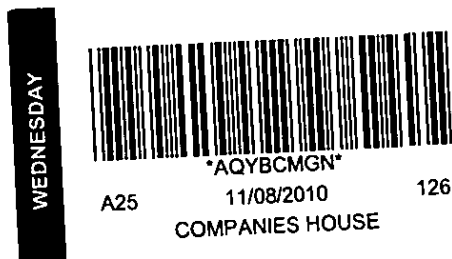


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Priory Investments Holdings Limited
Directors' report and consolidated financial statements for the
year ended 31 December 2009

Incorporated in the Cayman Islands with registered number MC-151157



Priory Investments Holdings Limited

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Priory Investments Holdings Limited

Directors' report

The directors present their annual report and the audited consolidated and company financial statements of Priory Investments Holdings Limited for the year ended 31 December 2009. These are the Group's first financial statements 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" and "PIHL" refer to Priory Investments Holdings Limited. References to the "Group" and "Priory Group" refer to Priory Investments Holdings Limited and its subsidiaries. All amounts are stated in GBP £'000, unless otherwise stated.

Principal activities

The Group is one of Europe's leading providers of acute mental healthcare, secure and step down services, specialist education, complex care and neuro-rehabilitation services, fostering and care homes. The Group operates a network of over 50 facilities, comprising hospitals, care homes, specialist care facilities and specialist educational facilities. The Group operates in three 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 **Elderly Care** segment provides long-term, short-term and respite nursing care for older people who are physically frail or suffering with dementia related disorders.

Business review and future developments

The results for the year are set out in the consolidated income statement on page 8 and the financial position of the Group as at 31 December 2009 is set out in the consolidated balance sheet on page 10.

The Group's management is committed to a continued growth strategy. During the year the Group opened four new elderly care homes totaling 297 beds, located in the Midlands, Yorkshire and Northern Ireland. The Group has a further development pipeline of over 2,000 additional beds, primarily leasehold, which are expected to open in the next 18 months. On 18 March 2010 the Group acquired Affinity Healthcare Holdings Limited, a specialist provider of complex adult and young peoples' mental health services, operating over 250 beds across Northern England.

During the year, net costs of £2.7m (2008 net costs of £10.0m) were recognised as exceptional items in the consolidated income statement, and are explained further in note 7 to the consolidated financial statements.

The Group uses financial instruments as part of an overall interest rate risk management strategy. It does not enter financial instruments for trading purposes. Further details are given in note 25 to the consolidated financial statements.

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, available beds 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 uses 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 3 to the consolidated financial statements.

As at 31 December 2009, the total number of available beds across the Group was 2,250 (2008 2,169) and the average occupancy for 2009 was 82.1% (2008 78.7%).

Share capital

In December 2009 the Group restructured its shareholder debt and agreed the conversion of loan notes and accrued interest with a carrying value of £369.8m into Senior A shares of the company. Further details are given in notes 17 and 21 to the consolidated financial statements.

Dividends

The directors do not recommend the payment of a dividend (2008 Nil).

Principal risks and uncertainties

As the Group is focussed on the healthcare, education and elderly care 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, 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.

Priory Investments Holdings Limited

Directors' report

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.

Employees

The Group's performance depends largely on its regional managers and local staff. The resignation 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 year and up to the date of signing the financial statements were as follows:

Philip van Wijngaarden

Per Batelson (resigned 12 January 2010)

Andrew Willson (resigned 12 January 2010)

Mark Danby (appointed 5 January 2009)

On 12 January 2010, Philip Scott and Elizabeth Brown were appointed as directors of the Company.

Political and charitable contributions

The Group does not make political contributions (2008: £nil). Donations to UK charities in the year amounted to £1,826 (2008: £4,500), 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 creditor balance of £5.1m at 31 December 2009 (2008: £4.1m). The Company had a trade creditor balance of £nil at 31 December 2009 (2008: £nil). The average credit period taken for trade purchases in 2009 was 31 days (2008: 29 days).

Going concern

The Group meets its day to day working capital requirements through available cash balances and committed banking facilities, which are discussed in note 25 to the consolidated financial statements. As at 31 December 2009, the Group had cash balances of £14.1m (2008: £29.3m) and committed banking facilities of £619.7m (of which £5.0m was undrawn at 31 December 2009) (2008: £678.9m), with £60.8m of debt due within one year (2008: £65.9m). In April 2010, the Group re-negotiated certain of its banking facilities such that the amount of debt as at 31 December 2009 due within one year reduced to £13.1m. The Group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Group will be able to operate within the current level of financial resources available.

After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and consolidated financial statements.

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 pursue employment policies which will continue to attract, retain and motivate its employees. In addition, employees are encouraged to participate in the performance of the Group through share ownership via the Employee Incentive Trust.

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.

