

Priory Group No. 1 Limited

**Directors' report and consolidated financial statements for the
period ended 31 December 2011**

Registered number 07480152



Priory Group No. 1 Limited

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Priory Group No. 1 Limited

Directors' report

The directors present their annual report and the audited consolidated and Company financial statements of Priory Group No. 1 Limited for the period from incorporation on 30 December 2010 to 31 December 2011. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and IFRIC interpretations (IFRS) as adopted by the European Union (EU).

Throughout the document, references to the "Company" refer to Priory Group No. 1 Limited. References to the "Group" and "Priory Group" refer to Priory Group No. 1 Limited and its subsidiaries. All amounts are stated in GBP £'000, unless otherwise stated.

Principal activities

The Company was incorporated on 30 December 2010 in the United Kingdom as Crown Newco 1 Limited and changed its name to Priory Group No. 1 Limited on 21 June 2011. The principal activity of the parent company is to act as an investment holding company.

The Group is the largest independent provider of mental health, specialist care and specialist education services in the United Kingdom, by number of beds, focusing on the provision of acute psychiatry, secure and rehabilitation services, complex care, specialist education, older people care and specialist services, and one of the top three independent providers of secure and rehabilitation services by number of beds. At 31 December 2011, the Group had 265 facilities with 7,235 available beds located throughout the United Kingdom. The Group operates in four sectors:

- The **Healthcare** segment focuses on the treatment of patients with a variety of psychiatric conditions which are treated in both open and secure environments. This segment also provides neuro-rehabilitation services.
- The **Education** segment provides day and residential schooling, care and assessment for children with emotional and behavioural difficulties or autistic spectrum disorders.
- The **Older People** segment provides long term, short term and respite nursing care for older people who are physically frail or suffering with dementia related disorders.
- The **Specialist Services** segment focuses on the care of service users with a variety of learning difficulties and mental health illnesses. This segment includes care homes and supported living services.

Business review

On 4 March 2011, the Group acquired 100% of the issued ordinary share capital of Priory Investments Holdings Limited. On 14 April 2011, the Group acquired 100% of the issued ordinary share capital of Craegmoor Group Limited (Craegmoor). Refer to note 9 for further details on acquisitions in the period.

The results for the period are set out in the consolidated income statement on page 7 and the financial position of the Group as at 31 December 2011 is set out in the consolidated balance sheet on page 8. The Group Adjusted EBITDAR for the period was £110.6m, which represented a margin of 30.7% of revenue. Adjusted EBITDA before future minimum rental increases was £102.2m in the period, which represented a margin of 28.4% of revenue.

The Group issued £600.0m of high yield bonds on 3 February 2011 and £206.0m on 14 April 2011. The proceeds from the issue of the bonds were used to fund the purchase of Priory Investments Holdings Limited on 4 March 2011 and Craegmoor on 14 April 2011. In addition unsecured loan notes of £130.0m were issued on 4 March 2011 and £51.5m on 14 April 2011. Refer to note 17 for further details.

During the period, net costs of £11.3m were recognised as exceptional items in the consolidated income statement, and are explained further in note 6 to the consolidated financial statements.

Land and buildings of Priory and Craegmoor (including fixtures and fittings) were recorded at fair values on acquisition, as determined by independent third party valuers. The net book value at 31 December 2011 of £1.3bn is therefore considered to be market value.

Financial risk management

The use of financial instruments is managed under policies and procedures approved by the Board. These are designed to reduce the financial risks faced by the Group, which primarily relates to credit, interest and liquidity risks, which arise in the normal course of the Group's business. Financial risks are also considered by the Group risk management committee.

Credit risk

Financial instruments which potentially expose the Group to credit risk consist primarily of cash and trade receivables. Cash is only deposited with major financial institutions that satisfy certain credit criteria.

Credit risk is not considered to be significant given that the vast majority of revenue is derived from publicly funded entities and payment is taken in advance for privately funded healthcare services. Credit evaluations are carried out on privately funded residents in the Older People business.

Interest rate risk

The Group finances its operations through called up share capital, retained earnings, bank facilities, high yield bonds and the sale of assets, if appropriate. At 31 December 2011 we had fixed rate debt only, thereby removing interest rate risk. Future drawings under the revolving credit facility would expose the Group to interest rate risk. The interest rate on cash advances under the revolving credit facility is the aggregate of the applicable margin, LIBOR/EURIBOR and mandatory costs (if any). The margin may range from 4.00% to 3.00% based on the ratio of certain of our total net debt to EBITDA.

Priory Group No. 1 Limited

Directors' report

Liquidity risk

The Group prepares annual cash flow forecasts reflecting known commitments and anticipated projects. Borrowing facilities are arranged as necessary to finance requirements. The Group has sufficient available bank facilities and cash flows from profits to fund current commitments.

Further 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 25 to the consolidated financial statements.

Post balance sheet event

On 15 February 2012 the Group acquired 75% of the share capital of Harbour Care (UK) Limited for cash consideration of £12.0m. Harbour Care operates Specialist Services homes in the South of England.

Future developments

Management consider the Group to be in a strong position to pursue a growth strategy across all divisions. This strategy will comprise organic growth, strategic acquisitions and new developments at existing sites in order to increase the number of available beds and broaden our care pathway. In the Healthcare division, the Group has identified opportunities to build two new facilities in 2012. In addition, initiatives are in place to reposition a number of key sites in order to broaden the care pathway and increase profitability. In the Education division, focus remains on increasing occupancy and profitability at existing schools. In 2011 the decision was made to cancel all non-committed Older People developments; therefore we anticipate the opening of only two new homes in 2012, and immature homes will continue to fill throughout 2012 which will increase occupancy in the division. The Specialist Services division will benefit in 2012 from the restructuring of the supported living business. The review of pathways between Healthcare and Specialist Services units will continue, and we will consider further strategic acquisitions, such as Harbour Care.

Key performance indicators

The Group's management uses a range of financial and non-financial indicators to measure the operational and strategic performance of the business. These include Adjusted EBITDAR and Adjusted EBITDA, Adjusted EBITDAR margin, operating cash conversion, available beds, average daily census ("ADC") and occupancy percentages.

Adjusted EBITDAR reflects earnings before interest, tax, depreciation, amortisation, rent and operating exceptional items. Adjusted EBITDA reflects earnings before interest, tax, depreciation, amortisation and operating exceptional items. In addition, management use EBITDA before future minimum rental increases to assess the performance of the business before the non-cash cost associated with future property rental increases. These measures are presented as part of the consolidated income statement and in note 2 to the consolidated financial statements. Adjusted EBITDAR margin reflects Adjusted EBITDAR divided by revenue and was 30.7% in the period. Operating cash conversion (calculated as net cash generated from operations before tax divided by EBITDA before future minimum rental increases (including exceptional items)) was 102.1% in 2011.

As at 31 December 2011, the total number of available beds across the Group was 7,235. During the period average ADC was 5,265 and average occupancy was 79.3%.

Dividends

The directors do not recommend the payment of a dividend.

Principal risks and uncertainties

As the Group is focussed on the healthcare, education, older people care and specialist services sectors, the performance of the Group can be impacted by external factors. The principal factors are changes in the UK government's policy towards outsourcing of health and education, changes in the regulatory regime and competitive threats from other independent providers. The following are the most significant risks and uncertainties facing the Group.

Loss of revenue from contracts with UK local authorities, PCTs and other NHS trusts

A substantial proportion of the Group's revenue derives from publicly funded bodies such as Local Authorities, Primary Care Trusts (PCTs) and other NHS trusts. The Group expects to continue to rely on the ability and willingness of these bodies to pay for the Group's services. There are risks that either budget constraints or other financial pressures could cause such publicly funded bodies to allocate less money to the types of service that the Group provides or that political change or policy changes mean that fewer services are contracted from independent sector providers. To mitigate these risks the Group regularly assesses services provided to ensure they represent value for money and where necessary repositions services to align with demand.

Failure to comply with regulation and increased regulatory costs

All of the Group's services are subject to a high level of regulation by various regulatory bodies. New regulations may be introduced that could impose increased costs on the Group's operations. The Group is unable to predict the content of new legislation and regulations and their effect on its business. Whilst the Group would seek to recover such costs from its customers, there can be no assurance that the Group's operations will not be adversely affected by regulatory development.

Inspections are carried out on both an announced and unannounced basis dependent on the specific regulatory provisions relating to different care services. The failure to comply with government regulations, the receipt of a negative report that leads to the determination of regulatory non-compliance or the failure of the Group to cure any defect noted in an inspection report could result in the revocation of the registration of any service or a decrease in, or cessation of, services provided by the Group.

To mitigate these risks, the quality of care is monitored by an experienced team through the establishment of robust policies and procedures. Homes are regularly audited by the team to ensure compliance with care standards. Supporting vulnerable people is an inherently risky activity. Risks are mitigated by investing significantly in recruitment and training.

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Directors' report

Employees

The Group's performance depends largely on its regional managers and local staff. The loss of key individuals and the inability to recruit people with the right experience and skills from the local community could adversely impact the Group's results. To mitigate these issues the Group have introduced a learning programme for all employees and have implemented a number of schemes linked to the Group's results that are designed to retain key individuals.

