eliminating potential differences caused by variations in capital structures (affecting finance income and costs), tax positions, the age and book depreciation of property, plant and equipment (affecting relative depreciation expense) and intangible assets identified (affecting amortisation expense).

2.10 Exceptional Costs

Exceptional costs are events or transactions that fall within the activities of the Group and which, by virtue of their size or incidence, have been disclosed in order to improve a reader's understanding of the financial information.

2.11 Segmental Reporting

During the period, the Group has adopted the requirements of IFRS 8 'Operating Segments'. Based on the requirements of IFRS 8, the Directors consider the Group to have two reportable segments, Elderly Care and Specialist, which remain unchanged from those reported at 27 September 2009. Further details are provided in note 3 on page 56.

2.12 Share-based Compensation

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external valuer using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions, number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

2.13 Derivative Financial Instruments

The Group uses derivative financial instruments such as interest rate caps and collars to hedge its risks associated with interest rate fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently measured at fair value.

Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Fair value movements are recognised in the income statement.

2.14 Property, Plant and Equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and accumulated impairment losses. Cost includes the original purchase price of the asset and costs attributable to bringing the asset to its working condition for its intended use. Borrowing costs attributable to assets under construction are recognised as an expense as incurred. No depreciation is charged on assets under construction.

Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the balance sheet date, of each asset on a straight-line basis over its estimated useful life as follows:

- Freehold buildings – 2% per annum
- Short leasehold property – over life of lease
- Motor vehicles – 25% per annum
- Fixtures and fittings – 14% per annum
- Computer equipment – 33⅓% per annum
- The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Impairment reviews are carried out at a cash generating unit level, except where management become aware of a specific asset that is impaired within a cash generating unit.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are recognised in the income statement.

2 Accounting Policies (continued)

2.15 Intangibles

Other Intangibles

Intangible assets are carried at cost less accumulated amortisation and impairment charges

An intangible asset acquired as part of a business combination is recognised outside of goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably

2.16 Employee Benefit Costs

Staff costs comprise salaries, wages and pensions for the Group's staff as well as other staff costs. The Group operates defined contribution pension plans, which are plans under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. Contributions are recognised as employee benefit expenses as they fall due.

2.17 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in first-out (FIFO) method. Where necessary, impairment is made for obsolete, slow moving and defective stocks.

2.18 Taxation Including Deferred Tax

The tax credit or expense represents the sum of the tax currently payable and deferred tax. The tax currently payable is based on taxable profit for the period. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been in force during the period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available against which the temporary differences can be utilised. Deferred tax is calculated at the average tax rates that are expected to apply in the period when the liability is settled or the asset is realised.

Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to reserves, in which case the deferred tax is also dealt with in reserves.

2.19 Cash and Cash Equivalents

Cash and cash equivalents includes cash and balances in accounts at no or short notice.

2.20 Finance Costs

Finance costs include interest and amortisation of loan arrangement fees. Loan arrangement fees are amortised evenly using the effective rate method.

2.21 Finance Income

Finance income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

2.22 Receivables

Trade receivables defined in accordance with IAS 39 are recorded initially at fair value and subsequently measured at amortised cost using the effective interest method less provision for impairment for any doubtful amounts. A provision for impairment of trade receivables is established when there is evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the assets' carrying amount and the present value of future cash flows discounted at the effective interest rate. The movement in the provision is recognised in the income statement.

Any other receivables are recognised at their original amount less an allowance for any doubtful amounts. An allowance is made when collection of the full amount is no longer considered probable.

Notes to the Consolidated Financial Statements (continued)

2 Accounting Policies (continued)

2 23 Other Payables

Other payables primarily comprise holiday pay liabilities, other taxes and interest payable, which are measured at the best estimate of the expenditure required to settle the obligation

2 24 Government Grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the income statement on a straight-line basis over the expected lives of the related assets

2 25 Trade Payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method

2 26 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method

2 27 Share Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds

2 28 Dividend Distribution

Final dividend distribution to the Company's Shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's Shareholders. Interim dividends are recognised when paid

Financial Risk Management

2 29 Financial Risk Factors

The Group's activities expose it to a variety of financial risks: market risk (including cash flow interest rate risk), liquidity risk, and credit risk. The Group's overall risk management strategy focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance

Risk management is monitored by the Group Risk Management Committee under policies approved by the Board of Directors

2 30 Market Risk

Cash Flow Interest Rate Risk

The Group's interest rate risk arises from long-term borrowings which are issued at variable rates that expose the Group to cash flow interest rate risk

The interest exposure of the Group is managed within the constraints of the Group's business plan and the financial covenants under its facilities. The Group aims to reduce exposure to the effect of interest rate movements by hedging an appropriate amount of interest rate exposure. The impact of movements in interest rates is managed, where considered appropriate, through the use of floating rate debt and interest rate caps and collars

The Group has performed calculations to analyse its interest rate exposure taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Group calculates the impact on profit and loss of a defined interest rate shift. The scenarios are run only for liabilities that represent the major interest-bearing positions

The impact on post tax profit of a 1% shift would be a maximum increase of £0.8m (2009: £0.6m) or decrease of £0.8m (2009: £0.6m), respectively

2 31 Liquidity Risk

The policy of the Group has throughout the period been to maintain a mix of short and long-term borrowings with short-term flexibility achieved through overdraft and revolving credit facilities

2 Accounting Policies (continued)

2 32 Credit Risk

Credit risk is managed on a Group basis. Credit risk arises from cash and deposits with banks and financial institutions, as well as credit exposures to residents, including outstanding receivables. For banks and financial institutions, only institutions with a short-term credit rating, as determined by Moody's, of P-1 are accepted.

2 33 Capital Risk Management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for Shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to Shareholders, return capital to Shareholders, issue new shares or sell assets to reduce debt.

The Group's short-term objective is to reduce its debt. During the period the Group has continued to pursue its policy of reducing debt by disposing of freehold assets, making repayments of bank loans and not proposing to pay a final dividend. Further information regarding the Group's financial liabilities and undrawn facilities are set out in note 22 and the movement in net debt position is shown in note 27.

2 34 Fair Value Estimation

Interest rate cap and collar contracts have been marked to market to produce fair value figures.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of long-term borrowings approximate to the carrying value reported in the balance sheet, as the majority are variable rate borrowings.

2 35 Operating Lease Rental Increases

The majority of the Group's homes are subject to operating rental lease agreements which incorporate future increases to rental amounts currently payable. The Group's longer-term cash position depends upon it continuing to increase Adjusted EBITDA ahead of future increases to rental amounts currently payable.

Notes to the Consolidated Financial Statements (continued)

3 Segmental Analysis

During the period, the Group has adopted the requirements of IFRS 8 'Operating Segments'. The standard requires the reporting of segmental information in line with the information reviewed regularly by the 'Chief Operating Decision Maker' (CODM). The Group has concluded that the CODM is the Executive Committee. The operating segments have been identified as the four geographical segments within the Elderly Care business and the Specialist segment. Management consider the aggregation criteria of IFRS 8 have been met for the operating segments within the Elderly Care business and therefore the reportable segments remain unchanged to those reported at 27 September 2009, being Elderly Care and Specialist. Revenue, loss before taxation and total equity of the Group are wholly attributable to the operation of care homes and arise solely within the United Kingdom.