Priory Investments Holdings Limited

Directors' report

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/she ought to have taken as a director in order to make himself/ herself 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

PO Box 309
Ugland House
Grand Cayman
KY1-1104
Cayman Islands

28 May 2010

Priory Investments Holdings Limited

Directors' responsibilities

The directors are responsible for preparing the group financial statements in accordance with International Financial Reporting Standards 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) for and only for the directors to meet their stewardship obligations and fiduciary responsibilities in respect of the company pursuant to section 401 of the Companies Act 2006. 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 have

- selected suitable accounting policies and then applied them consistently,
- made judgements and accounting estimates that are reasonable and prudent,
- stated the basis of preparation and accounting policies applied,
- prepared 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 and the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group. 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.

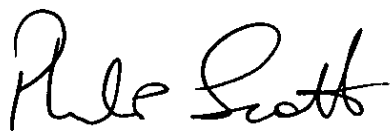
By order of the Board



Mark Danby

Chairman

28 May 2010



Philip Scott

Director

28 May 2010

Priory Investments Holdings Limited

Independent auditors' report - Group

INDEPENDENT AUDITORS' REPORT TO THE DIRECTORS OF PRIORY INVESTMENTS HOLDINGS LIMITED

We have audited the group financial statements of Priory Investments Holdings Limited for the year ended 31 December 2009 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of changes in equity and the related notes. The financial reporting framework that has been applied in the preparation of these group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of the directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 6 the directors are responsible for the preparation of the group financial statements in accordance with Companies Act 1985 applicable to overseas companies and for being satisfied that they give a true and fair view. Our responsibility is to audit the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for and only for the directors to meet their stewardship obligations and fiduciary responsibilities in respect of the Company pursuant to section 401 of the Companies Act 2006 in order that the Company's subsidiary undertakings are exempt from the requirement to prepare group financial statements in accordance with our engagement letters dated 18 December 2009 and 30 March 2010 and for no other purpose. We do not, in giving this opinion, 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 including without limitation under any contractual obligations of the Company, 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 group financial statements sufficient to give reasonable assurance that the group 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 group financial statements.

Opinion on financial statements

In our opinion the group financial statements

- give a true and fair view of the state of the Group's affairs as at 31 December 2009 and of its loss and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been properly prepared in accordance with the Companies Act 1985 applicable to overseas companies.

Other matter

We have reported separately on the parent company financial statements of Priory Investments Holdings Limited for the year ended 31 December 2009.



PricewaterhouseCoopers LLP

Chartered Accountants

Manchester

28 May 2010

Priory Investments Holdings Limited

Consolidated income statement

£'000	Note	Year ended 31 December 2009		
		Before exceptional items	Exceptional items (note 7)	Total
Revenue	3	256,680	-	256,680
Operating costs	4	(191,752)	(3,491)	(195,243)
Operating profit	3	64,928	(3,491)	61,437
Analysed as				
EBITDAR	3	86,472	(3,075)	83,397
Rental amounts currently payable		(548)	-	(548)
EBITDA before future minimum rental increases		85,924	(3,075)	82,849
Future minimum rental increases		(161)	-	(161)
EBITDA		85,763	(3,075)	82,688
Depreciation	4	(20,835)	-	(20,835)
Loss on closure of facilities		-	(352)	(352)
Loss on disposal of fixed assets		-	(64)	(64)
Operating profit		64,928	(3,491)	61,437
Finance costs	8	(105,816)	-	(105,816)
Finance income	8	118	-	118
Loss before tax		(40,770)	(3,491)	(44,261)
Tax	9	42,819	803	43,622
Loss for the year attributable to owners of the parent		2,049	(2,688)	(639)

£'000	Note	Year ended 31 December 2008		
		Before exceptional items	Exceptional items (note 7)	Total
Revenue	3	242,173	-	242,173
Operating costs	4	(189,017)	(11,715)	(200,732)
Operating profit	3	53,156	(11,715)	41,441
Analysed as				
EBITDAR	3	74,073	(4,658)	69,415
Rental amounts currently payable		(215)	-	(215)
EBITDA before future minimum rental increases		73,858	(4,658)	69,200
Future minimum rental increases		-	-	-
EBITDA		73,858	(4,658)	69,200
Depreciation	4	(20,702)	-	(20,702)
Permanent diminution in value of properties		-	(6,345)	(6,345)
Loss on closure of facilities		-	(1,453)	(1,453)
Profit on disposal of fixed assets		-	741	741
Operating profit		53,156	(11,715)	41,441
Finance costs	8	(99,918)	-	(99,918)
Finance income	8	708	-	708
Loss before tax		(46,054)	(11,715)	(57,769)
Tax	9	(4,548)	1,711	(2,837)
Loss for the year attributable to owners of the parent		(50,602)	(10,004)	(60,606)

EBITDAR represents earnings before interest, tax, depreciation, amortisation and rent. EBITDA represents earnings before interest, tax, depreciation and amortisation. 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 2.

The notes on pages 13 to 37 are an integral part of these financial statements. All activities relate to continuing operations.