Directors

The directors who held office during the period and up to the date of signing the financial statements were as follows:

Desmond Mitchell	(appointed 30 December 2010, resigned 4 April 2011)
Thomas Allen	(appointed 4 March 2011)
Humphrey Battcock	(appointed 4 March 2011)
Matthew Franzidis	(appointed 4 March 2011)
Michael Jeffries	(appointed 14 March 2011)
Jason Lock	(appointed 4 March 2011)
Phillip Scott	(appointed 4 March 2011)
Ronald Sheldon	(appointed 4 March 2011)
Christopher Thompson	(appointed 4 March 2011)
William Moyes	(appointed 1 December 2011)

Political and charitable contributions

The Group does not make political contributions. Donations to UK charities in the period amounted to £93,692 which was donated to a wide range of healthcare related charities.

Policy and practice on payment of creditors

The Company's policy, in relation to all its suppliers, is to settle the terms of payment when agreeing the terms of the transaction and to abide by those terms provided that it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions. The Company does not follow any code or standard on payment practice. The Group had a trade payables balance of £11.4m at 31 December 2011. At 31 December 2011 the Group's supplier payment period was 57 days.

Employees

The directors recognise that the continued position of the Group in the health care industry depends on the quality and motivation of its employees and as such the Group is committed to pursuing employment policies which will continue to attract, retain and motivate its employees.

Good and effective employee communications are particularly important, and throughout the business it is the directors' policy to promote the understanding by all employees of the Group's business aims and performance. This is achieved through internal publications, presentations on performance and a variety of other approaches appropriate for a particular location. Employees are consulted on issues through workshops which are run regularly across the Group.

The directors believe that it is important to recruit and retain capable and caring staff regardless of their sex, marital status, race or religion. It is the Group's policy to give full and fair consideration to applications for employment from people who are disabled, to continue wherever possible the employment of, and to arrange appropriate training for, employees who become disabled and to provide equal opportunities for the career development, training and promotion of disabled employees.

Corporate Social Responsibility

Carbon reduction commitments

The Group continues its registration with the CRC Energy Efficiency Scheme under Priory Central Services for those meters that required registration as at 30th September 2010. The volume has increased significantly with the acquisition of Craegmoor, which in turn has increased the Group's efforts to reduce its carbon footprint. More specifically an Energy Manager has been appointed on a consultancy basis to drive forward the programme of efficiency savings where identified.

Ethical trading

With the help of group suppliers the Group attempts to purchase goods and services with the least environmental impact. Waste recycling collection procedures have been introduced through the use of a group commercial waste contractor which commenced 1st July 2011 and the recently renewed Cafe Bar agreement insists on the use of Fair Trade products.

The Group's largest supplier Brakes has numerous awards for corporate social responsibility and has instigated procedures in respect of the use of double-decker vehicles resulting in fuel reduction, converting waste cooking oil to diesel, packing supplies within "topless" boxes therefore saving on cardboard and using only corrugated and biodegradable packaging.

Estates and facilities

The Group has recently undertaken a major upgrade of its acute hospitals' bedrooms, and took the opportunity to replace electrical fittings with low energy units as part of the process, achieving noticeable savings in energy costs upon completion. The impact is presently being assessed but early indications show that energy efficient lighting and flat screen televisions and computer monitors alone offer significant carbon savings. In addition, a segment of the estate was surveyed in the later part of 2010 to identify other energy saving opportunities. Two key areas were identified, heating system upgrades and lighting replacements.

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The initial programme undertaken in 2010 has been extended to install new controls over heat distribution and energy efficient lighting at 25 sites, costing £0.1m, but yielding direct savings of £0.1m per annum together with related carbon emission savings. The involvement of an Energy Manager has identified further opportunities to save energy at other sites, and to consider other forms of energy saving such as solar power generation, water harvesting and for new structures, ground source heating.

Quality and Safety

The Group has an established track record of clinical quality, demonstrated by robust outcome data made available to Commissioners. The Group has teaching hospital status at a number of hospitals which are recognised as a teaching environment by the General Medical Council. Facilities have reported a high level of compliance with the Care Quality Commission and other regulatory standards such as those of Ofsted.

The Group has strict clinical governance protocols to ensure a consistently high quality of clinical care. The Chief Medical Officer (CMO) has primary responsibility for quality and safety across the entire business. Moreover, the corporate policy requires each hospital director to convene clinical governance and health and safety committees on a regular basis. A medical director, professionally reporting to the CMO, is responsible for all medical activity on site and for representing the views of a Medical Advisory Committee to the hospital director.

A Quality and Safety team, whose director reports directly to the CMO, operates functions of compliance management, review of policy standards, and review of complaints not resolved at site level.

Human Resources - single equality scheme

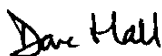
The Group is committed to challenging discrimination and promoting equality for all. The single equality scheme outlines the longstanding commitment to ensuring services are accessible and appropriate for the diverse patient, resident and student community served and that employment practices are fair, and value the workforce employed. In choosing a single equalities approach, the Group is acknowledging that it has responsibilities to tackle discrimination and promote equality that go beyond the positive duties set out in legislation. The single equalities approach also enables the Group to effectively challenge multiple discrimination.

The single equality scheme is intended to inform employees, patients, residents, students and their carers, visitors, contractors and all other stakeholders, how equality and diversity is part of carrying out the Group's core business and the actions taken to ensure this happens. It is now the responsibility of all individuals in the Group to ensure the principles of the scheme are embraced and ensure they translate into the delivery of a truly inclusive service for communities and in the Group being recognised as an Employer of Choice.

Provision of information to auditors

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware. Each director 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 section 418 of the Companies Act 2006.

By order of the board



David Hall
Company Secretary

21, Exhibition House
Addison Bridge Place
London
W14 8XP
28 March 2012

Priory Group No. 1 Limited

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

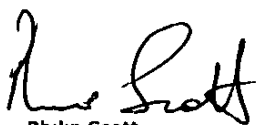
Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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,
- 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 comply with the Companies Act 2006. 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.

On behalf of the Board



Philip Scott

Chief Executive Officer

28 March 2012



Jason Lock

Chief Financial Officer

28 March 2012

Priory Group No. 1 Limited

Independent auditors' report - Group

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PRIORY GROUP NO. 1 LIMITED

We have audited the Group financial statements of Priory Group No. 1 Limited for the period ended 31 December 2011 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of cash flows, the consolidated statement of changes in 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 statement of directors' responsibilities set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the 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. In addition, we read all the financial and non-financial information in the directors' report and consolidated financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 31 December 2011 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 period for which the Group financial statements are prepared is consistent with the Group financial statements.

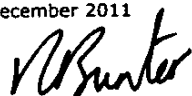
Matters on which we are required to report by exception

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

- 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 parent company financial statements of Priory Group No. 1 Limited for the period ended 31 December 2011.



Richard Bunter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Newcastle upon Tyne

28 March 2012

Priory Group No. 1 Limited

Consolidated income statement

£'000	Note	2011
Revenue	2	359,774
Operating costs	3	(308,107)
Operating profit	2	51,667
Analysed as		
Adjusted EBITDAR	2	110,622
Rental amounts currently payable		(8,431)
Adjusted EBITDA before future minimum rental increases		102,191
Future minimum rental increases		(2,465)
Adjusted EBITDA		99,726
Depreciation	3	(31,513)
Amortisation	3	(5,267)
Exceptional items	6	(11,279)
Operating profit		51,667
Finance costs	7	(72,468)
Finance income	7	208
Loss before tax		(20,593)
Tax	8	9,486
Loss for the period	22	(11,107)

Adjusted EBITDAR represents earnings before interest, tax, depreciation, amortisation, rent and exceptional items. Adjusted EBITDA represents earnings before interest, tax, depreciation, amortisation and exceptional items. Adjusted EBITDA before future minimum rental increases is adjusted to exclude the non-cash cost associated with future property rental increases. All are non-GAAP measures, and are discussed in more detail in note 1.

There is no difference between the loss for the period and the total comprehensive loss for the period attributable to equity shareholders of the parent.