Period ended 30 September 2010

	Elderly Care Number	Specialist Number	Total Number
Available beds – average			
Acquisitions	238	–	238
Continuing operations	37,363	930	38,293
Segment available beds	37,601	930	38,531
Occupied beds			
Acquisitions	81	–	81
Continuing operations	31,864	734	32,598
Segment occupied beds	31,945	734	32,679
	Elderly Care %	Specialist %	Total %
Occupancy – average			
Acquisitions	34.0	–	34.0
Continuing operations	85.3	78.9	85.1
Segment occupancy	85.0	78.9	84.8
	£	£	£
Average weekly fee			
Acquisitions	587	–	587
Continuing operations	545	1,086	558
Segment average weekly fee	545	1,086	558

Average occupancy for the Group's mature homes (excluding new developments, or refurbished homes that have been trading for less than 12 months) was 86.1% (2009: 88.4%).

Acquisitions relate to four homes acquired during the period through agreements to lease.

Following a review of double occupancy rooms, the Group has reclassified 1,303 rooms as single occupancy. As at the beginning of FY11, this will have the net impact of reducing the number of available beds across the Group by 1,303 beds to 37,300. For FY10, this amendment to available beds would have had the effect of increasing average occupancy for the Group from 84.8% to 87.8%.

3 Segmental Analysis (continued)
52-week period ended 27 September 2009

	Elderly Care Number	Specialist Number	Total Number
Available beds – average			
Acquisitions	370	–	370
Continuing operations	36,364	930	37,294
Segment available beds	36,734	930	37,664
Occupied beds			
Acquisitions	178	–	178
Continuing operations	32,080	768	32,848
Segment occupied beds	32,258	768	33,026
	Elderly Care %	Specialist %	Total %
Occupancy – average			
Acquisitions	48.1	–	48.1
Continuing operations	88.2	82.6	88.1
Segment occupancy	87.8	82.6	87.7
	£	£	£
Average weekly fee			
Acquisitions	616	–	616
Continuing operations	532	1,097	545
Segment average weekly fee	533	1,097	546

Notes to the Consolidated Financial Statements (continued)

3 Segmental Analysis (continued)

Primary Reporting Format – Business Segment results for the period ended 30 September 2010 were as follows

	Elderly Care £'m	Specialist £'m	Total £'m
Revenue			
Acquisitions	2 5	–	2 5
Continuing operations	914 2	41 9	956 1
Segment revenue	916 7	41 9	958 6
Home payroll costs			
Acquisitions	(2 0)	–	(2 0)
Continuing operations	(529 7)	(26 1)	(555 8)
Segment Home payroll costs	(531 7)	(26 1)	(557 8)
Home running costs			
Acquisitions	(0 3)	–	(0 3)
Continuing operations	(115 1)	(4 5)	(119 6)
Segment Home running costs	(115 4)	(4 5)	(119 9)
Home EBITDAR before central costs			
Acquisitions	0 2	–	0 2
Continuing operations	269 4	11 3	280 7
Segment Home EBITDAR before central costs	269 6	11 3	280 9
Home EBITDAR before central costs (%)			
Acquisitions	8 0	–	8 0
Continuing operations	29 5	27 0	29 4
Segment Home EBITDAR before central costs (%)	29 4	27 0	29 3
Total rent			
Acquisitions	(2 1)	–	(2.1)
Continuing operations	(237 8)	(8 4)	(246.2)
Segment rent	(239 9)	(8 4)	(248.3)
Home EBITDA before central costs			
Acquisitions	(1 9)	–	(1 9)
Continuing operations	31 6	2 9	34 5
Segment Home EBITDA before central costs	29 7	2 9	32 6
Other expenses			
Loss on disposal of property, plant and equipment and subsidiary undertakings	(0 2)	–	(0 2)
Impairment of freehold assets held for sale	–	(1 1)	(1 1)
Onerous contracts and related impairments	(2 4)	(9 1)	(11 5)
Depreciation	(25 7)	(1 4)	(27 1)
Central payroll costs	(20 0)	(0 9)	(20 9)
Exceptional central costs	(6 3)	–	(6 3)
Unallocated expenses			
Central costs			(9 6)
Operating loss			(44 1)
Segments assets and liabilities			
Segment assets	408 9	27 5	436 4
Segment liabilities	(358 2)	(19 5)	(377 7)
Net segment assets	50 7	8 0	58 7
Unallocated liabilities			(6 8)
Total net assets			51 9
Other segmental items			
Capital expenditure			
- Property, plant and equipment	29 0	1 5	30 5
- Development expenditure	1 5	–	1 5
Total segmental capital expenditure	30 5	1 5	32 0
Unallocated capital expenditure			3 8
Total			35 8

3 Segmental Analysis (continued)

Unallocated liabilities comprise non-current borrowings of £6 0m, current borrowings of £0 6m and derivatives of £0 2m

The analysis above includes the charge in the period for future minimum rental increases. Excluding the impact of this charge, Home EBITDA before central costs is as follows

	Elderly Care £'m	Specialist £'m	Total £'m
Home EBITDA before the charge for future minimum rental increases and central costs			
Acquisitions	(1 0)	–	(1 0)
Continuing operations	80 3	4 6	84 9
Segment Home EBITDA before the charge for future minimum rental increases and central costs	79 3	4 6	83 9

The segment results for the 52-week period ended 27 September 2009 were as follows

	Elderly Care £'m	Specialist £'m	Total £'m
Revenue			
Acquisitions	5 7	–	5 7
Continuing operations	887 6	43 8	931 4
Segment revenue	893 3	43 8	937 1
Home payroll costs			
Acquisitions	(4 0)	–	(4 0)
Continuing operations	(501 8)	(27 9)	(529 7)
Segment Home payroll costs	(505 8)	(27 9)	(533 7)
Home running costs			
Acquisitions	(0 2)	–	(0 2)
Continuing operations	(108 0)	(4 6)	(112 6)
Segment Home running costs	(108 2)	(4 6)	(112 8)
Home EBITDAR before central costs			
Acquisitions	1 5	–	1 5
Continuing operations	277 8	11 3	289 1
Segment Home EBITDAR before central costs	279 3	11 3	290 6
Home EBITDAR before central costs (%)			
Acquisitions	26 3	–	26 3
Continuing operations	31 3	25 8	31 0
Segment Home EBITDAR before central costs (%)	31 3	25 8	31 0
Total rent			
Acquisitions	(2 4)	–	(2 4)
Continuing operations	(227 8)	(8 9)	(236 7)
Segment rent	(230 2)	(8 9)	(239 1)
Home EBITDA before central costs			
Acquisitions	(0 9)	–	(0 9)
Continuing operations	50 0	2 4	52 4
Segment Home EBITDA before central costs	49 1	2 4	51 5
Other expenses			
Loss on disposal of property, plant and equipment and subsidiary undertakings	(3 5)	(0 6)	(4 1)
Impairment of freehold assets held for sale	(5 1)	(2 6)	(7 7)
Depreciation	(20 4)	(1 2)	(21 6)
Central payroll costs	(21 8)	(0 8)	(22 6)
Unallocated expenses			
Central costs			(8 2)
Operating loss			(12 7)

Notes to the Consolidated Financial Statements (continued)

3 Segmental Analysis (continued) Segments assets and liabilities

	Elderly Care £'m	Specialist £'m	Total £'m
Segment assets	438 0	36 7	474 7
Segment liabilities	(331 0)	(13 0)	(344 0)
Net segment assets	107 0	23 7	130 7
Unallocated liabilities			(42 4)
Total net assets			88 3
Other segmental items			
Capital expenditure			
- Property, plant and equipment	26 6	1 7	28 3
- Development expenditure	16 7	-	16 7
Total segmental capital expenditure	43 3	1 7	45 0
Unallocated capital expenditure			1 9
Total			46 9