Priory Investments Holdings Limited

Consolidated statement of comprehensive income

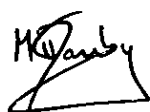
£'000	2009	2008
Loss for the year	(639)	(60,606)
Other comprehensive income		
Cash flow hedges	1,197	(46,445)
Tax impact of cash flow hedges	10,069	2,787
Total comprehensive income (loss) for the year attributable to owners of the parent	10,627	(104,264)

Priory Investments Holdings Limited

Consolidated balance sheet

£'000	Note	2009	2008	2007
Non-current assets				
Goodwill	10	216,191	216,191	216,191
Property, plant and equipment	11	658,617	660,293	693,925
Derivative financial instruments	18	-	-	9,843
Deferred tax	19	57,020	-	2,787
		931,828	876,484	922,746
Current assets				
Inventories	12	4	16	76
Trade and other receivables	13	34,268	27,082	27,852
Cash	14	14,117	29,348	9,559
Assets held for sale	15	29,860	7,509	-
		78,249	63,955	37,487
Total assets		1,010,077	940,439	960,233
Current liabilities				
Trade and other payables	16	(65,682)	(53,710)	(49,708)
Borrowings	17	(60,783)	(65,931)	(9,993)
Derivative financial instruments	18	-	(1,655)	-
		(126,465)	(121,296)	(59,701)
Net current liabilities		(48,216)	(57,341)	(22,214)
Non-current liabilities				
Borrowings	17	(728,184)	(1,047,908)	(1,052,351)
Deferred tax	19	(3,325)	-	(2,787)
Derivative financial instruments	18	(35,958)	(35,500)	(553)
		(767,467)	(1,083,408)	(1,055,691)
Net assets (liabilities)		116,145	(264,265)	(155,159)
Equity attributable to the owners of the parent				
Share capital	21	393,574	23,791	23,791
Cash flow hedge reserve		(25,889)	(37,155)	6,503
Retained loss	22	(251,540)	(250,901)	(185,453)
Total equity (deficit) attributable to the owners of the parent		116,145	(264,265)	(155,159)

The consolidated financial statements of PIHL (registered company number MC-151157) on pages 8 to 37 were approved by the board of directors and authorised for issue on 28 May 2010. They were signed on its behalf by



Mark Danby
Chairman



Philip Scott
Director

Priory Investments Holdings Limited

Consolidated cash flow statement

£'000	Note	2009	2008
Operating activities			
Operating profit		61,437	41,441
Non-cash exceptional items		(67)	6,641
Depreciation of property, plant and equipment	4	20,835	20,702
Decrease in inventories		12	60
(Increase) decrease in trade and other receivables		(7,186)	770
Increase in trade and other payables		13,227	2,382
Operating lease payments		161	-
		<u>88,419</u>	<u>71,996</u>
Taxation		(268)	(252)
Net cash inflow from operating activities		88,151	71,744
Investing activities			
Interest received		118	708
Purchase of a subsidiary	26	(430)	-
Proceeds on disposal of property, plant and equipment		494	11,274
Purchases of property, plant and equipment		(41,238)	(10,525)
Net cash (used in) generated from investing activities		(41,056)	1,457
Financing activities			
Repayment of borrowings		(68,122)	(7,506)
Repayment of obligations under finance leases		(579)	(630)
Issue of shares		10	-
New bank loans raised		53,398	15,638
Financing costs		(2,889)	-
Interest paid		(44,144)	(44,465)
Repurchase of own shares		-	(16,449)
Net cash used in financing activities		(62,326)	(53,412)
Net (decrease) increase in cash		(15,231)	19,789
Cash at the beginning of the year	14	29,348	9,559
Cash at the end of the year	14	14,117	29,348

In the year the Group entered into a non-cash transaction to restructure its shareholder debt and was released from its obligations in respect of PIHL loan notes with a carrying value of £369.8m (principal and accrued interest) in consideration for the issue of 369,772,888 PIHL Senior A Shares. The transaction is discussed in note 17.

Priory Investments Holdings Limited

Consolidated statement of changes in equity

£'000	Note	Share capital	Retained loss	Cash flow hedge reserve	Total equity (deficit)
At 1 January 2008		23,791	(185,453)	6,503	(155,159)
Loss for the year		-	(60,606)	-	(60,606)
Cash flow hedges		-	-	(43,658)	(43,658)
Purchase of own shares	22	-	(4,842)	-	(4,842)
At 31 December 2008		23,791	(250,901)	(37,155)	(264,265)
Loss for the year		-	(639)	-	(639)
Cash flow hedges		-	-	11,266	11,266
Issue of shares	21	369,783	-	-	369,783
At 31 December 2009		393,574	(251,540)	(25,889)	116,145

Cash flow hedge reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred

Priory Investments Holdings Limited

Notes to the consolidated financial statements

1. General information

The company is registered in the Cayman Islands and is the parent company for the Priory Group whose operations are conducted entirely within the UK. The purpose of these financial statements is therefore to meet the obligations for filing in the Cayman Islands and also to act as the consolidated financial statements for the Group as a whole for filing with the UK Registrar of Companies. The directors consider that there is no ultimate parent company of the Group.