Priory Group No. 1 Limited

Consolidated balance sheet

£'000	Note	2011
Non-current assets		
Intangible assets	10	210,388
Property, plant and equipment	11	1,314,416
		<u>1,524,804</u>
Current assets		
Inventories	12	57
Trade and other receivables	13	24,627
Cash	14	44,259
		<u>68,943</u>
Assets held for sale	15	6,694
		<u>75,637</u>
Total assets		<u>1,600,441</u>
Current liabilities		
Trade and other payables	16	(84,054)
Borrowings	17	(23,499)
Provisions for liabilities and charges	18	(2,193)
		<u>(109,746)</u>
Net current liabilities		<u>(34,109)</u>
Non-current liabilities		
Borrowings	17	(989,149)
Deferred tax	19	(226,510)
Provisions for liabilities and charges	18	(13,740)
		<u>(1,229,399)</u>
Net assets		<u>261,296</u>
Equity attributable to the owners of the parent		
Share capital	21	261,178
Share premium account	21	11,225
Retained earnings	22	(11,107)
Total equity		<u>261,296</u>

The consolidated financial statements of Priory Group No. 1 Limited (registered company number 07480152) on pages 7 to 31 were approved by the board of directors and authorised for issue on 28 March 2012. They were signed on its behalf by



Philip Scott
Chief Executive Officer



Jason Lock
Chief Financial Officer

Priory Group No. 1 Limited

Consolidated statement of cash flows

£'000	Note	2011
Operating activities		
Operating profit		51,667
Profit on disposal of property, plant and equipment	6	(356)
Non cash exceptional items		2,079
Depreciation of property, plant and equipment	3	31,513
Amortisation of intangible assets	3	5,267
Decrease in inventories		32
Decrease in trade and other receivables		409
Decrease in trade and other payables, including provisions		(257)
Provision for future minimum rental increases		2,465
		<u>92,819</u>
Taxation		(1,521)
Net cash generated from operating activities		<u>91,298</u>
Investing activities		
Interest received	7	208
Purchase of subsidiaries, net of cash acquired	9	(258,432)
Proceeds on disposal of property, plant and equipment		569
Purchases of property, plant and equipment	11	(37,467)
Net cash used in investing activities		<u>(295,122)</u>
Financing activities		
Repayment of bank and other borrowings		(835,866)
Repayment of obligations under finance leases		(1,274)
Issue of ordinary shares	21	7,943
Issue of preference shares	21	192,132
Issue of high yield bonds	17	808,000
Issue of loan notes	17	130,000
Debt issue costs	17	(22,674)
Interest paid	7	(30,178)
Net cash generated from financing activities		<u>248,083</u>
Net increase in cash		44,259
Cash at the beginning of the period	14	-
Cash at the end of the period	14	<u>44,259</u>

Priory Group No. 1 Limited

Consolidated statement of changes in equity

£'000	Note	Share capital	Share premium account	Retained loss	Total equity
Loss for the period		-	-	(11,107)	(11,107)
Issue of shares	21	261,178	11,225	-	272,403
At 31 December 2011		261,178	11,225	(11,107)	261,296

Priory Group No. 1 Limited

Notes to the consolidated financial statements

1. Significant accounting policies

a) Basis of preparation

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and IFRIC interpretations as adopted by the European Union (EU). They also comply with applicable UK Companies' Legislation, references to Companies Act 2006 as applicable to companies using IFRS and other legislation are therefore references to UK legislation. The Company has elected to prepare its parent company financial statements in accordance with UK generally accepted accounting principles (UK GAAP).

The financial statements have been prepared on the going concern basis, and under the historical cost convention. Historical cost is generally based on the fair value of the consideration given in exchange for the assets.

The accounting policies set out below have been applied consistently. The Group has not adopted any new IFRS standards, amendments to standards or interpretations prior to their effective date.

The preparation of financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable in the particular circumstance, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The areas involving a higher degree of complexity, or areas where assumptions and estimates are significant to the financial statements are discussed on page 14.

b) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiary undertakings made up to 31 December 2011. Subsidiary undertakings are entities over which the Group has the power to govern the financial and operating policies. Subsidiaries are included within the consolidated financial statements from the date on which the Group obtains control and are excluded from the date on which that control ceases. The purchase method is used to account for the acquisition of subsidiaries and group reorganisations. Under the purchase method the cost of the acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred in exchange for the subsidiary. Identifiable assets, liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date. All acquisition costs are expensed immediately.

Intercompany transactions and balances between group entities are eliminated on consolidation. Where necessary, the accounting policies applied by subsidiaries have been changed to ensure consistency with the accounting policies applied by the Group.

c) Non-current assets held for sale

Non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale and expect the sale to complete within one year from the date of classification or the reporting date.

d) Intangible assets

(i) Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at least annually, or more frequently where circumstances suggest an impairment may have occurred. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units on an EBITDAR basis, in line with the expected benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of that unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

(ii) Brands and customer contracts

Acquired brands and customer contracts acquired in a business combination are shown at fair value at the acquisition date. They have finite useful economic lives and are carried at cost less accumulated amortisation. Brands are amortised on a straight line basis to allocate the cost of a brand over its estimated useful life of 30 years. Customer contracts are amortised on an attrition basis over their useful economic lives of between 8 and 10 years. Attrition rates are calculated with reference to the average length of stay of service users.

e) Segment reporting

The Group operates solely in the UK, therefore no geographical disclosures are presented. Segmental information is presented in respect of the Group's operating segments, based on management's internal reporting structure and information reported to the

Priory Group No. 1 Limited

Notes to the consolidated financial statements

chief operating decision maker, which is considered to be the board of directors. Further details are provided in note 2 to the consolidated financial statements.

f) Revenue recognition

Revenue represents consideration received for the provision of healthcare, education, older people care and specialist services. Revenue is recognised to the extent it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates and sales taxes. Revenue in respect of the provision of healthcare, education, older people care and specialist services is recognised in respect of the number of days of care that have been provided in the relevant period. Revenue in respect of ancillary services is recognised as the services are provided, assuming the other revenue recognition criteria are met. Revenue paid in advance is included in deferred income until the service is provided. Revenue in respect of services provided but not yet invoiced by the period end is included within accrued income.

g) Borrowing costs and interest

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised in the income statement in the period in which they are incurred. Interest income is recognised in the income statement as it accrues, using the effective interest method.

h) Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due, when the service is provided by the employee. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

The Group, through one of its subsidiary companies, operates a funded defined benefit pension scheme, the "Health & Care Services (UK) Limited Pension and Life Assurance Scheme" for staff at one of its homes. The plan is closed to new members and all benefits accruing to current members are frozen. The Group recognises a liability in the financial statements representing the net obligation under the plan based on a valuation from an independent actuary which is updated at least annually, but does not recognise an asset. Movements in the net obligation are credited/charged to the income statement. Full IAS19 defined benefit disclosures are not given because the defined benefit obligation, plan assets and net surplus/deficit are not material.

i) Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit can differ 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, or that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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 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.

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 to allow all or part of the asset to be recovered.

Deferred tax is calculated at the 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 equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority, and the Group intends to settle its current tax assets and liabilities on a net basis.

j) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Where the asset takes a substantial period of time to get ready for its intended use, the cost of the asset includes capitalised borrowing costs.

Assets in course of construction represent the direct costs of purchasing, constructing and installing property, plant and equipment ahead of their productive use. No depreciation is provided on an asset that is in the course of construction until it is completed and the asset is ready for its intended use.

Depreciation is provided to write off the cost less the estimated residual value of property, plant and equipment by equal instalments over their estimated useful economic lives as follows:

Freehold buildings and long leasehold properties	50 years
Short leasehold properties	over the period of the lease
Fixtures and fittings	3 to 16 years
Motor vehicles	over the shorter of the lease term and 4 years

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The expected residual values and useful lives of the assets to the business are reassessed, and adjusted if appropriate at each balance sheet date. Land is not depreciated on the basis that land has an unlimited life. Where the cost of land and buildings cannot be split, the directors have estimated that the value attributable to land is 22% of the cost of the land and buildings, based on experience.

k) Inventory

Inventory comprises primarily medical drugs and catering supplies and is stated at the lower of cost and net realisable value.

l) Leases

Leases in which the Group assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Where land and buildings are held under leases the accounting treatment of the land is considered separately from that of the buildings. Leased assets acquired by way of finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at the inception of the lease, less accumulated depreciation and impairment losses. Leased assets classified as property, plant and equipment are depreciated over the shorter of their useful economic life or the period of the lease.

Lease payments made in respect of finance leases are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Lease payments made in respect of operating leases are recognised on a straight line basis over the term of the lease. Minimum future rental increases are also recognised on a straight line basis and this non cash element is included in provisions until it is reversed in future periods.

m) Non derivative financial instruments

Non derivative financial instruments comprise trade and other receivables, cash, borrowings and trade and other payables. Non derivative financial instruments are recognised initially at fair value. The Group has no financial instruments measured at fair value through the income statement. Subsequent to initial recognition, financial instruments are measured as described below.

i) Trade and other receivables

Trade and other receivables are initially stated at fair value and subsequently measured at amortised cost using the effective interest rate method, less any impairment losses, and are assessed for indicators of impairment at each balance sheet date. Trade and other receivables are considered to be impaired where there is objective evidence that the estimated future cash flows associated with the asset have been affected. In addition, certain trade and other receivables that not considered to be individually impaired, may be assessed for impairment on a collective basis. Objective evidence for impairment for a portfolio of receivables could include the Group's past experience of collecting payment, an increase in the number of delayed payments, as well as observable changes in national or local economic conditions.

ii) Cash

Cash comprises all bank balances and is stated in the balance sheet at fair value. The Group does not hold any cash equivalents.

iii) Trade and other payables

Trade and other payables are initially stated at fair value and subsequently measured at amortised cost using the effective interest rate method.

iv) Borrowings

All borrowings are initially stated at the fair value of proceeds received after deduction of finance costs and are subsequently measured at amortised cost using the effective interest rate method. The issue costs are amortised over the life of the underlying borrowings at a constant rate on the carrying amount.

On early repayment of the borrowings, the balance of the un-amortised issue costs, and any premium and discounts arising in the early repayment of borrowings are recognised in the income statement.