Unallocated liabilities comprise of non-current borrowings of £41 0m, current borrowings of £0 6m, current tax of £0 4m and derivatives of £0 4m

The analysis above includes the charge in the period for future minimum rental increases. Excluding the impact of this charge, Home EBITDA before central costs is as follows

	Elderly Care £'m	Specialist £'m	Total £'m
Home EBITDA before the charge for future minimum rental increases and central costs			
Acquisitions	(0 1)	-	(0 1)
Continuing operations	99 0	4 4	103 4
Segment Home EBITDA before the charge for future minimum rental increases and central costs	98 9	4 4	103 3

4 Exceptional Costs

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Exceptional costs	6 3	-

Exceptional costs relate to the internal change programme 'New Horizons', which was announced at the end of the previous financial year and other exceptional costs. In respect of New Horizons, £5 3m has been incurred to date with a further £0 2m being provided at 30 September 2010 in accordance with IAS 37 (note 20). The total costs associated with New Horizons are expected to be £6m with the majority of the remaining costs anticipated to be incurred during the first half of FY2011. Other exceptional costs of £1 0m were incurred during the period, the majority of which related to costs incurred in respect of a review of the Group's operating lease portfolio.

5 Sale of Subsidiary Undertakings, Property, Plant and Equipment, Impairment of Freehold Assets Held for Sale and Onerous Contracts and Related Impairments

During the period the Group disposed of subsidiary undertakings for net cash consideration totalling £25 5m. The related assets had a net book value of £25 7m, resulting in a loss on disposal of £0 2m.

During the period the Group disposed of freehold assets for net cash consideration totalling £5 7m which was equal to the book value of the assets.

Further freehold assets were sold for a deferred cash consideration of £0 6m, being equal to the book value of the assets.

Impairment of Freehold Assets Held for Sale

The Group has reviewed the carrying values of its freehold properties. Following this review, a number of properties were found to have a fair value less than their carrying value. As a result the carrying value of the related freeholds has been written down by £1 1m.

Onerous Contracts and Related Impairments

During the period, management took the decision to close two of its homes, as a result a charge of £11 5m has been recognised in respect of onerous contracts and included £0 9m of related impairment charges. Further disclosure is included in note 20 below.

6 Operating Loss

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
The following items have been included in arriving at operating loss		
Staff costs (note 28)	564.5	548.2
Operating lease rentals – land and buildings	248.3	239.1
Depreciation of property, plant and equipment – owned assets (note 11)	26.5	21.0
Depreciation on assets held under finance leases (note 11)	0.6	0.6
Consumables expenses through home running costs	12.0	11.9

Depreciation of property, plant and equipment includes £0.5m in relation to amortisation of government grants (2009: £0.5m)

Auditors' Remuneration

During the period, the Group obtained the following services from its Auditors at costs detailed below

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Fees payable to the Group's Auditor for the audit of the Group's annual financial statements (including the consolidated financial statements)	0.2	0.2
Fees payable to the Group's Auditor for other services		
- the auditing of financial statements of undertakings of the Group pursuant to legislation	0.1	0.1
- all other services	0.1	0.1

Other services related to fees in respect of advice on the Group's tax affairs

7 Finance Costs and Finance Income

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Interest payable on bank borrowings	2.2	6.0
Amortisation of loan arrangement fees	1.1	0.7
Movement on fair value of financial instruments	-	0.5
Other finance costs	0.4	0.7
Finance costs	3.7	7.9
Interest received on tax repayment	(0.2)	(0.6)
Movement on fair value of financial instruments	(0.2)	-
Bank interest receivable	-	(0.2)
Finance income	(0.4)	(0.8)
Finance costs – net	3.3	7.1

Notes to the Consolidated Financial Statements (continued)

8 Taxation

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Current tax		
- Current period	-	-
- Prior period (realisation of taxable losses)	-	(21 4)
- Prior period (other)	(0 3)	(2 8)
Deferred tax (note 23)		
- Current period	(8 2)	(3 9)
- Impact of rate change	0 9	-
- Prior period (realisation of taxable losses)	-	21 4
- Prior period (reversal of deferred tax asset)	(0 3)	9 7
- Prior period (other)	(2 8)	(0 7)
Taxation (credit)/charge	(10 7)	2 3

The tax for the period is higher than the average standard rate of corporation tax in the United Kingdom (28%) (2009 28%). The differences are explained below

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Loss before taxation	(47 4)	(19 8)
Loss before taxation multiplied by the standard rate of corporation tax in the United Kingdom of 28% (2009 28%)	(13 3)	(5 5)
Effects of		
Amounts in respect of prior periods	(3 4)	6 2
Expenses not deductible for tax purposes	0 7	0 2
Impairment - other	0 3	2 2
Loss on disposal - other	0 1	0 8
Tax losses arising not recognised	8 0	-
Rate differences	0 9	-
Utilisation of tax losses	(0 3)	(0 4)
Other	(3 7)	(1 2)
Tax (credit)/charge for the period	(10 7)	2 3

There are trading losses of £28.6m (tax effected £8.0m) arising in the period that cannot be recognised due to the uncertainty of their economic benefit

The tax charge is expected to be lower than the standard rate of tax in future periods due to the availability of tax losses, furthermore the tax charge will be impacted by the change in the standard rate of corporation tax from 28% to 27% from April 2011

9 Dividends Paid and Proposed

The Directors declared an interim dividend of £Nil (2009 £Nil) per ordinary share, totalling £Nil (2009 £Nil)

The Directors have decided not to recommend a final dividend for the period ended 30 September 2010

10 Loss per Ordinary Share

Loss per share is calculated by dividing the loss for the period attributable to ordinary equity holders of the parent, by the weighted average number of ordinary shares outstanding during the period

Diluted loss per share is calculated by dividing the loss for the period attributable to ordinary equity holders of the parent, by the weighted average number of ordinary shares outstanding during the period plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares

10 Loss per Ordinary Share (continued)

The following reflects the share data used in the basic and diluted earnings per share calculations

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Basic weighted average number of shares (excluding treasury shares)	188,067,377	188,067,377
Dilutive potential ordinary shares		
Employee share options	Nil	Nil
Diluted weighted average number of shares	188,067,377	188,067,377

The Group presents exceptional items and charges future minimum rental increases on the face of the income statement. Items that are considered exceptional, by virtue of their size or incidence, are disclosed in order to improve a reader's understanding of the financial information. To this end, additional basic and diluted earnings per share information, is also presented on this basis. Reconciliations of earnings and the weighted average number of ordinary shares used are set out below.