These are the Group's first financial statements prepared in accordance with International Financial Reporting Standards and IFRIC Interpretations (IFRS) as adopted by the European Union (EU). They also comply with applicable UK Companies' Legislation, references to Companies Act 2006 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, with the exception of the mark to market of certain financial instruments. 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 to all periods presented, including the opening IFRS balance sheet as at 31 December 2007. 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 16.

2 Significant accounting policies

a) Adoption of IFRS

As explained above, these are the Group's first financial statements prepared in accordance with IFRS and the Group has therefore applied IFRS 1, 'First time adoption of IFRS'. An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Group is provided in note 28.

IFRS 1 grants certain exemptions from the full requirements of IFRS in the transition period. The following exemption has been taken in these financial statements:

- Business combinations – business combinations that took place prior to 31 December 2007 have not been restated.

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 2009. 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. 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 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) 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 profit or loss and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to 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.

Priory Investments Holdings Limited

Notes to the consolidated financial statements

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

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date

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 business segments, based on management's internal reporting structure and information reported to the chief operating decision maker, which is considered to be the board of directors. Further details are provided in note 3 to the consolidated financial statements.

f) Revenue recognition

Revenue represents consideration received for the provision of healthcare, education and elderly care 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 and elderly care services is recognised in respect of the days 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 invoiced in advance is included in deferred income until 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

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. To the extent that fixed rate borrowings are used to finance a qualifying asset and are hedged in an effective fair value hedge of interest rate risk, the capitalised borrowing costs reflect the hedged interest rate.

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.

h) Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. 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.

i) Operating profit

Operating profit is stated after charging restructuring costs but before net finance costs.

j) 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 set off 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.

k) 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 tangible fixed assets 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 tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

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

The expected useful lives of the assets to the business are reassessed periodically in light of experience. 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.

l) Inventory

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

m) 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.

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.

n) 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 profit or loss. Subsequent to initial recognition, financial instruments are measured as described below.

a) Trade and other receivables

Trade and other receivables are measured at amortised cost, 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.

b) Cash

Cash comprises all bank balances and is stated in the balance sheet at fair value.

c) Trade and other payables

Trade and other payables are stated in the balance sheet at fair value.

d) Borrowings

All borrowings are stated at the fair value of proceeds received after deduction of finance costs. The finance costs are amortised over the life of the underlying borrowings at a constant rate on the carrying amount. Preference shares are classified as liabilities, and the accrued redemption premium on preference shares is recognised in the income statement as part of finance costs.

Interest differentials under interest rate swaps are recognised by adjustment of the underlying interest payable on the hedged loan (see note 17 for a description of the instruments used during the year) over the term of the interest rate agreement. Premiums and discounts in connection with such financial instruments are amortised over the term of the interest rate agreement.

On early repayment of the underlying borrowings, the balance of the un-amortised premium or discount on the hedging interest rate agreement, and any premium payable or receivable on early termination of the interest rate agreement are immediately recognised in the income statement.

On early repayment of the borrowings, the balance of the un-amortised finance 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.

o) Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged. In order to qualify for hedge accounting, the Group is required to document the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate that the hedge is highly effective on an on-going basis. The effectiveness test is re-performed at each period end to ensure the hedge remains highly effective.

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. The associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss. The ineffective part of the gain or loss is recognised immediately in the income statement.

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When a hedging instrument expires or is sold, terminated or exercised or the entity revokes designation of the hedge relationship but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss is recognised immediately in the income statement.

p) 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.

Shares in the parent company, PIHL, held by employee share ownership trusts are recorded in the balance sheet as a deduction from shareholders' equity (retained loss) at cost.

q) 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.

r) Non GAAP measures

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 and Rent (EBITDAR), Earnings before Interest, Tax, Depreciation, Amortisation and future minimum rental increases (EBITDA before future minimum rental increases), and, Earnings before Interest, Tax, Depreciation and Amortisation (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.

s) 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 year 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.

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.

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 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.

t) Accounting standards and interpretations issued but not yet adopted

IFRS 3 (Revised), 'Business Combinations'

IFRS 3 (Revised) 'Business Combinations' was issued in January 2008. The following changes will be relevant to the Group's operations.

- Contingent consideration will be measured at fair value, with subsequent changes to the fair value being recognised in profit.
- Transaction costs, other than share and debt issue costs, will be expensed as incurred.
- Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognised in profit.
- Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

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The revised Standard is effective for the Group's business combinations arising on or after 1 January 2010 and will be applied prospectively from that date

Amendment to IAS 27, 'Consolidated and Separate Financial Statements (2008)'

An amendment to IAS 27 'Consolidated and Separate Financial Statements (2008)' was issued in January 2008. The amendment requires changes in ownership interests in a subsidiary, while maintaining control, to be recognised as an equity transaction. If control of a subsidiary is lost, any retained interest is measured at fair value with the gain or loss recognised in profit. The amendment is effective for accounting periods beginning on or after 1 July 2009 and is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

IFRS 9, 'Financial Instruments'

IFRS 9 'Financial Instruments' was issued in November 2009. It is applicable to financial assets and requires classification and measurement in either the amortised cost or the fair value category. It is effective for accounting periods beginning on or after 1 January 2013. The adoption of IFRS 9 is not expected to have a significant impact upon the net results or net assets of the Group.