Details of the Group's financial risk management policies are included in note 25.

n) Classification of financial instruments issued by the Group

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Instruments issued that do not evidence a residual interest in the assets of the Group are classified as liabilities. Equity instruments issued by the Group are recognised in equity at the value of the net proceeds received.

o) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

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p) Non GAAP measures and exceptional items

The Group assesses its operational performance using a number of financial measures, some of which are 'non-GAAP measures' as they are not measures recognised in accordance with IFRS. These measures include Earnings before Interest, Tax, Depreciation, Amortisation, Rent and exceptional items (Adjusted EBITDAR), Earnings before Interest, Tax, Depreciation, Amortisation, exceptional items and future minimum rental increases (Adjusted EBITDA before future minimum rental increases), and, Earnings before Interest, Tax, Depreciation, Amortisation and exceptional items (Adjusted EBITDA). Management believe presenting the Group's results in this way provides users of the financial statements with additional useful information on the underlying performance of the business, and is consistent with how business performance is monitored internally.

Items that are both material and non-recurring and whose significance is sufficient to warrant separate disclosure and identification within the consolidated financial information are referred to as exceptional items. Items that may give rise to classification as exceptional include, but are not limited to, significant and material restructuring and reorganisation programmes, re-financing and acquisition costs and profits or losses on the disposal of assets. Further detail of exceptional items is provided in note 6.

q) Significant sources of estimation, uncertainty and critical accounting judgements in applying the Group's accounting policies

The preparation of financial statements in conformity with adopted IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period then ended. Management bases its estimates on historical experience and various other assumptions that are considered to be reasonable in the particular circumstances. Actual results may differ from these estimates.

Estimates are used in accounting for allowances for uncollected receivables, depreciation, impairment, taxes and contingencies. Estimates and assumptions are reviewed periodically and the effects of the revision are reflected in the financial statements in the period that an adjustment is determined to be required.

Significant accounting judgements have been applied by the Group in order to prepare the consolidated financial statements with respect to the valuation of deferred tax assets and the impairment of goodwill. These judgements are described below.

(i) Deferred tax

Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income. Refer to note 19 for further detail of deferred tax assets recognised.

(ii) Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires management to estimate the future cash flows and growth rates expected to arise from the cash-generating unit and select a suitable discount rate in order to calculate present value. Changes to the assumptions regarding discount rates, growth rates and expected changes to revenues and costs used in making these forecasts could significantly alter the assessment of the carrying value of goodwill. Refer to note 10 for details of the key assumptions used in the calculation of the value in use of the cash generating units to which goodwill is attributed and the impairment review performed.

r) Changes in accounting policy and disclosure

The following standards and revisions to existing standards have been published and are mandatory for periods beginning on or after 1 January 2012 and have not been adopted early.

IAS 1, 'Financial statement presentation' regarding other comprehensive income

The main change resulting from these amendments is a requirement for entities to group items presented in other comprehensive income (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendment is effective for annual periods beginning on or after 1 July 2012 and is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

IFRS 13, 'Fair value measurement'

This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The amendment is effective for annual periods beginning on or after 1 January 2013 and is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

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Notes to the consolidated financial statements

2. Segmental information

The Group is organised into the following operating segments

- The **Healthcare** segment focuses on the treatment of patients with a variety of psychiatric conditions which are treated in both open and secure environments. This segment also provides neuro-rehabilitation services
- The **Education** segment provides day and residential schooling, care and assessment for children with emotional and behavioural difficulties or autistic spectrum disorders
- The **Older People** segment provides long term, short term and respite nursing care for older people who are physically frail or suffering with dementia related disorders
- The **Specialist Services** segment focuses on the care of service users with a variety of learning difficulties and mental health illnesses. This segment includes care homes and supported living services

The Group also has a central office, which carries out administrative and management activities. All of the Group's revenue arises in the United Kingdom (UK). There are no sales between segments and all revenue arises from external customers. All of the Group's assets are domiciled in the UK.

Segment revenues and results

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 1. The measure of segment profit is adjusted earnings before interest, tax, depreciation, amortisation, rent and exceptional items (Adjusted EBITDAR), being EBITDAR before exceptional items. Adjusted EBITDAR is reported to the Group's chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

Central costs include the Group's centralised functions such as finance and accounting centres, IT, sales and marketing, human resources, payroll and other costs not directly related to the hospitals, schools and older people care homes included in the reportable segments.

The following is an analysis of the Group's revenue and results by reportable segment

Period ended 31 December 2011

£'000	Healthcare	Education	Older People	Specialist Services	Central	Total
Revenue	178,428	80,558	42,276	58,512	-	359,774
Adjusted EBITDAR	59,678	32,252	8,237	22,123	(11,668)	110,622
Rent	(131)	(2,502)	(5,106)	(524)	(168)	(8,431)
Adjusted EBITDA before future minimum rental	59,547	29,750	3,131	21,599	(11,836)	102,191
Future minimum rental increases						(2,465)
Adjusted EBITDA						99,726
Depreciation (note 3)						(31,513)
Amortisation (note 3)						(5,267)
Exceptional items (note 6)						(11,279)
Operating profit						51,667
Net finance costs (note 7)						(72,260)
Loss before tax						(20,593)
Tax (note 8)						9,486
Loss for the period attributable to owners of the parent						(11,107)

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Notes to the consolidated financial statements

Segment assets

£'000	2011
Healthcare	945,475
Education	219,951
Older People	91,608
Specialist Services	289,067
Central	10,081
Total segment assets	1,556,182
Unallocated assets	
Cash	44,259
Total assets	1,600,441
Intangible assets	
Healthcare	102,362
Education	52,114
Older People	11,840
Specialist Services	44,072
	210,388
Assets held for sale	
Healthcare	483
Education	-
Older People	4,067
Specialist Services	2,144
	6,694

£'000	Amortisation 2011	Depreciation 2011	Additions to non- current assets 2011
Healthcare	611	18,011	14,690
Education	2,929	6,196	7,790
Older People	-	2,155	11,193
Specialist Services	1,727	2,826	5,859
Central	-	2,325	3,649
Total	5,267	31,513	43,181

Information about major customers

In 2011 revenue from no individual customer (including PCTs and Local Authorities) represented more than 5% of total revenue. On a consolidated basis, revenue of £176.5m and £133.6m arose from Social Services and the NHS respectively, which each represent more than 10% of the Group's total revenue. Of this revenue, £140.4m arose in the Healthcare segment, £78.8m arose in the Education segment, £55.9m arose in the Specialist Service segment and £35.0m in the Older People segment.

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Notes to the consolidated financial statements

3. Operating costs

£'000	2011
Staff costs (note 5)	197,351
Other operating costs	51,486
Depreciation of property, plant and equipment	
Owned	30,545
Leased	968
Amortisation of intangible assets	5,267
Rentals under operating leases	
Property leases	10,896
Other operating leases	315
Exceptional items (note 6)	11,279

4. Auditors' remuneration

£'000	2011
Fees payable to the Company's auditors for the audit of the Company's financial statements	10
Total audit fees	10
Fees payable to the Company's auditors for the audit of the Company's subsidiaries pursuant to legislation	203
Services relating to corporate finance transactions	130
Total other fees	333
	343

Auditors' remuneration is stated net of value added tax

5. Employee numbers and costs

The average monthly number of employees (including executive directors) was

Number	2011
Healthcare	5,153
Education	2,276
Older People	2,578
Specialist Services	2,672
Central	411
	13,090

Their aggregate remuneration comprised

£'000	2011
Wages and salaries	175,870
Social security costs	17,405
Other pension costs	4,076
	197,351

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Notes to the consolidated financial statements

6. Exceptional items

£'000	2011
Reorganisation and rationalisation costs	11,025
Acquisition costs	610
Profit on disposal of property, plant and equipment	(356)
	11,279

Reorganisation and rationalisation costs relate to a number of projects undertaken by the Group to streamline its operations and integrate recent acquisitions. The costs are primarily redundancy costs in order to deliver synergies. Acquisition costs relate principally to legal and professional fees incurred as a result of the acquisitions explained in note 9.

7. Net finance costs

£'000	2011
Interest on bank facilities	1,154
High yield bond interest	51,672
Loan note interest	17,365
Amortisation of issue costs	2,099
Release of premium on issue of high yield bonds	(203)
Interest on obligations under finance leases	94
Provisions: unwinding of discount	287
Total finance costs	72,468
Interest receivable on bank deposits	(208)
Net finance costs	72,260

8. Tax

£'000	2011
Current tax	
Current tax charge	-
Deferred tax	
Origination and reversal of temporary differences (note 19)	(9,486)
Taxation	(9,486)

Corporation tax is calculated at 26.49% of the estimated taxable loss for the period. The expected tax credit for the period can be reconciled to the credit per the income statement as follows:

	2011 £'000
Loss before tax	(20,593)
Tax at the UK corporation tax rate of 26.49%	(5,455)
Non deductible expenses	1,393
Movement on provisions	12,927
Movement in tax base of fixed assets	(2,422)
Effect of change in tax rate	(15,929)
Tax credit for the period	(9,486)

The standard rate of corporation tax in the UK changed from 28% to 26% with effect from 1 April 2011. A further reduction in this corporation tax rate from 26% to 25% was substantively enacted for the purposes of IAS 12 on 5 July 2011. Accordingly, the Company's profits for this accounting period are taxed at an effective rate of 26.49% and will be taxed at 25% in the future.