	Period ended 30 Sept 2010			52 weeks ended 27 Sept 2009		
	Earnings £'m	Basic per share amount p	Diluted per share amount p	Earnings £'m	Basic per share amount p	Diluted per share amount p
Loss attributable to ordinary Shareholders	(36.7)	(19.51)	(19.51)	(22.1)	(11.75)	(11.75)
Exceptional central costs	6.3	3.35	3.35	-	-	-
Charge for future minimum rental increases	51.3	27.27	27.27	51.8	27.54	27.54
Taxation impact of above	(16.1)	(8.56)	(8.56)	(14.5)	(7.71)	(7.71)
Profit attributable to ordinary shareholders before exceptional central costs and charges for future minimum rental increases and taxation impact thereof	4.8	2.55	2.55	15.2	8.08	8.08

11 Property, Plant and Equipment

	Freehold properties £'m	Fixtures, fittings and equipment £'m	Short leasehold property £'m	Motor vehicles £'m	Assets under construction £'m	Total £'m
Cost						
At 28 September 2008	9.0	98.8	29.2	5.3	21.8	164.1
Additions	-	25.2	1.8	0.5	19.4	46.9
Transfers	(4.4)	2.0	2.6	-	(34.8)	(34.6)
Disposals	-	(0.3)	(0.3)	-	(0.2)	(0.8)
At 27 September 2009	4.6	125.7	33.3	5.8	6.2	175.6
Additions	-	29.5	4.4	0.4	1.5	35.8
Transfers	-	3.0	2.2	-	(5.2)	-
Impairment	-	(0.1)	(0.8)	-	-	(0.9)
Disposals	(0.6)	-	-	(0.2)	-	(0.8)
At 30 September 2010	4.0	158.1	39.1	6.0	2.5	209.7
Accumulated depreciation						
At 28 September 2008	0.2	37.6	2.6	2.4	-	42.8
Charge for the period	-	19.5	1.1	1.0	-	21.6
Disposals	-	(0.1)	(0.1)	-	-	(0.2)
At 27 September 2009	0.2	57.0	3.6	3.4	-	64.2
Charge for the period	-	24.6	1.5	1.0	-	27.1
At 30 September 2010	0.2	81.6	5.1	4.4	-	91.3
Net book amount						
At 30 September 2010	3.8	76.5	34.0	1.6	2.5	118.4
At 27 September 2009	4.4	68.7	29.7	2.4	6.2	111.4

Notes to the Consolidated Financial Statements (continued)

11 Property, Plant and Equipment (continued)

The net book value of assets held under finance leases totalled £1.0m at 30 September 2010 (2009: £1.6m). The assets related to motor vehicles and other fixtures and fittings.

Following management's decision to close Abbeydale the associated fixed assets were impaired by £0.9m (see note 20). The impairment has been recognised within onerous contracts and related impairments in the income statement.

Transfers of assets under construction of £5.2m relates to the completion of three leasehold homes during the period and an extension of one home, with their associated costs being transferred to leasehold additions (£2.2m) and fixtures and fittings (£3.0m).

12 Goodwill

Group	£'m
Cost	
At 28 September 2008	218.5
Other acquisitions	0.7
At 27 September 2009 and 30 September 2010	219.2

Other acquisitions represent professional costs and associated fees in respect of acquisitions completed in the previous financial year.

Impairment Test for Goodwill

Goodwill is allocated to the Group's two business segments as shown below:

	30 Sept 2010 £'m	27 Sept 2009 £'m
Elderly care	204.0	204.0
Specialist	15.2	15.2
Services relating to corporate finance and acquisitions	219.2	219.2

Goodwill arising on acquisitions, as noted above, is not being amortised but tested annually for impairment. The date elected for impairment testing is 30 September unless there is a clear indication of impairment.

The Group conducts an annual impairment test on the carrying value of goodwill, based on the recoverable amount of the group of cash generating units ('CGUs') to which goodwill has been allocated. The recoverable amounts of the grouped CGUs are determined from in-house calculations. The key assumptions in the value-in-use calculations are the discount rate applied, the operating margin, which is driven by occupancy assumptions, and the long-term growth rate of net operating cash flows. In all cases, the Group prepares cash flow forecasts derived from the approved budgets for the next 5 years following which it extrapolates cash flows on an estimated growth rate of 3%, excluding inflation. The growth rate applied does not exceed the growth rate for the industry and country in which the Group operates.

The pre-tax rate used to discount the forecast cash flows for all CGUs is 12%. This rate represents a pre-tax rate that reflects the market value of money at the balance sheet date and the risks specific to the CGU.

The long-term operating margin assumed for a CGU's operations is primarily based on past performance at home level except where management have a strong belief that a different profit margin can be achieved.

As at 30 September 2010 and 27 September 2009, no impairment charge to goodwill has been required.

Sensitivity to Changes in Assumptions

For the Elderly Care segment, the value in use exceeds the carrying value of goodwill by approximately £53m. The following changes in assumptions would cause the following changes in the recoverable amount:

- 1% change in average annual occupancy would change the value in use by £108m
- 1% change in the long-term growth rate would change the value in use by £25m
- 1% change in the discount rate would change the value in use by £33m

For the Specialist segment, the value in use exceeds the carrying value of goodwill by approximately £1m. The following changes in assumptions would cause the following changes in the recoverable amount:

- 1% change in average annual occupancy would change the value in use by £2m
- 1% change in the long-term growth rate would change the value in use by £2m
- 1% change in the discount rate would change the value in use by £2m

13 Property Assets Held for Sale

	No of homes	£'m
Cost		
At 28 September 2008	11	36.1
Transfer from assets under construction	4	30.2
Transfer from freehold assets	8	4.4
Disposals	(3)	(16.5)
Impairment	-	(7.7)
At 27 September 2009	20	46.5
Disposals	(6)	(31.4)
Impairment	-	(1.1)
At 30 September 2010	14	14.0

Property assets held for sale consists of 14 freehold properties with a carrying value of £14.0m which the Group expects to sell in the near future. Four of the homes are included within the Elderly Care segment and ten homes within the Specialist segment.

The Group has reviewed the carrying value of properties held for sale on an individual property basis. Following this review, a number of properties were found to have a fair value lower than their carrying value. As a result the carrying value of the properties has been impaired by £1.1m (2009: £7.7m).

14 Other Non-Current Assets

	30 Sept 2010 £'m	27 Sept 2009 £'m
Other non-current assets	3.4	3.4

Other non-current assets relate to landlord rental security deposits.

15 Cash and Cash Equivalents

	30 Sept 2010 £'m	27 Sept 2009 £'m
Cash at bank and in hand	1.2	31.8

16 Trade Receivables and Other Current Assets

	30 Sept 2010 £'m	27 Sept 2009 £'m
Trade receivables	40.6	45.8
Less: provision for impairment of receivables	(8.0)	(8.1)
Trade receivables – net	32.6	37.7
Other receivables	1.2	1.7
Prepayments and accrued income	20.1	7.2
Other current assets	21.3	8.9

The carrying value of trade receivables and other current assets is stated after a provision for impairment of receivables has been made. The provision for impairment for trade receivables is calculated on an individual account by account assessment based on past and current credit history. There is no concern over the credit quality of amounts past due not impaired since most relate to local Government and for the remainder the risk is spread over a number of unrelated counterparties. The Directors consider that the carrying value of trade receivables and other current assets approximates to their fair value.

Notes to the Consolidated Financial Statements (continued)

16 Trade Receivables and Other Current Assets (continued)

Movement on the Group provision for impairment of trade receivables is as follows

	30 Sept 2010 £'m	27 Sept 2009 £'m
Opening	8 1	6 0
Provision for receivables impairment	1 6	3 6
Receivables written off during the period as uncollectible	(1 7)	(1 5)
Closing	8 0	8 1

The other classes within trade and other receivables do not contain impaired assets

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

Ageing of Trade Receivables

The ageing analysis of trade receivables and the associated provision for impairment is shown below

	30 Sept 2010		27 Sept 2009	
	Gross value £'m	Provision for impairment £'m	Gross value £'m	Provision for impairment £'m
Not yet due	11 8	–	15 9	–
Past due 0-60 days	17 2	(0 2)	17 7	(0 2)
Past due 61-119 days	3 4	(0 2)	4 6	(0 5)
Past due 120 days	8 2	(7 6)	7 6	(7 4)
	40 6	(8 0)	45 8	(8 1)

17 Inventories

	30 Sept 2010 £'m	27 Sept 2009 £'m
Consumables	1 1	1 1

The replacement cost of inventory does not differ materially from the costs stated above. There were no write-downs of inventory in the period ended 30 September 2010 or the 52 weeks ended 27 September 2009.