Amendment to IFRS 5, 'Non-current Assets Held for Sale and Discontinued Operations'

An amendment to IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' was issued in May 2008 and provides clarification that assets and liabilities of a subsidiary should be classified as held for sale if the Parent is committed to a plan involving loss of control of the subsidiary, regardless of whether the entity will retain a non-controlling interest after the sale. The amendment is effective for accounting periods beginning on or after 1 July 2009 and is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

Amendment to IAS 39, 'Financial Instruments: Recognition and Measurement - Eligible Hedged Items'

The amendment to IAS 39 'Financial Instruments: Recognition and Measurement - Eligible Hedged Items' deals with two situations where diversity in practice exists on the designation of inflation as a hedged risk and the treatment of 'one-sided' risks on hedged items. The amendment is effective for accounting periods beginning on or after 1 July 2009. The amendment is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

Annual improvements to IFRSs, 2008

The standard makes amendments to existing standards and amends 20 standards, basis of conclusion and guidance. The improvements include changes in presentation, recognition and measurement plus terminology and editorial changes. Due to the wide ranging nature of amendments, the Group is in the process of assessing the potential impact upon the net results, net assets and disclosures of the Group.

The following IFRIC interpretations have been issued but are not yet adopted by the Group.

- Amendments to IFRIC 14 'Prepayments of a Minimum Funding Requirement'
- IFRIC 17 'Distributions of Non-cash Assets to Owners'
- IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments'

The interpretations are effective for accounting periods commencing on or after 1 January 2011, 1 July 2009 and 1 July 2010 respectively. The adoption of these interpretations is not expected to have a significant impact upon the net results, net assets or disclosures of the Group.

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3. Segmental information

The Group is organised into three business 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 **Elderly Care** segment provides long term, short term and respite nursing care for older people who are physically frail or suffering with dementia related disorders

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

Segment revenues and results

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 2. The measure of segment profit is adjusted earnings before interest, tax, depreciation, amortisation and rent (Adjusted EBITDAR), being EBITDAR before operating 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.

The Elderly Care segment was created in 2009, therefore no results are presented for this segment in 2008.

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

Year ended 31 December 2009

£'000	Healthcare	Education	Elderly Care	Central	Total
Revenue	173,039	82,008	1,633	-	256,680
Adjusted EBITDAR	64,267	31,739	(143)	(9,391)	86,472
Exceptional items within EBITDAR	(359)	(140)	(61)	(2,515)	(3,075)
EBITDAR	63,908	31,599	(204)	(11,906)	83,397
Rent					(709)
Depreciation					(20,835)
Loss on closure of facilities					(352)
Loss on disposal of fixed assets					(64)
Operating profit					61,437
Net finance costs					(105,698)
Loss before tax					(44,261)
Tax					43,622
Loss for the year attributable to owners of the parent					(639)

Year ended 31 December 2008

£'000	Healthcare	Education	Central	Total
Revenue	168,201	73,972	-	242,173
Adjusted EBITDAR	60,296	23,614	(9,837)	74,073
Exceptional items within EBITDAR	(1,400)	(154)	(3,104)	(4,658)
EBITDAR	58,896	23,460	(12,941)	69,415
Rent				(215)
Depreciation				(20,702)
Permanent diminution in value of property				(6,345)
Loss on closure of facilities				(1,453)
Profit on disposal of fixed assets				741
Operating profit				41,441
Net finance expense				(99,210)
Loss before tax				(57,769)
Tax				(2,837)
Loss for the year attributable to owners of the parent				(60,606)

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In 2009, the loss on closure of facilities related to the Healthcare segment (£0.1m) and the Education segment (£0.3m). The loss on disposal of fixed assets related to the Healthcare and Education segments (2008 Healthcare £0.7m profit). In 2008, the permanent diminution in value of property related to the Healthcare segment (£0.9m) and the Education segment (£5.4m).

Segment assets

£'000	2009	2008	2007
Healthcare	689,755	686,597	703,822
Education	202,560	219,032	232,037
Elderly care	24,935	-	-
Central	21,690	5,462	12,028
Total segment assets	938,940	911,091	947,887
Unallocated assets			
Cash	14,117	29,348	9,559
Deferred tax	57,020	-	2,787
Total assets	1,010,077	940,439	960,233
Goodwill			
Healthcare	179,036	179,036	179,036
Education	37,155	37,155	37,155
Elderly care	-	-	-
	216,191	216,191	216,191
Assets held for sale			
Healthcare	1,732	2,300	-
Education	5,209	5,209	-
Elderly care	22,919	-	-
	29,860	7,509	-

	Depreciation and amortisation		Additions to non-current assets	
£'000	2009		2009	2008
Healthcare	15,281	14,490	11,331	5,088
Education	5,224	5,937	4,772	2,902
Elderly care	-	-	22,634	2,413
Central	330	275	3,447	1,079
Total	20,835	20,702	42,184	11,482

Information about major customers

In 2009 revenue of £128.0m (2008 £116.9m) arose from the Group's largest customer, which represents more than 10% of the Group's total revenue. All of this revenue arose in the Healthcare segment.