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In addition to the changes in rates of corporation tax disclosed above a number of further changes to the UK corporation tax system were announced in the March 2011 UK Budget Statement. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements.

The proposed reductions of the main rate of corporation tax by 1% per year to 23% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the further changes from 25% to 23%, if these applied to the deferred tax balance at the balance sheet date, would be a further reduction in the net deferred tax liability of £18.1m.

9. Business combinations

Priory Investments Holdings Limited

On 4 March 2011, the Group acquired 100% of the issued ordinary share capital of Priory Investments Holdings Limited, for a consideration of £55.6m (comprising £277.4m cash consideration less £221.8m repayment of shareholder loans).

£'000	
Cash consideration	55,626
Fair value of net liabilities acquired	55,030
Goodwill	110,656

The fair values of the net liabilities acquired are as follows:

£'000	Fair value
Intangible assets	34,906
Property, plant and equipment	968,945
Cash	35,987
Inventory	12
Trade and other receivables	16,611
Trade and other payables	(56,348)
Provisions	(5,802)
Deferred tax	(191,687)
Derivatives	(30,365)
Borrowings	(827,289)
Net liabilities	(55,030)

The derivatives and borrowings were repaid as part of the acquisition. Goodwill recognised in respect of the acquisition of Priory Investments Holdings Limited is attributable to the skill and talent of the workforce acquired. In addition the deferred tax policy adopted results in liabilities being recognised, however a cash outflow in the short term in relation to these liabilities is not anticipated. Separately identifiable intangible assets have been recognised in relation to the Priory brand and customer contracts. From the date of acquisition to 31 December 2011, the contribution of Priory Investments Holdings Limited to the Group results was as follows:

£'000	
Revenue	250,672
Adjusted EBITDA before future minimum rental increases	72,198

Craegmoor Group Limited

On 14 April 2011, the Group acquired 100% of the issued ordinary share capital of Craegmoor Group Limited (Craegmoor) for share consideration of £123.6m.

£'000	
Consideration	123,629
Fair value of net assets acquired	(70,620)
Goodwill	53,009

The consideration above comprises £3.0m A ordinary shares, £69.0m preference shares and £51.5m of loan notes.

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The fair values of the net assets acquired are as follows

£'000	Fair value
Intangible assets	14,297
Property, plant and equipment	317,816
Cash	5,863
Inventory	77
Trade and other receivables	5,577
Trade and other payables	(20,310)
Deferred tax	(41,827)
Borrowings	(203,150)
Provisions	(7,723)
Net assets	70,620

Goodwill recognised in respect of the acquisition of Craegmoor Group Limited is attributable to the synergies expected to be achieved through integration of the business with the rest of the Group, together with the skills and talent of the acquired workforce. A separately identifiable intangible asset has been recognised in relation to customer contracts.

From the date of acquisition to 31 December 2011, the contribution of Craegmoor Group Limited to the Group results was as follows

£'000	
Revenue	109,102
Adjusted EBITDA before future minimum rental increases	29,993

Velocity Healthcare Limited

The Group acquired Velocity Healthcare Limited on 20 April 2011 which owns a Secure Hospital in the North West of England. The consideration paid was £17.9m which relates principally to the freehold. Goodwill of £2.3m arose on the acquisition.

Care Developments (Coventry) Limited

The Group acquired Care Developments (Coventry) Limited on 23 September 2011 which owns an Older People care home in Coventry. The consideration paid was £5.0m which relates principally to the freehold. Goodwill of £0.5m arose on the acquisition.

Proforma results of the Group

Proforma results for the Group for the period ended 31 December 2011, prepared on the basis that all acquisitions had been made at the beginning of the period, are as follows

£'000	Revenue	Adjusted EBITDA before future minimum rental increases
Group - reported	359,774	102,191
Priory Investments Holdings Limited	52,181	13,432
Craegmoor	43,402	8,440
Group - proforma	455,357	124,063

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10. Intangible assets

£'000	Goodwill	Brand	Customer contracts	Total
Cost				
Arising on business combinations	166,452	22,049	27,154	215,655
At 31 December 2011	166,452	22,049	27,154	215,655
Accumulated amortisation				
Amortisation charge	-	(611)	(4,656)	(5,267)
At 31 December 2011	-	(611)	(4,657)	(5,267)
Net book value				
At 31 December 2011	166,452	21,438	22,498	210,388

The brand intangible asset, with a carrying value of £21.4m, relates to the Priory Brand and has a remaining amortisation period of 29.2 years

Customer contracts arising from the Priory Investments Holdings Limited business combination relate to the education division and have a carrying value of £9.9m and a remaining amortisation period of 9.2 years. Customer contracts arising from the Craegmoor Group acquisition relate to the specialist division and have a carrying value of £12.6m and a remaining amortisation period of 7.3 years

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. The Group's cash generating units are the same as its reportable segments, and goodwill is allocated as follows

£'000	2011
Healthcare	80,924
Education	42,186
Older People	11,840
Specialist Services	31,502
	166,452

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding forecast cash flows, discount rates and future growth rates.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next three years, and extrapolates cash flows for the following three years based on estimated growth rates. Growth rates do not exceed the average long-term growth rate for the relevant markets. Growth rates are determined by management based on their experience of both the industry and the wider economic environment.

Management estimates discount rates using post tax rates that reflect current market assessments of the time value of money. There is no significant difference in the risks associated with each individual CGU, therefore the same post tax discount rate is applied to the post tax cash flows of all units.

In 2011, the key assumptions used were as follows

	2011
Pre tax discount rate	11.5%
Growth rate	2.0%-3.0%

The Group has conducted a sensitivity analysis on the impairment test of each CGU's carrying value and management has concluded that no reasonably possible changes to the key assumptions would result in an impairment charge for any CGU.

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Notes to the consolidated financial statements

11. Property, plant and equipment

£'000	Land and buildings	Assets in the course of construction	Fixtures and fittings	Motor vehicles	Total
Cost					
Arising on business combinations	1,240,424	431	65,978	2,823	1,309,656
Additions	17,186	823	22,642	2,530	43,181
Disposals	(140)	-	(65)	(9)	(214)
At 31 December 2011	1,257,470	1,254	88,555	5,344	1,352,623
Accumulated depreciation					
Charge for the period	18,690	-	11,673	1,150	31,513
At 31 December 2011	18,690	-	11,673	1,150	31,513
Net book value – 31 December 2011	1,238,780	1,254	76,882	4,194	1,321,110
Assets held for sale (note 15)	(5,245)	-	(1,449)	-	(6,694)
Reported net book value – 31 December 2011	1,233,535	1,254	75,433	4,194	1,314,416

Substantially all of the Group's freehold land and buildings is pledged as security against certain of the Group's borrowings (note 17). At 31 December 2011, the carrying amount of assets (motor vehicles) held under finance lease was £3.7m. The Group's obligations under finance leases are secured by the lessors' title to the leased assets.

At 31 December 2011, the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £14.7m.

12. Inventories

£'000	2011
Consumable supplies	57

13. Trade and other receivables

£'000	2011
Trade receivables	20,883
Allowance for doubtful debts	(1,146)
	19,737
Other receivables	1,579
Prepayments and accrued income	3,311
	24,627

14. Cash

£'000	2011
Cash	44,259

15. Assets held for sale

£'000	2011
Assets held for sale	6,694

All properties held for resale are actively marketed and are expected to be sold within 12 months of the year end.

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Notes to the consolidated financial statements

16. Trade and other payables

£'000	2011
Trade payables	11,351
Accruals and deferred income	55,901
Other payables	10,307
Corporation tax payable	208
Other taxes and social security	6,287
	84,054

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. At 31 December 2011 the Group's supplier payment period was 57 days. The Group has financial risk management policies in place to ensure that all payables are paid within the pre-agreed credit terms. The directors consider that the carrying amount of trade payables approximates to their fair value.

17. Borrowings

£'000	2011
Borrowings due less than one year	
Finance lease liabilities	1,136
Accrued interest – Senior secured notes	16,562
Accrued interest – Senior unsecured notes	5,801
Total borrowings due less than one year	23,499
Unsecured borrowings due greater than one year	
Senior unsecured notes	175,000
Unamortised issue costs	(5,044)
Loan notes (including accrued interest)	198,914
	368,870
Secured borrowings due greater than one year	
Senior secured notes	631,000
Unamortised issue costs	(13,686)
Finance lease liabilities	2,965
	620,279
Total borrowings due greater than one year	989,149
Total borrowings	1,012,648

All of the Group's borrowings are denominated in Sterling.

The Group issued £600.0m of high yield bonds on 3 February 2011, comprising £425.0m senior secured notes with a fixed rate of 7.0% and £175.0m senior unsecured notes with a fixed rate of 8.875%, with maturity dates of 15 February 2018 and 15 February 2019 respectively. The senior secured notes are secured by fixed and floating charges over substantially all of the Group's property and assets.