18 Trade and Other Payables – Current

	30 Sept 2010 £'m	27 Sept 2009 £'m
Trade payables	15 4	16 6
Other tax and social security payable	12 6	14 8
Other payables	25 6	30 4
Accruals	40 1	35 7
Corporation tax payable	–	0 4
	93 7	97 9

The Directors believe that the carrying value of the current trade and other payables approximates to their fair values as a result of the short maturity period of the amounts as at the balance sheet date.

19 Financial Liabilities – Borrowings

a) Short-term Borrowings

	30 Sept 2010 £'m	27 Sept 2009 £'m
Bank loans (secured) – net of arrangement fees totalling £Nil (2009 £0.9m)	–	20.9
Obligations under finance leases	0.6	0.6
	0.6	21.5

b) Long-term Borrowings

	30 Sept 2010 £'m	27 Sept 2009 £'m
Bank loans (secured) – net of arrangement fees totalling £1.9m (2009 £0.8m)	5.6	40.7
Obligations under finance leases	0.4	1.0
	6.0	41.7

Bank Loans

On 18 May 2010 the Group consolidated its existing banking arrangements into a revised £50m revolving credit facility. Interest on drawn amounts is charged at margins between 2.75% and 3.25% above LIBOR. At 30 September 2010, the Group had £7.5m drawn on the facility all of which is due for repayment after one year. Unamortised arrangement fees were £1.9m.

At 30 September 2010, the Group had the following interest rate instruments in place:

- Interest rate caps which cap the interest paid on £13.6m of the Group's variable rate debt at 4.62% plus margin and which expire in June 2011.
- Interest rate collars which mean that the Group will pay a maximum of 4.5% plus margin and minimum of 2.57% plus margin on £14.3m of the Group's variable debt and which expire in June 2011.

Finance Leases

As at 30 September 2010, the Group had finance leases due in less than one year of £0.6m (2009 £0.6m), due in one to two years of £0.4m (2009 £0.5m) and due in three to five years of £Nil (2009 £0.5m).

20 Provisions and Similar Obligations

	Vacant properties £'m	Onerous contracts £'m	Other provisions £'m	Total £'m
At 29 September 2008	5.1	4.3	–	9.4
Additions	1.1	2.9	–	4.0
Utilised in the period	(0.5)	–	–	(0.5)
At 27 September 2009	5.7	7.2	–	12.9
Additions	2.4	9.1	0.7	12.2
Utilised in the period	(0.6)	(3.0)	(0.5)	(4.1)
At 30 September 2010	7.5	13.3	0.2	21.0
Analysis of total provisions at 27 September 2009				
Current	0.6	–	–	0.6
Non-current	5.1	7.2	–	12.3
	5.7	7.2	–	12.9
Analysis of total provisions at 30 September 2010				
Current	1.3	0.8	0.2	2.3
Non-current	6.2	12.5	–	18.7
	7.5	13.3	0.2	21.0

Notes to the Consolidated Financial Statements (continued)

20 Provisions and Similar Obligations (continued)

The provision for vacant properties relates to rents payable on leased properties. During the period, £2.4m was charged to the income statements in respect of a vacant property. Of the £7.5m provision, £1.3m is expected to be utilised within one year with the remaining £6.2m to be utilised in more than one year.

During the period £9.1m was charged to the income statement in relation to an onerous contract. Of the provision, £3.0m was utilised in the period with £0.8m due to be utilised within one year and £12.5m in more than one year.

A further provision of £0.7m has been recognised in the period being direct expenses arising from the 'New Horizons' change programme, and has been charged to exceptional central costs in accordance with IAS 37. Of this provision, £0.5m has been utilised in the period with the remaining £0.2m due to be fully utilised within one year.

21 Future Minimum Rental Increase Accrual

	30 Sept 2010 £'m	27 Sept 2009 £'m
Future minimum rental increase accrual	260.8	209.5

The future minimum rental increase accrual represents the cumulative difference between operating lease charges under IFRS and the amounts actually payable up to the period end.

An analysis of the movement during the period is given below.

	30 Sept 2010 £'m	27 Sept 2009 £'m
Opening balance	209.5	157.7
Charged to income statement	51.3	51.8
Closing balance	260.8	209.5

22 Financial Instruments

Numerical financial instruments disclosures are set out below. Additional disclosures are set out in the accounting policies relating to risk management.

In accordance with IAS 39, 'Financial Instruments: Recognition and Measurement', management has reviewed contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. No such embedded derivatives were found.

Financial Instruments

The Group's financial instruments, other than derivatives, comprise borrowings, cash and liquid resources and various items such as trade receivables and trade payables, that arise directly from its operations. The main purpose of these financial instruments is to manage the financing of the Group's operations. The Group also enters into derivative transactions. The purpose of such transactions is to manage the interest rate risks arising from the Group's operations and its sources of finance.

It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies remained unchanged throughout the periods presented.

Currency Risks

The Group is based in the United Kingdom, with its operations entirely within the United Kingdom. It does not hold any investment in overseas operations and consequently the balance sheet is not exposed to movements in currency exchange rates. The Group does not have sales or purchase transactions in currencies other than the unit's functional currency and consequently does not have transactional currency exposures.

22 Financial Instruments (continued)

Numerical Disclosures

Interest Rate Risk

The Group has both interest bearing assets and liabilities. Interest bearing assets comprise only cash balances, which earn interest at a floating rate of interest linked to UK Bank base rate. The Group's policy and processes for managing interest rate risk are explained in the accounting policies (note 2.29).

After taking into account interest rate caps and collars entered into by the Group, the interest rate profile of the Group's financial liabilities is

	30 Sept 2010 £'m	27 Sept 2009 £'m
Floating rate borrowings		
Bank borrowings	7.5	63.3
Fixed rate liabilities		
Finance leases	1.0	1.6
Total borrowings	8.5	64.9
Fixed rate weighted average interest rate, excluding no interest-paid items (%)	8.05%	8.14%
Fixed rate weighted average interest period, excluding no interest-paid items (years)	2.2	3.0

The floating rate financial liabilities have comprised

Sterling denominated bank borrowings and overdrafts that bear interest at rates between 2.75% and 3.25% above UK bank base rates.

Maturity of Financial Liabilities and Undrawn Commitments

The maturity profile of the Group's financial liabilities is as follows

	30 Sept 2010 £'m	27 Sept 2009 £'m
Within one year	98.7	123.4
In more than one year, but less than two years	11.2	43.6
In more than two years, but less than five years	15.0	12.1
More than five years	4.0	4.1
	128.9	183.2

Included within the above is £3.1m of expected future interest charges (2009: £5.0m)

Notes to the Consolidated Financial Statements (continued)

22 Financial Instruments (continued)

The Group's undrawn commitments expiry date profile is as follows

	30 Sept 2010 £'m	27 Sept 2009 £'m
Within one year	–	–
In more than one year, but less than two years	–	34.5
In more than two years, but less than five years	29.7	–
	29.7	34.5

Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below

	2010 Loans and receivables £'m
Assets as per balance sheet	
Cash and cash equivalents	1.2
Trade receivables	32.6
Other current assets	1.2
Other non-current assets	3.4
	38.4