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4. Operating costs

£'000	2009	2008
Staff costs	120,688	119,576
Other operating costs	49,064	47,452
Depreciation of property, plant and equipment	20,835	20,702
Owned	20,118	19,922
Leased	717	780
Rentals under operating leases		
Property leases	709	843
Other operating leases	456	444
Exceptional items	3,491	11,715
	195,243	200,732

5. Auditors' remuneration

£'000	2009	2008
Fees payable to the company's auditors for the audit of the company's financial statements	10	10
Fees payable to the company's auditors for the audit of the company's subsidiaries pursuant to legislation	166	158
Total audit fees	176	168
Other services pursuant to legislation		
- Services relating to corporate finance transactions	671	245
Total non-audit fees	671	245
Fees payable to the company's auditors and their associates for the audit of the Priory Group Money Purchase pension scheme	-	14
	847	427

6. Staff costs

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

Number	2009	2008
Healthcare	3,499	3,963
Education	1,798	1,815
Elderly Care	64	-
Central	160	188
	5,521	5,966

Their aggregate remuneration comprised

£'000	2009	2008
Wages and salaries	107,862	106,839
Social security costs	9,971	10,017
Other pension costs	2,855	2,720
	120,688	119,576

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7. Exceptional items

£'000	2009	2008
Reorganisation and rationalisation costs	2,645	4,658
Re-financing and acquisition costs	430	-
Exceptional items included within operating costs	3,075	4,658
Loss on closure of facilities	352	1,453
Loss (profit) on disposal of fixed assets	64	(741)
Permanent diminution in value of property	-	6,345
	3,491	11,715
Tax on exceptional items	(803)	(1,711)
	2,688	10,004

The costs of £2.6m incurred in respect of reorganisation and rationalisation costs were incurred in respect of a number of projects undertaken by the Group to streamline its operations. Costs of £0.4m incurred in respect of re-financing and acquisitions relate to the proposed transaction of Affinity Healthcare Holdings Limited which completed after the balance sheet date (note 26).

8. Net finance costs

£'000	2009	2008
Interest on bank overdrafts and loans	45,461	45,508
On all other loans	55,061	50,768
Preference shares - redemption premium	2,855	2,560
Amortisation of issue costs	2,760	994
Interest on obligations under finance leases	101	113
	106,238	99,943
Interest capitalised within the cost of qualifying assets	(422)	(25)
Total finance costs	105,816	99,918
Interest receivable on bank deposits	(118)	(708)
Net finance costs	105,698	99,210

Borrowing costs capitalised within the cost of qualifying assets arose on the general borrowing pool and are calculated by applying an average capitalisation rate of 9.5% per cent to expenditure on such assets (2008: 9.3%).

9. Tax

£'000	2009	2008
Current tax		
Current tax charge	(4)	(9)
Adjustment in respect of prior years	-	(41)
	(4)	(50)
Deferred tax		
Origination and reversal of temporary differences	43,626	(2,787)
Taxation	43,622	(2,837)

Corporation tax is calculated at 28% (2008: 28.5%) of the estimated taxable profit for the year. The charge for the year can be reconciled to the profit per the income statement as follows:

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	2009 £'000	2009 %	2008 £'000	2008 %
Loss before tax	(44,261)		(57,769)	
Tax at the UK corporation tax rate of 28% (2008 28.5%)	12,393	28.0	16,464	28.5
Depreciation of non-qualifying assets	(4,153)	(9.4)	(5,808)	(10.1)
Non deductible expenses	(7,153)	(16.2)	(6,602)	(11.4)
Un provided movement on deferred tax	-	-	(6,850)	(11.9)
Recognition of temporary differences	42,156	95.3	-	-
Adjustments in respect of prior years	-	-	(41)	-
Other	379	0.9	-	-
Tax credit and effective tax rate for the year	43,622	98.6	(2,837)	(4.9)

10. Goodwill

£'000	2009, 2008 and 2007
Carrying amount	216,191
At 31 December 2009, 2008 and 2007	216,191

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	2009, 2008 and 2007
Healthcare	179,036
Education	37,155
Elderly Care	-
	216,191

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.