The Group issued additional senior secured notes on 14 April 2011 of £206.0m with a fixed rate of 7.0% due 15 February 2018. A premium on issue of £2.0m was received which is included within unamortised issue costs and will be amortised to the income statement over the term of the notes. The proceeds were used to repay existing Craegmoor bank debt on acquisition.

The high yield bonds are listed on the Luxembourg stock exchange.

The Group issued unsecured loan notes on 4 March 2011 of £130.0m with a fixed rate of 12% and a maturity date of 4 March 2060. Additional loan notes were issued on the 14 April 2011 of £51.5m with a fixed rate of 12% and a maturity date 18 July 2057.

Accrued interest of £4.4m in relation to the £51.5m loan notes was settled on 31 December 2011 by the issue of £4.5m PIK notes on the same terms as the original loan notes.

Priory Group No. 1 Limited

Notes to the consolidated financial statements

The weighted average interest rates during the period were

	2011
Loan notes	12.0%
High yield bonds	7.4%

18. Provisions for liabilities and charges

£'000	Dilapidations	Onerous contracts and legal costs	Future minimum rent	Retirement benefit	2011
Arising on business combinations	2,904	7,982	2,302	337	13,525
Charge to income statement	-	820	2,465	-	3,285
Used during period	-	(843)	-	(34)	(877)
At 31 December 2011	2,904	7,959	4,767	303	15,933

Analysis of provisions

£'000	2011
Current	2,193
Non – current	13,740
Total provisions	15,933

Dilapidation provisions

Provisions have been recorded for costs of returning properties held under operating leases to the state of repair at the inception of the lease. These provisions are expected to be utilised on the termination of the underlying leases.

Onerous contracts and litigation matters

Provisions have been recorded for the onerous payments on certain lease arrangements. They have been established on the basis of the expected onerous element of future lease payments over the remaining life of the relevant leases and agreements. These have been discounted and the provisions are expected to be utilised, with the discounts unwinding accordingly, over the remaining terms of the corresponding lease arrangements.

In light of a number of small outstanding legal claims, provisions have been made which represent management's best estimate of the amounts required to settle the claims. The directors anticipate that these will be settled over the next year.

Future minimum rent

Provisions have been recorded for future rent payable as a result of the policy to straight line rent payments in the income statement. The provisions will be utilised over the life of the leases.

Retirement benefit

The retirement benefit provision held by the Group is to cover post-employment benefits accruing to certain employees of Health & Care Services (UK) Limited.

19. Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current period.

£'000	Accelerated tax depreciation	Short term timing differences	Intangibles	Property, plant and equipment	Total
Arising on business combinations	(8,757)	(55,930)	13,140	287,543	235,996
(Credit)/charge to income statement	(2,069)	20,646	(2,156)	(25,907)	(9,486)
At 31 December 2011	(10,826)	(35,284)	10,984	261,636	226,510

Priory Group No. 1 Limited

Notes to the consolidated financial statements

At the balance sheet date, the Group has unused tax losses of £124m available for offset against future profits, representing a potential deferred tax asset on losses of £31m. A deferred tax asset of £17m has been recognised in respect of such losses in the current period based on an assessment of the probability that taxable profits will arise in the foreseeable future against which these losses can be offset. As at 31 December 2011, a potential deferred tax asset of £14m has not been recognised with respect to losses of £56m as it is not currently anticipated that such losses will be offset in the foreseeable future. The Group expects to utilise approximately £7m of the deferred tax asset and £3m of the deferred tax liability within one year of the date of these financial statements.

Based on an assessment of the probability that temporary differences related to accelerated tax depreciation and short term timing differences will reverse against suitable taxable profits in future periods, deferred tax assets on such temporary differences have been recognised in the amounts noted above as at the balance sheet date.

A deferred tax liability of £261.6m has been recognised in respect of the differences between the carrying values of property, plant and equipment and their tax base cost.

20. Obligations under finance leases

	Present value of minimum lease payments
£'000	2011
Amounts payable under finance leases:	
Within one year	1,136
In the second to fifth years inclusive	2,965
Present value of lease obligations	4,101

The Group's finance leases relate to leased vehicles. The average lease term is 4 years. In 2011, the average borrowing rate on finance leases was 5.4%. Interest rates are fixed at the contract date. All lease obligations are denominated in Sterling. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The fair value of the Group's lease obligations is approximately equal to their carrying amount. The Group's obligations under finance leases are secured by the lessors' rights over the leased assets disclosed in note 11.

21. Share capital

	Number 000s	2011 Nominal value £'000
Allotted		
A ordinary shares of £0.001 each	10,072	10
B ordinary shares of £0.001 each	58	-
C ordinary shares of £0.001 each	1,106	1
D ordinary shares of £0.001 each	2,008	2
Preference shares of £1 each	261,165	261,165
	274,409	261,178

The following shares were issued in the period:

10,072,403 £0.001 A ordinary shares for a consideration of £10,072,403 giving a premium on issue of £10,062,331.

57,801 £0.001 B ordinary shares for a consideration of £57,801, giving a premium on issue of £57,743.

1,106,250 £0.001 C ordinary shares for a consideration of £1,106,250, giving a premium on issue of £1,105,144. Of this amount £247,500 is unpaid at the period end, relating to 90% of the value of 275,000 shares.

2,008,272 £0.001 D ordinary shares at par value for a consideration of £2,008. Of this amount 1,974,000 of shares totalling £1,974 are unpaid at the period end.

261,165,177 £1 preference shares at par value for a consideration of £261,165,177.

Of the above shares 3,046,870 A ordinary shares and 69,033,977 preference shares were issued as part of the acquisition of Craegmoor disclosed in note 9.

Priory Group No. 1 Limited

Notes to the consolidated financial statements

A Ordinary Shares

Each holder of an A Ordinary Share is entitled to receive notice of and to attend and vote at general meetings of the Company. The A ordinary shares rank equally with the B ordinary shares and C ordinary shares but behind the Preference Shares in respect of a distribution of profits by way of dividend and on any winding up of the Company or other return of capital.

B Ordinary Shares

Each holder of a B Ordinary Share is entitled to receive notice of and attend and speak at any general meeting but is not entitled to vote. The B ordinary shares rank equally with the A ordinary shares and C ordinary shares but behind the Preference Shares in respect of a distribution of profits by way of dividend and on any winding up of the Company or other return of capital.

C Ordinary Shares

Each holder of a C Ordinary Share is entitled to receive notice of and attend and speak at any general meeting but is not entitled to vote. The C ordinary shares rank equally with the A ordinary shares and B ordinary shares but behind the Preference Shares in respect of a distribution of profits by way of dividend and on any winding up of the Company or other return of capital.

D Ordinary Shares

Each holder of a D Ordinary Share is entitled to receive notice of and to attend and vote at general meetings of the Company. The D Ordinary Shares do not carry any entitlement to a dividend and D shareholders are only entitled to the nominal value of the shares on a winding up of the Company or other return of capital.

Preference Shares

Each holder of a Preference Share is entitled to receive notice of and attend and speak at any general meeting but is not entitled to vote. The Preference Shares rank ahead of the A ordinary shares, B ordinary shares, C ordinary shares and D ordinary shares in relation to dividends at a rate of 12% per annum and on any winding up of the Company or other return of capital. The Preference Shares may be redeemed in whole or in part by the Company at any time. Other than on a return of capital, preference dividends are payable entirely at the discretion of the Company.

22. Retained earnings

£'000	
Loss for the year	(11,107)
At 31 December 2011	(11,107)

23. Contingent liabilities

There are no contingent liabilities in respect of legal or potential claims arising in the ordinary course of business, the outcome of which cannot at present be foreseen. Appropriate liabilities have been recognised in the balance sheet for all liabilities that are, in the opinion of the directors, likely to materialise.

24. Operating lease arrangements

£'000		2011
Minimum lease payments under operating leases recognised as an expense in the year		8,746

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

		2011	
£'000	Land and buildings	Other	Total
Within one year	11,882	394	12,276
Two – five years inclusive	48,245	412	48,657
After five years	292,989	-	292,989

Operating lease payments represent rentals payable by the Group for certain of its operational and office properties, as well as leases for other assets used at the Group's sites. Most property leases have an average term of between 20 to 30 years. The period for which rentals are fixed varies for each lease.

Priory Group No. 1 Limited

Notes to the consolidated financial statements

25. Financial instruments and risk management

The use of financial instruments is managed under policies and procedures approved by the Board. These are designed to reduce the financial risks faced by the Group, which primarily relates to credit, interest and liquidity risks, which arise in the normal course of the Group's business.

Credit risk

Financial instruments which potentially expose the Group to credit risk consist primarily of cash and trade receivables. Cash is only deposited with major financial institutions that satisfy certain credit criteria.

Credit risk is not considered to be significant given that the vast majority of revenue is derived from publicly funded entities and payment is taken in advance for privately funded healthcare services. Credit evaluations are carried out on privately funded residents in the Older People business.

The Group provides credit to customers in the normal course of business and the balance sheet is net of allowances of £1.1m for doubtful receivables. The Group does not require collateral in respect of financial assets. In 2011, £6,000 was charged to the Income Statement in respect of bad and doubtful debts, within operating costs. Trade receivables are measured at amortised cost.