	Liabilities at fair value through profit and loss £'m	2010 Other financial liabilities £'m	Total £'m
Liabilities as per balance sheet			
Short-term financial liabilities – borrowings	–	0.6	0.6
Long-term financial liabilities – borrowings	–	7.9	7.9
Trade and other payables	–	67.9	67.9
Derivative financial instruments – interest rate cap and collar	0.2	–	0.2
	0.2	76.4	76.6

	2009 Loans and receivables £'m
Assets as per balance sheet	
Cash and cash equivalents	31.8
Trade receivables	37.7
Other current assets	1.7
Other non-current assets	3.4
	74.6

22 Financial Instruments (continued)

	Liabilities at fair value through profit and loss £'m	2009 Other financial liabilities £'m	Total £'m
Liabilities as per balance sheet			
Short-term financial liabilities – borrowings	–	22 4	22 4
Long-term financial liabilities – borrowings	–	42 5	42 5
Trade and other payables	–	69 4	69 4
Derivative financial instruments – interest rate cap and collar	0 4	–	0 4
	0 4	134 3	134 7

The Directors consider that the carrying amount of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values

The interest rate cap and collar is included within accruals (note 18)

Interest rate cap and collar contracts have been marked to market to produce fair value figures. All other fair values shown above have been calculated by discounting cash flows at prevailing interest rates. For floating rate bank loans, fair values closely approximate to book values.

The fair value of short-term loans and overdrafts approximate to the fair carrying value because of the short maturity of these instruments. The fair value of long-term borrowings approximate to the carrying value reported in the balance sheet as the majority are floating rate.

23 Deferred Tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 27% (2009: 28%)

The movement on the deferred tax account is as shown below

	30 Sept 2010 £'m	27 Sept 2009 £'m
Opening balance	(14 7)	(41 2)
Income and expense (credit)/charge (note 8)	(10 4)	26 6
Tax charged directly to equity	(0 1)	(0 1)
Closing balance	(25 2)	(14 7)

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets where it is probable that these assets will be recovered. At the period end deferred tax assets of £39.7m (2009: £33.3m) were not recognised.

A number of changes to the UK Corporation tax system were announced in the June 2010 Budget Statement. The Finance (No 2) Act 2010, which was substantively enacted on 20 July 2010, includes legislation reducing the main rate of corporation tax from 28% to 27% from 1 April 2011. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 24% by 1 April 2014.

The proposed reductions of the main rate of corporation tax by 1% per year to 24% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the changes from 27% to 24%, if these applied to the deferred tax balance at 30 September 2010 would be to reduce the deferred tax asset by approximately £2.8m (being £24.3m recognised in 2012, £23.3m recognised in 2013 and £22.4m recognised in 2014).

The movements in deferred tax assets and liabilities (prior to the offsetting of balances within the same jurisdiction as permitted by IAS12) during the period are shown below

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

Notes to the Consolidated Financial Statements (continued)

23 Deferred Tax (continued)

Deferred Tax Assets

	Accelerated tax depreciation £'m	Other £'m	Total £'m
At 28 September 2009	(16 1)	1 4	(14 7)
Income and expense (credit)/charge	(7 9)	0 6	(7 3)
Tax charged directly to equity	–	(0 1)	(0 1)
Prior period adjustments	(2 5)	(0 6)	(3 1)
At 30 September 2010	(26 5)	1 3	(25 2)

24 Share Capital

	30 Sept 2010 Number	27 Sept 2009 Number
Authorised		
Ordinary shares of 1p each	300,000,000	300,000,000
	£'m	£'m
Ordinary shares of 1p each	3	3
	Number	Number
Allotted, called up and fully paid		
Ordinary shares of 1p each	188,067,377	188,067,377
	£'m	£'m
Ordinary shares of 1p each	1 9	1 9

25 Cash Flows from Operations

Reconciliation of operating loss before taxation to net cash flow from operating activities

	30 Sept 2010 £'m	27 Sept 2009 £'m
Operating loss	(44 1)	(12 7)
Adjustments for		
Loss on disposal of property, plant and equipment and subsidiary undertakings	0 2	4 1
Impairment of freehold assets held for sale	1 1	7 7
Depreciation	27 1	21 6
Share-based payments	0 3	0 2
Changes in working capital (excluding effects of acquisitions and sale of subsidiaries and other businesses)		
Decrease in inventories	–	0 2
(Increase)/decrease in trade and other receivables	(7 3)	6 0
(Decrease)/increase in payables	(3 3)	9 1
Increase in future minimum rental accrual	51 3	51 8
Increase/(decrease) in provisions	8 1	(0 5)
Cash generated from operations	33 4	87 5

26 Reconciliation of Net Cash Flow to Movement in Net Debt

	30 Sept 2010 £'m	27 Sept 2009 £'m
Net (decrease)/increase in cash for the period	(30 6)	29 6
Cash outflow from decrease in debt	56 4	35 6
	25 8	65 2
Non-cash items		
New finance leases	–	(0 4)
Rolled-up interest	–	(0 4)
Movement in net debt	25 8	64 4
Opening net debt	(33 1)	(97 5)
Closing net debt	(7 3)	(33 1)

27 Analysis of Net Debt

	At 28 Sept 2009 £'m	Cash flow £'m	At 30 Sept 2010 £'m
Cash	31 8	(30 6)	1 2
Bank loans due within one year	(21 8)	21 8	–
Finance leases due within one year	(0 6)	–	(0 6)
Bank loans due after more than one year	(41 5)	34 0	(7 5)
Finance leases due after more than one year	(1 0)	0 6	(0 4)
	(64 9)	56 4	(8 5)
Net debt	(33 1)	25 8	(7 3)

28 Staff Costs

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Staff costs for the Group during the period		
Wages and salaries	523 6	508 5
Social security costs	39 9	38 9
Other pension costs	1 0	0 8
	564 5	548 2
Staff costs for the Group by function		
Home payroll costs – excluding agency and other staff-related costs	543 6	525 7
Central payroll costs	20 9	22 5
	564 5	548 2

Home payroll costs, as disclosed on the face of the income statement include agency and other staff-related costs. Agency and other staff related costs totalled £14.2m and £8.0m for the periods ended 30 September 2010 and 27 September 2009 respectively.

Average monthly number of people (including Executive Directors) employed

	Period ended 30 Sept 2010 Number	52 weeks ended 27 Sept 2009 Number
By activity		
Care and ancillary	35,760	35,222
Management and administration	2,103	2,107
	37,863	37,329

Notes to the Consolidated Financial Statements (continued)

28 Staff Costs (continued)

Directors' Remuneration

A detailed analysis of Directors' remuneration, including salaries, performance-related bonuses and share option schemes is provided in the remuneration report on pages 37 to 43 under the heading Directors' remuneration, which form part of these financial statements

The total remuneration of the Directors comprises

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m
Aggregate emoluments	1 2	1 9
Compensation for loss of office	0 4	0 1
Company contributions to money purchase pension schemes	0 1	0 2
	1 7	2 2

Details of the highest paid Director are given in the remuneration report under the heading Directors' remuneration (audited)

Compensation for loss of office relates to termination benefits

The key management of the Group are deemed to be the Board of Directors, who have authority and responsibility for planning and controlling all significant activities of the Group

29 Contingent Liabilities

The Group has provided guarantees to certain of the Group's landlords and holders of loan notes. As at 30 September 2010, these guarantees totalled £11.8m (2009: £11.5m)

30 Financial Commitments

At 30 September 2010, and 27 September 2009 the Group had total commitments under non-cancellable operating leases as follows

	30 Sept 2010 £'m	27 Sept 2009 £'m
Within one year	250 4	246 6
Within one to five years	1,001 6	986 4
Over five years	4,524 3	4,694 2
	5,776 3	5,927 2