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

In 2009 and 2008, the key assumptions used were as follows:

	2009	2008
Discount rate	8%	9%
Growth rate	2.0-2.75%	2.75%

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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11. Property, plant and equipment

£'000	Land and buildings	Assets in the course of construction	Fixtures and fittings	Motor vehicles	Total
Cost					
At 1 January 2007	684,388	6,007	30,364	2,210	722,969
Additions	1,344	9,883	6,338	1,058	18,623
Disposals	-	(97)	(445)	(403)	(945)
Transfers	1,494	(2,671)	1,177	-	-
At 1 January 2008	687,226	13,122	37,434	2,865	740,647
Additions	35	2,957	8,453	37	11,482
Disposals	(701)	(11,391)	(10)	(100)	(12,202)
Transfers	(72)	(1,931)	2,003	-	-
At 1 January 2009	686,488	2,757	47,880	2,802	739,927
Additions	17,466	6,090	17,609	1,019	42,184
Disposals	(562)	(40)	(238)	(507)	(1,347)
Transfers	650	(1,043)	393	-	-
At 31 December 2009	704,042	7,764	65,644	3,314	780,764
Accumulated depreciation					
At 1 January 2007	(18,225)	-	(6,904)	(362)	(25,491)
Charge for the year	(14,220)	-	(5,335)	(819)	(20,374)
Disposals	-	-	336	368	704
Impairment	-	(1,561)	-	-	(1,561)
At 1 January 2008	(32,445)	(1,561)	(11,903)	(813)	(46,722)
Charge for the year	(14,522)	-	(5,341)	(839)	(20,702)
Disposals	-	1,561	-	83	1,644
Impairment	(6,345)	-	-	-	(6,345)
At 1 January 2009	(53,312)	-	-	(1,569)	(72,125)
Charge for the year	(13,948)	-	(6,147)	(740)	(20,835)
Disposals	40	-	151	482	673
At 31 December 2009	(67,220)	-	(23,240)	(1,827)	(92,287)
Net book value – 31 December 2007	654,781	11,561	25,531	2,052	693,925
Net book value – 31 December 2008	633,176	2,757	30,636	1,233	667,802
Assets held for sale	(7,509)	-	-	-	(7,509)
Reported net book value – 31 December 2008	625,667	2,757	30,636	1,233	660,293
Net book value – 31 December 2009	636,822	7,764	42,404	1,487	688,477
Assets held for sale	(29,860)	-	-	-	(29,860)
Reported net book value – 31 December 2009	606,962	7,764	42,404	1,487	658,617

All of the Group's freehold land and buildings is pledged as security against certain of the Group's borrowings (note 17). The Group is not allowed to pledge these assets as security for other borrowings, or to sell them to another entity without the consent of the lender.

At 31 December 2009, the carrying amount of assets (motor vehicles) held under finance lease was £1.4m (2008: £1.2m, 2007: £2.0m). The Group's obligations under finance leases are secured by the lessors' title to the leased assets.

At 31 December 2009, the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £20.4million (2008: £15.7million, 2007: £2.3m).

The impairment charge in 2008 represents the write down of certain fixed assets to their net realisable value following the closure of two facilities. The write down represents the difference between the carrying value and the estimated recoverable amount. Management's expectation is that the properties will be sold outside of the Group, therefore the recoverable amount reflects the estimated fair value less costs to sell.

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12. Inventories

£'000	2009	2008	2007
Consumable supplies	4	16	76

13. Trade and other receivables

£'000	2009	2008	2007
Trade receivables	34,497	28,281	28,812
Allowance for doubtful debts	(2,954)	(3,107)	(1,873)
	31,543	25,174	26,939
Other receivables	381	33	62
Prepayments and accrued income	2,344	1,875	851
	34,268	27,082	27,852

14. Cash

£'000	2009	2008	2007
Cash	14,117	29,348	9,559

15. Assets held for sale

£'000	2009	2008	2007
Assets held for sale	29,860	7,509	-

In 2009, the Group decided to dispose of certain of its property assets through sale and leaseback transactions with third parties, which are expected to complete during the course of 2010. The carrying amount of the properties of £22.4m has therefore been reclassified from 'Property, Plant and Equipment' to 'Assets held for Sale'. No gain or loss has been recognised in respect of the reclassification of the properties.

In 2008 the Group also made the decision to dispose of certain of its property assets through sale to a third party. In 2008, the carrying amount of these properties of £7.5m was therefore reclassified from 'Property, Plant and Equipment' to 'Assets held for Sale'. Prior to reclassification, an impairment loss of £6.4m was recorded to reflect the difference between the carrying amount and the estimated fair value less costs to sell. At 31 December 2008, management's expectation was that these transactions would complete within 2009, however the properties were still owned by the Group at 31 December 2009. As at 31 December 2009, management expect the transactions to complete during the course of 2010 and do not consider a further impairment of the carrying value to have occurred.

16. Trade and other payables

£'000	2009	2008	2007
Trade payables	5,064	4,050	3,964
Accruals and deferred income	52,848	42,600	38,312
Other payables	3,910	2,843	2,674
Corporation tax payable	694	962	1,164
Other taxes and social security	3,166	3,255	3,594
	65,682	53,710	49,708

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 31 days (2008: 29 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.