The average credit period taken at the year end on the provision of services is 14 days. Allowances against doubtful debts are recognised against trade receivables based on estimated irrecoverable amounts determined by reference to past default experience of the counterparty. The majority of the Group's allowance for doubtful debts relates to specific trade receivables that are not considered to be recoverable, and management only considers it appropriate to create a collective provision based on the age of the trade receivable in respect of certain types of trade receivables.

The ageing of trade receivables at 31 December is as follows:

£'000	2011
Current	12,498
30-60 days	6,216
60-150 days	1,615
150 days +	554
	20,883

The directors consider that the carrying amount of trade and other receivables is approximately equal to their fair value.

The ageing of trade receivables past due but not impaired at 31 December is as follows:

£'000	2011
60 days +	1,023

The movement in allowance for doubtful debts in 2011 is as follows:

£'000	2011
Arising on business combinations	2,895
Amounts written off during the period as uncollectible	(1,749)
Balance at end of period	1,146

Apart from the Group's two largest customers (PCTs and Local Authorities on a consolidated basis), the Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The Group defines counterparties as having similar characteristics if they are related entities.

There is no concern over the credit quality of amounts past due but not impaired since the risk is spread over a number of unrelated counterparties which include central and local Government. The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above and cash held by the Group.

Interest rate risk

The Group finances its operations through called up share capital, retained earnings, bank facilities, high yield bonds and the sale of assets, if appropriate. At 31 December 2011 we had fixed rate debt only, thereby removing interest rate risk. Future drawings under the revolving credit facility would expose the Group to interest rate risk. The interest rate on cash advances under the revolving credit facility is the aggregate of the applicable margin, LIBOR/EURIBOR and mandatory costs (if any). The margin may range from 4.00% to 3.00% based on the ratio of certain of our total net debt to EBITDA.

Liquidity risk

The Group prepares both annual and short term cash flow forecasts reflecting known commitments and anticipated projects. Borrowing facilities are arranged as necessary to finance requirements. The Group has sufficient available bank facilities and cash flows from profits to fund current commitments.

Priory Group No. 1 Limited

Notes to the consolidated financial statements

The following table shows the contractual cash flow maturities of financial liabilities

£'000	Total	0-1 years	2-5 years	5 years and over
Trade and other payables	53,578	53,578	-	-
High yield bonds	1,185,643	59,483	237,930	888,230
Finance lease liabilities	4,101	1,136	2,965	-
	1,243,322	114,197	240,895	888,230

The loan notes and associated interest have been excluded from the above table. Interest accruing on the loan notes can be settled in PIK notes, which are not due for repayment until July 2057 or March 2060 in line with the initial capital. Cash outflows are therefore not expected until maturity hence given the length of time to maturity it is deemed reasonable to exclude from the above analysis. Trade and other payables in the table above exclude £30.3m of deferred income as this is not a cash settled obligation.

Capital risk management

The Group's objective when managing its capital is to ensure that entities in the Group will be able to continue as a going concern whilst maximising returns for stakeholders through the optimisation of debt and equity. The Group manages its capital structure and makes adjustments to it with respect to changes in economic conditions and the strategic objectives of the Group. The Group also aims to maintain a strong credit rating and adequate headroom within the Group's banking facilities, whilst ensuring that all covenants are met. Throughout the period the Group has operated comfortably in line with this policy.

The Group's capital structure is as follows

£'000	2011
Cash	44,259
Borrowings	(1,012,648)
Equity	261,296

The Group is not subject to any externally imposed capital requirements. Debt is defined as long-term and short-term borrowings less cash.

Foreign currency risk

The Group operates entirely in the UK and is not exposed to any foreign currency risks.

Sensitivity analysis

The Group's borrowings are at fixed interest rates and as a result at 31 December 2011, a general increase of one percentage point in interest rates would not have a significant impact on the Group's loss before tax.

Fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet are shown in the table below. The fair value of the Group's high yield bonds has been derived from observable market prices at the year end. The Group's fixed rate loan notes are not considered to be significantly different to the book value, therefore book value is considered to be a reasonable proxy.

	2011	
£'000	Carrying amount	Fair value
Loans and receivables		
Cash and cash equivalents	44,259	44,259
Trade receivables	19,737	19,737
	63,996	63,996
Financial liabilities at amortised cost		
Trade and other payables	(83,846)	(83,846)
High yield bonds	(828,363)	(717,365)
Loan notes	(198,914)	(198,914)
Finance lease liabilities	(4,101)	(4,101)
	(1,115,224)	(1,004,226)

Priory Group No. 1 Limited

Notes to the consolidated financial statements

Financing facilities

The Group has the following undrawn borrowing facilities

£'000	2011
Secured revolving credit facility	
- floating rate expiring beyond one year	98,247

The revolving credit facility was entered into on 3 March 2011 and expires on 3 February 2017. £1.8m of the £100m facility has been utilised by outstanding letters of credit and other ancillary facilities. The revolving credit facility provides for borrowings up to an aggregate of £70.0m on a committed basis and a further £30.0m on an uncommitted basis.

26. Events after the balance sheet date

On 15 February 2012 the Group acquired 75% of the share capital of Harbour Care (UK) Limited for cash consideration of £12.0m. Harbour Care operates Specialist Services homes in the South of England.

27. Related party transactions

Priory Group No. 1 Limited is beneficially owned by funds managed by Advent International Corporation which is considered by the directors to be the ultimate controlling party of the Company.

Balances and transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Remuneration of key management personnel

The key management of the Group are deemed to be the board of directors. The remuneration of the directors is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*.

£'000	2011
Short-term employee benefits (including employer's national insurance)	1,473
Post-employment benefits	227
	1,700

The emoluments of the highest paid director of the Company were £417,000 (excluding employer's national insurance contributions of £56,000). No pension contributions were paid on his behalf.

In addition to the emoluments disclosed above one director received a one off bonus of £738,000 (excluding employer's national insurance of £96,000) arising from the acquisition of Priory Investments Holdings Limited.

The loan notes issued by the Group are owned by funds managed by Advent International Corporation. See Note 17 for further details.

The Group has entered into several lease agreements with Zest Investments ("Zest") and with Sistine Properties ("Sistine"), as summarised below. Philip Scott, a director of Priory Group No. 1 Limited, is a 30% shareholder in Zest. Sistine Properties is a party to certain trust agreements, the beneficiaries of which are Mr. Scott's family. Mr. Scott is also a director of certain Sistine Property Group companies.

The agreements are

- the lease of an older people care home at Buckingham Lodge, Norwich Road, Watton, Norfolk between Zest Investments (Watton) Limited, Zest Investment Group Limited, Priory (Watton) Limited and Priory Holdings Company No 4 Limited which took effect on 16 September 2010 (the "Buckingham Lodge Lease"),
- the lease of Sheridan School, Thetford Road, Northwold, Norfolk between Sistine Properties (Thetford) Limited, Thetford Trustee LLP and Priory Care Homes Holdings Limited, dated 19 October 2009 and related Stamp Duty Land Tax structuring arrangements (the "Sheridan School Lease"),
- the lease of an older people care home at Atkinson Court, Ings Road, Leeds between Pethmet (Ings Road) Limited (a Sistine entity), Priory Elderly Care Limited and Priory Investments Holdings Limited, dated 19 March 2010 (the "Atkinson Court Lease"),
- the lease of an older people care home at Cloyfin Road, Bohill, Coleraine, Northern Ireland between Zest Investments (Bohill) Limited, Zest Investment Group Limited, Priory (Watton) Limited and Priory Holdings Company No 4 Limited (the "Bohill Home Lease") which took effect from 11 July 2011, and

Priory Group No. 1 Limited

Notes to the consolidated financial statements

- the lease of a specialist services unit at Cloyfin Road, Bohill, Coleraine, Northern Ireland between Zest Investments (Bohill) Limited, Zest Investments Group Limited, Priory (Watton) Limited and Priory Holdings Company No 4 Limited (the "Bohill LDU Lease") which took effect from 11 July 2011

Under the Buckingham Lodge Lease, the Group has paid £0.4m rent in the period ended 31 December 2011 and £0.1m was prepaid at 31 December 2011

Under the Sheridan School Lease, the Group has paid £0.5m rent in the period

Under the Atkinson Court Lease, which was entered into as part of a sale and leaseback transaction, the Group has paid £0.5m in the period and £0.1m was prepaid at 31 December 2011

Under the Bohill Home and Bohill LDU Lease, the Group has paid £0.3m rent in the period and £0.1m was prepaid at 31 December 2011

At 31 December 2011, one further property was under development in respect of which the Group will enter into a lease with Zest once the development is complete. This is an older people care home at Dakota Avenue, Newtownards, County Down, Northern Ireland and the agreement for the lease is between Zest Investment (Newtownards) Limited, Zest Investment Group Limited, Priory (Watton) Limited and Priory Investments Holdings Limited. The Newtownards Home is expected to open in April 2012 and the initial annual rent will be approximately £0.4m

The Group's Chief Medical Officer, Chris Thompson, has a private psychiatric practice from which he earns in-patient fees for patients he refers to Priory