The majority of operating leases provide for fixed annual increases at 2.5% or 2.75%, or annual rent increases based on the retail price index ('RPI'), subject to negotiated caps and floors

Financial commitments, due within one year, under non-cancellable operating leases and analysed by nature of lease terms are included below

	30 Sept 2010 £'m	27 Sept 2009 £'m
Annual rental increases based on RPI subject to cap and floor arrangement	63 2	61 1
Fixed annual rental increases	144 3	142 8
Five-yearly, fixed, rental increases	34 0	33 9
Annual rental increases based on RPI	8 9	8 8
	250 4	246 6

31 Share-based Payments

The total charge for share-based payments was £0.3m (2009: £0.2m), all of which relates to equity-settled transactions

2006 Performance Share Plan

The Southern Cross Healthcare Group 2006 Performance Share Plan (the 'PSP') was amended on 24 March 2009 by adding an HMRC-approved section to the plan. The PSP is available to Executive Directors and approximately 1,000 members of management. Annual grants are made under the PSP with a value of up to 100% of an individual's salary. Vesting of shares is subject to performance conditions based on earnings per share and, in respect of the 2008 awards, total shareholder return. Further details of the vesting conditions are given in the remuneration report on page 39.

31 Share-based Payments (continued)

A reconciliation of option movements during the period is given below

	Period ended 30 Sept 2010		52 weeks ended 27 Sept 2009	
	Number '000	Weighted average exercise price p	Number '000	Weighted average exercise price p
Outstanding				
Beginning of period	5,139	£Nil	5,010	£Nil
Granted	1,866	£Nil	2,515	£Nil
Lapsed	(3,334)	£Nil	(2,386)	£Nil
End of period	3,671	£Nil	5,139	£Nil

The fair value per option granted and the assumptions used in the calculation are as follows

Grant date	January 2010	October 2009	July 2009	May 2009	May 2008	January 2008
Share price at grant date	£1 55	£1 27	£1 48	£1 30	£3 83	£4 55
Exercise price	£Nil	£Nil	£Nil	£Nil	£Nil	£Nil
Number granted	1,735,903	130,000	150,000	2,365,000	370,970	3,719,808
Vesting period (years)	3	3	3	3	3	3
Expected volatility	n/a	n/a	n/a	n/a	29 00%	29 00%
Contracted life (years)	3	3	3	3	3	3
Risk free rate	n/a	n/a	n/a	n/a	4 26%	4 26%
Dividend yield	n/a	n/a	n/a	n/a	2 16%	2 16%
Fair value per option	£1 55	£1 27	£1 48	£1 30	£6 96	£6 96

January and May 2008 Awards

Options were valued using the Monte Carlo option-pricing model

Expected volatility is based on historical volatility of shares in the same sector over the past four years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with assumed option life

The weighted average remaining contractual life of options outstanding at the end of the period was 3 months

No options were exercisable at 30 September 2010

May, July and October 2009 Awards

The options will become exercisable on attainment of a performance target based on Adjusted EBITDA. As such, the expected volatility is not applicable and the fair value per option is the share price at the grant date

The weighted average remaining contractual life of options outstanding at the end of the period was 20 months

No options were exercisable at 30 September 2010

January 2010 Award

The options will become exercisable on attainment of a performance target based on Adjusted EPS. As such, the expected volatility is not applicable and the fair value per option is the share price at the grant date

The weighted average remaining contractual life of options outstanding at the end of the period was 27 months

No options were exercisable at 30 September 2010

Share Option Plans

Share Option Plans are available to the Chief Executive and Group Finance Director. The plans are similar in design but differ in specific clauses, reflecting the different timing and circumstances of each Director's appointment. Further details are given in the remuneration report on page 39

Notes to the Consolidated Financial Statements (continued)

31 Share-based Payments (continued)

A reconciliation of the Chief Executive and Group Finance Director option movements during the period is given below

	Period ended 30 Sept 2010		52 weeks ended 27 Sept 2009	
	Number '000	Weighted average exercise price p	Number '000	Weighted average exercise price p
Outstanding				
Beginning of period	5,500	1.36	–	n/a
Granted	–	n/a	5,500	1.36
End of period	5,500	1.36	5,500	1.36

The fair value of the options granted and the assumptions used in the calculation are as follows

	February 2009
Grant date	
Share price at grant date	£0.92
Exercise price (weighted average)	£1.36
Number granted	5,500,000
Vesting period (years)	3
Expected volatility	39%
Contracted life (years)	3
Risk free rate	n/a
Dividend yield	n/a
Fair value per option (weighted average)	£0.18

Options were valued using the Binomial lattice model

Expected volatility is based on historical volatility of shares in the same sector over the past four years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with assumed option life.

The weighted average remaining contractual life of options outstanding at the end of the period was 13.0 months.

No options were exercisable at 30 September 2010.

32 Related Party Transactions

Except for transactions with subsidiary undertakings, there were no related party transactions during the period ended 30 September 2010. Details of principal subsidiary undertakings are given in note 34.

33 Events After the Balance Sheet Date

Revisions to Banking Facilities

Following recent discussions with the Group's lenders, revisions to the existing banking arrangements were agreed on 6 December 2010. The Group's facility now comprises an amortising £45m RCF repayable in September 2012, with the fixed charge covenant relaxed from 1.23x to 1.1x. The first amortisation, of £3.3m, takes place on 1 October 2011.

34 Principal Subsidiary Undertakings

The principal subsidiary undertakings as at 30 September 2010, all of which have a period end of 30 September 2010, and 100% of the ordinary shares are owned and registered in England and Wales (unless otherwise stated SC = registered in Scotland) and have been consolidated in the Group financial statements, are as follows

Care Home Operating Companies	Intermediate Holding Companies
APTA Healthcare (UK) Limited	APTA Healthcare Limited
Ashbourne (Eton) Limited	Ashbourne Holdings Limited
Ashbourne Group UK Limited (SC)	Ashbourne Limited
Ashbourne Homes Limited (SC)	CCSX Holdings Limited
Exceler Health Care Group Limited	CCSX Limited
Exceler Healthcare Services Limited	CCSX Ventures Limited
Southern Cross BC Opco Limited	Southern Cross (Highfield Holdco) Limited
Southern Cross Cymru Limited	Southern Cross (SX Holdco) Limited
Southern Cross Care Homes No 2 Limited	Southern Cross Bidco Limited
Southern Cross (Focus) Limited	Southern Cross Care Homes Holdings Limited
Southern Cross Healthcare Services Limited	Southern Cross Care Homes Limited
Southern Cross Home Properties Limited	Southern Cross Finance Limited
Southern Cross (LSC) Limited	Southern Cross Healthcare Investments No 1 Limited
Southern Cross Opco Limited	Southern Cross Healthcare Investments No 2 Limited
Trinity Care Limited	Southern Cross Healthcare Limited

Independent Auditors' Report to the Members of Southern Cross Healthcare Group PLC (Company)

We have audited the parent company financial statements of Southern Cross Healthcare Group PLC for the period ended 30 September 2010 which comprise the company balance sheet, company statement of changes in shareholders' equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 30, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2010,
- have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006,
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' Report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the group financial statements of Southern Cross Healthcare Group PLC for the period ended 30 September 2010.