28. Subsidiaries

The principal undertakings at the period end are as follows

Subsidiary undertakings	Principal activities	Class and percentage Of shares held
Priory Group No 2 Limited*	Intermediate holding company	100% ordinary
Priory Group No 3 plc	Intermediate holding company	100% ordinary
Priory Investments Holdings Limited	Intermediate holding company	100% ordinary
Priory Health No 1 Limited	Intermediate holding company	100% ordinary
Priory Health No 2 Limited	Intermediate holding company	100% ordinary
Priory Finance Property LLP	Property company	100% ordinary
Priory Holdings Company No 1 Limited	Intermediate holding company	100% ordinary
Priory Holdings Company No 2 Limited	Intermediate holding company	100% ordinary
Priory Holdings Company No 3 Limited	Intermediate holding company	100% ordinary
Priory New Investments Limited	Intermediate holding company	100% ordinary
Priory Healthcare Limited	Specialist healthcare services	100% ordinary
Priory Rehabilitation Services Limited	Brain injury rehabilitation services	100% ordinary
Priory Secure Services Limited	Forensic psychiatric services	100% ordinary
Priory Education Services Limited	Schools for children with special needs	100% ordinary
Priory Central Services Limited	Management services	100% ordinary
Priory (Prestwick) Limited	Elderly care services	100% ordinary
Priory Elderly Care Limited	Elderly care services	100% ordinary
Priory Elderly Care (Wednesfield) Limited	Elderly care services	100% ordinary
Priory (Ben Madigan) Limited	Elderly care services	100% ordinary
Priory (Warrenpoint) Limited	Elderly care services	100% ordinary
Priory (Watton) Limited	Elderly care services	100% ordinary
Renova LLP	Specialist healthcare services	100% ordinary
Priory Finance Company Limited	Financing company	100% ordinary
Affinity Hospitals Limited	Management services	100% ordinary
Cheadle Royal Healthcare Limited	Specialist healthcare services	100% ordinary
Middleton St George Healthcare Limited	Specialist healthcare services	100% ordinary
Priory Troup House Limited	Specialist education services	100% ordinary
Priory New Education Services Limited	Specialist education services	100% ordinary
Craegmoor Group Limited	Intermediate holding company	100% ordinary
Craegmoor Older People Care Limited	Care delivery	100% ordinary
Specialty Healthcare Limited	Care delivery	100% ordinary

Priory Group No. 1 Limited

Notes to the consolidated financial statements

Subsidiary undertakings	Principal activities	Class and percentage Of shares held
Health&Care Services (NW) Limited	Care delivery	100% ordinary
Parkcare Homes (No. 2) Limited	Care delivery	100% ordinary
Greymount Properties Limited	Care delivery	100% ordinary
Craegmoor Healthcare Company Limited	Care delivery	100% ordinary
Craegmoor Supporting You Limited	Care delivery	100% ordinary
Craegmoor Facilities Company Limited	Management services	100% ordinary
Craegmoor Hospitals Limited	Care delivery	100% ordinary
Burnside Care Limited	Care delivery	100% ordinary
Specialty Care (Care Homes) Limited	Care delivery	100% ordinary
Strathmore College Limited	Specialist education services	100% ordinary
Specialised Courses Offering Purposeful Education Limited	Specialist education services	100% ordinary
Specialty Care (Addison Court) Limited	Care delivery	100% ordinary
Specialty Care (EMI) Limited	Care delivery	100% ordinary and 100% convertible preference
Specialty Care (Rest Homes) Limited	Care delivery	100% ordinary
Specialty Care (UK Lease Homes) Limited	Care delivery	100% ordinary
J C Care Limited	Care delivery	100% ordinary
Lansdowne road Limited	Care delivery	100% ordinary
Lothlorien Community Limited	Care delivery	100% ordinary
R J Homes Limited	Care delivery	100% ordinary
Heddfan Care Limited	Care delivery	100% ordinary
Sapphire Care Services Limited	Care delivery	100% ordinary A and B
Autism Tasc Services Limited	Care delivery	100% ordinary
Craegmoor Homes Limited	Care delivery	100% ordinary
Johnson Care Limited	Care delivery	100% ordinary
Cotswold Care Services Limited	Care delivery	100% ordinary
Treehome Limited	Care delivery	100% ordinary
Strathmore Care Services Limited	Care delivery	100% ordinary
Lambs Support Services Limited	Care delivery	100% ordinary
Positive Living Limited	Care delivery	100% ordinary
Ferguson Care Limited	Care delivery	100% ordinary
Specialty Care (Rehab) Limited	Care delivery	100% ordinary
Specialty Care (Learning Disabilities) Limited	Care delivery	100% ordinary
Yorkshire Parkcare Company Limited	Care delivery	100% ordinary
Conquest Care Homes (Norfolk) Limited	Care delivery	100% ordinary
Conquest Care Homes (Soham) Limited	Care delivery	100% ordinary
Conquest Care Homes (Peterborough) Limited	Care delivery	100% ordinary
Parkcare Homes Limited	Care delivery	100% ordinary
Health&Care Services (UK) Limited	Care delivery	100% ordinary

* interests held directly by the Company. A full list of subsidiaries can be obtained by writing to the Company Secretary at 21 Exhibition House, Addison Bridge Place, London, W14 8XP

All subsidiary and associated undertakings are registered in England and Wales with the following exceptions

Priory Investments Holdings Limited, Priory Health No 1 Limited, Priory Health No 2 Limited, Priory Holdings Company No 1 Limited, Priory Holdings Company No 2 Limited, Priory Holdings Company No 3 Limited and Priory Finance Company Limited are registered in the Cayman Islands

Priory Group No. 1 Limited

Independent auditors' report – parent company

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PRIORY GROUP NO. 1 LIMITED

We have audited the parent company financial statements of Priory Group No. 1 Limited for the period ended 31 December 2011 which comprise the balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities set out on page 5, 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 and express an opinion on 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. In addition, we read all the financial and non-financial information in the financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 31 December 2011,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the directors' report for the financial period 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 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 Priory Group No. 1 Limited for the period ended 31 December 2011.



Richard Bunter (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Newcastle upon Tyne

28 March 2012

Priory Group No. 1 Limited

Parent company balance sheet

Company balance sheet

£'000	Note	2011
Fixed assets		
Investments	3	453,488
Current assets		
Debtors	4	4,268
Net current assets		4,268
Total assets less current liabilities		457,756
Creditors amounts falling due after more than one year	5	(198,914)
Net assets		258,842
Capital and reserves		
Called up share capital	6	261,178
Share premium account	7	11,225
Profit and loss account	7	(13,561)
Total shareholders' funds	7	258,842

The financial statements of Priory Group No. 1 Limited on pages 33 to 35 were approved by the board of directors and authorised for issue on 28 March 2012. They were signed on its behalf by


Philip Scott
Chief Executive Officer


Jason Lock
Chief Financial Officer

Priory Group No. 1 Limited

Notes to parent company financial statements

1. Significant accounting policies

a) Basis of preparation

The separate financial statements of the Company are presented as required by the Companies Act 2006. As permitted by that Act, the separate financial statements have been prepared in accordance with UK generally accepted accounting principles (UK GAAP). The financial statements are prepared on a going concern basis under the historical cost convention.

b) Investments in subsidiary undertakings

Investments in subsidiary undertakings are stated at cost and reviewed for impairment if there are indicators that the carrying value may not be recoverable.

2. Profit and loss account

The Company has taken advantage of the exemption under section 408 of the Companies Act 2006 from the requirement to present its own profit and loss account. The loss for the period was £13.6m. The auditors' remuneration for audit and other services was £10,000. The Company had no employees during the period. Details of directors' emoluments are given in note 27 to the consolidated financial statements.

3. Fixed asset investments

Cost and net book value	£'000
Additions	453,488
At 31 December 2011	453,488

The addition in the period relates to the acquisition of 100% of the ordinary share capital of Priory Group No. 2 Limited, an investment holding company incorporated in the United Kingdom.

4. Debtors

£'000	2011
Amounts owed by group undertakings	213
Group relief	3,806
Unpaid share capital	249
	4,268

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

£'000	2011
Accrued interest	12,942
Loan notes	185,972
	198,914

Details of loan notes are included in note 17 to the consolidated financial statements.

6. Called up share capital

Details of the Company's share capital and movements in the period are disclosed in note 21 to the consolidated financial statements.

7. Company reconciliation of movements in shareholders' funds

£'000	Called up share capital	Share premium account	Profit and loss account	Total shareholders' funds
Loss for the period	-	-	(13,561)	(13,561)
Issue of shares	261,178	11,225	-	272,403
As at 31 December 2011	261,178	11,225	(13,561)	258,842

Priory Group No. 1 Limited

Notes to parent company financial statements

8. Contingent liabilities, commitments and dividends

There are no contingent liabilities in respect of legal or potential claims arising in the ordinary course of business, the outcome of which at present cannot be foreseen. Appropriate liabilities have been recognised in the balance sheet for all liabilities that, in the opinion of the directors, are likely to materialise.

The Company does not have any commitments for capital expenditure. The directors do not recommend payment of a dividend.

9. Ultimate parent company and controlling party

Priory Group No. 1 Limited is beneficially owned by funds managed by Advent International Corporation which is considered by the directors to be the ultimate controlling party of the Company.