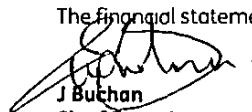
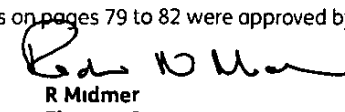
Randal Casson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
7 December 2010

Company Balance Sheet

As at 30 September 2010

	Note	30 Sept 2010 £'m	27 Sept 2009 £'m
ASSETS			
Non-current assets			
Investments	2	-	-
Other receivables - amounts due from subsidiary undertakings	3	238 2	232 4
Total non-current assets		238 2	232 4
Total assets		238 2	232 4
LIABILITIES			
Current liabilities			
Other payables	4	(2 6)	(3 2)
Total current liabilities		(2 6)	(3 2)
Non-current liabilities			
Provisions and similar obligations	5	(6 8)	(7 1)
Total non-current liabilities		(6 8)	(7 1)
Total liabilities		(9 4)	(10 3)
Net assets		228 8	222 1
Equity			
Share capital	6	1 9	1 9
Share premium		161 5	161 5
Retained earnings		65 4	58 7
Total equity		228 8	222 1

The financial statements on pages 79 to 82 were approved by the Board of Directors on 7 December 2010 and signed on their behalf by

 
J Buchan R Midmer
Chief Executive Finance Director

Company Statement of Changes in Shareholders' Equity

For the period ended 30 September 2010

	Share capital £'m	Share premium £'m	Retained earnings £'m	Total equity £'m
Balance at 28 September 2008	1 9	161 5	53 5	216 9
Profit attributable to ordinary shareholders	-	-	5 2	5 2
Balance at 27 September 2009	1 9	161 5	58 7	222 1
Profit attributable to ordinary shareholders	-	-	6 7	6 7
Balance at 30 September 2010	1 9	161 5	65 4	228 8

Registered Number 05328138

Statement of Accounting Policies

The Company's accounting policies are the same as those set out in the statement of accounting policies of the Group financial statements, except as noted below

Cash Flow Statement

The Company is a holding company and does not hold any bank accounts. Transactions such as dividend payments to Shareholders are paid by subsidiary companies and charged through intercompany accounts. Therefore no cash flow statement has been presented.

Fixed Asset Investments

Fixed asset investments are included at cost, less any provision for impairment.

Notes to the Financial Statements

For the period ended 30 September 2010

1 Income Statement

Southern Cross Healthcare Group PLC Company has not presented its own income statement as permitted by Section 408 of the Companies Act 2006. The profit attributable to ordinary shareholders for the financial period dealt with in the accounts of the Company is £6.7m (2009: £5.2m).

The audit fee in respect of the Company was £7,000 (2009: £7,000). The Company has no employees (2009: none). Directors are remunerated by other Group companies in the current period and prior period.

2 Investments

Company	£'000
At 30 September 2010 and 27 September 2009	3

The principal subsidiary undertakings as at 30 September 2010, all of which have a period end of 30 September 2010, and 100% of the ordinary shares are owned and registered in England and Wales (SC = registered in Scotland) unless otherwise stated and have been consolidated in the Group financial information, are given in note 34 of the Group financial statements.

All investments are held indirectly via the intermediate holding company, Southern Cross Bidco Limited, with the exception of Southern Cross Healthcare Investments No 1 Limited and Southern Cross Healthcare Investments No 2 Limited.

The Directors believe that the carrying value of the investments is supported by their underlying net assets.

3 Other Receivables

Amounts due after more than one year

	30 Sept 2010 £'m	27 Sept 2009 £'m
Amounts due from subsidiary undertakings	238.2	232.4

Amounts due from subsidiary undertakings are unsecured. Interest is charged at a rate of 4% (2009: 5%).

The fair value of trade and other receivables is equal to the amounts shown above.

4 Other Payables

	30 Sept 2010 £'m	27 Sept 2009 £'m
Corporation tax	2.6	3.2

5 Provisions and Similar Obligations

	Provisions £'m
At 27 September 2009	7.1
Utilised in the period	(0.3)
At 30 September 2010	6.8

Provisions relate to amounts provided in respect of an onerous contract, which is expected to be settled in more than one year.

Notes to the Financial Statements (continued)

6 Share Capital

	30 Sept 2010 Number	27 Sept 2009 Number
Authorised		
Ordinary shares of 1p each	300,000,000	300,000,000
	£'m	£'m
Ordinary shares of 1p each	3	3
	Number	Number
Allotted and fully paid		
Ordinary shares of 1p each	188,067,377	188,067,377
	£'m	£'m
Ordinary shares of 1p each	19	19

7 Dividends Paid and Proposed

The Directors declared an interim dividend of £Nil (2009 £Nil) per share, totalling £Nil (2009 £Nil)

The Directors have decided not to recommend a final dividend for the period ended 30 September 2010 (2009 £Nil)

8 Related Party Transactions

Transactions with subsidiary undertakings for the period ended 30 September 2010

	Movement in provisions £'m	Tax relief received £'m	Interest received £'m	Amounts owed to £'m
Subsidiary undertakings	(0.3)	(3.2)	9.3	238.2

Transactions with subsidiary undertakings for the period ended 27 September 2009

	Movement in provisions £'m	Dividend received £'m	Interest received £'m	Amounts owed to £'m
Subsidiary undertakings	-	(4.5)	11.3	232.4

Three-year Record

The following table shows the most recent three-year record under IFRS

	Period ended 30 Sept 2010 £'m	52 weeks ended 27 Sept 2009 £'m	52 weeks ended 28 Sept 2008 £'m
Revenue	958 6	937 1	889 4
Home payroll costs	(557 8)	(533 7)	(500 6)
Home running costs	(119 9)	(112 8)	(113 1)
Home EBITDAR ¹ before central costs	280 9	290 6	275 7
Rent			
Charge for rental amounts currently payable	(197 0)	(187 3)	(171 1)
Charge for future minimum rental increases	(51 3)	(51 8)	(50 5)
Total rent	(248 3)	(239 1)	(221 6)
Home EBITDA ² before central costs	32 6	51 5	54 1
Central costs	(36 8)	(30 8)	(26 5)
Adjusted EBITDA ³ before exceptional central costs and charge for future minimum rental increases	53 4	72 5	78 1
Exceptional central costs	(6 3)	-	-
Charge for future minimum rental increases	(51 3)	(51 8)	(50 5)
EBITDA	(4 2)	20 7	27 6
Loss on disposal of property, plant and equipment and subsidiary undertakings	(0 2)	(4 1)	(9 6)
Impairment of freehold assets held for sale	(1 1)	(7 7)	(4 5)
Depreciation	(27 1)	(21 6)	(17 6)
Amortisation	-	-	(1 1)
Onerous contract and related impairments	(11 5)	-	-
Operating loss	(44 1)	(12 7)	(5 2)
Finance costs	(3 7)	(7 9)	(11 2)
Exceptional finance costs	-	-	(6 9)
Total finance costs	(3 7)	(7 9)	(18 1)
Finance income	0 4	0 8	0 4
Loss before taxation	(47 4)	(19 8)	(22 9)
Taxation credit/(charge)	10 7	(2 3)	4 9
Loss attributable to ordinary shareholders	(36 7)	(22 1)	(18 0)

1 EBITDAR represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets held for sale, onerous contracts and related impairments, and rent

2 EBITDA represents earnings before interest, tax, depreciation, amortisation, loss on disposal of property, plant and equipment and subsidiary undertakings, impairment of freehold assets held for sale and onerous contracts and related impairments

3 Adjusted EBITDA represents EBITDA after adding back exceptional central costs and the charge for future minimum rental increases

Shareholder Information

2010/2011 Financial Calendar

Interim results - 10 May 2011
Financial year end - 30 September 2011

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Registered Number

05328138

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Capita Registrars

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Shareholder Enquiries

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