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17. Borrowings

£'000	2009	2008	2007
Secured borrowings due less than one year			
Bank loans	61,400	65,501	9,339
Unamortised issue costs	(1,204)	(136)	-
Finance lease liabilities	587	566	654
Total borrowings due less than one year	60,783	65,931	9,993
Unsecured borrowings due greater than one year			
Bank loans	18,327	16,775	-
Other loans	157,967	472,678	421,910
Preference shares	15,001	12,146	21,193
	191,295	501,599	443,103
Secured borrowings due greater than one year			
Bank loans	539,625	550,382	613,882
Unamortised issue costs	(3,766)	(4,854)	(5,984)
Finance lease liabilities	1,030	781	1,350
	536,889	546,309	609,248
Total borrowings due greater than one year	728,184	1,047,908	1,052,351
Total borrowings	788,967	1,113,839	1,062,344

All of the Group's borrowings are denominated in Sterling

In April 2010, the Group re-negotiated certain of its banking facilities such that the amount of debt as at 31 December 2009 due within one year reduced to £13 1m

Financing is obtained from a mixture of bank and other loans in Sterling at fixed and floating rates of interest. The main purpose of these financial instruments is to raise finance for the Group's operations. The main financial covenants are in respect of interest and cash flow cover. The secured bank loans are secured against certain freehold and leasehold properties of the Group. Finance lease liabilities are secured by the lessors' title to the leased assets.

As at 31 December 2009, the Group had fixed rate borrowings (including accrued interest) of £192 9m and variable rate borrowings of £601 0m. Interest rate swaps are in place to hedge the following principal amounts (interest rates are inclusive of the impact of interest rate swaps):

- £550 2m of variable interest rate borrowings at an average fixed rate of 6.89% up to 2012, and
- £6 5m of variable interest rate borrowings at an average fixed rate of 6.985% up to 2012

As at 31 December 2008, the Group had fixed rate borrowings (including accrued interest) of £502 9m and variable interest rate borrowings of £615 9m. Interest rate swaps were in place to hedge the following principal amounts (interest rates are inclusive of the impact of interest rate swaps):

- £559 1m of variable interest rate borrowings at an average fixed rate of 6.89% up to 2012,
- £6 5m of variable interest rate borrowings at an average fixed rate of 6.985% up to 2012, and
- £43 6m of variable interest rate borrowings at an average fixed rate of 8.07% up to 2009

As at 31 December 2007, the Group had fixed rate borrowings of £416 9m and variable interest rate borrowings of £621 3m. Interest rate swaps were in place to hedge the following principal amounts (interest rates are inclusive of the impact of interest rate swaps):

- £565 9m of variable rate borrowings at an average fixed rate of 6.89% up to 2012,
- £6 5m of variable interest rate borrowings at an average fixed rate of 6.985% up to 2012, and
- £43 6m of variable rate borrowings at an average fixed rate of 8.07% up to 2009

Other loans comprise PIHL loan notes and PIHL Payment in Kind (PIK) notes. Interest on both the loan notes and the PIK notes accrues at 12% per annum and the notes mature in 2015. In 2009, the Group restructured certain of its shareholder debt and on 18 December 2009 was released from its obligations in respect of PIHL loan notes with a carrying value of £369 8m (principal and accrued interest) in consideration for the issue of 369,772,888 PIHL Senior A shares. Details of the rights attaching to the Senior A shares is given in note 21. At the same time, the Group settled accrued interest of £39 4m on PIHL loan notes through the issue of PIK notes with a nominal value of the same amount.

The Preference shares do not entitle the holders to participate in any dividends and will be redeemed on or before 4 July 2015. The Preference shares entitle the holders to a Redemption Premium (details of which are set out in the Company's Articles of

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Association) The Preference shares entitle the holders to a return of capital equal to £1 per share and to the amount of the Redemption Premium due at the date of the winding up or reduction or return of capital

As discussed in note 21, the Priory Investments Holdings Limited Employee Incentive Trust ('the Trust') and the Priory Investments Holdings Limited Second Employee Incentive Trust ('the Second Trust') are the legal and beneficial owners of 11,607,399 preference shares in the Company. In the consolidated Group financial statements, the nominal amount of these preference shares has been netted off the total nominal value of the Preference shares in issue

The weighted average interest rates paid during the year were as follows

%	2009	2008	2007
Bank loans	7.39	7.33	7.12
Other loans	12.0	12.0	12.0
Preference shares	12.0	12.0	12.0

18 Derivative financial instruments

£'000	2009	2008	2007
Interest rate swaps			
Assets	-	-	9,843
Liabilities	(35,958)	(37,155)	(553)
	(35,958)	(37,155)	9,290
Analysed as			
Current	-	(1,655)	-
Non-current	(35,958)	(35,500)	9,290

19. Deferred tax

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

£'000	Accelerated tax depreciation	Short term timing differences	Financial derivatives	Tax losses	Total
At 31 December 2007	-	2,787	(2,787)	-	-
Charge to income statement	-	(2,787)	-	-	(2,787)
Credit to equity	-	-	2,787	-	2,787
At 31 December 2008	-	-	-	-	-
(Charge) credit to income statement	(2,520)	25,828	-	20,318	43,626
Credit to equity	-	-	10,069	-	10,069
At 31 December 2009	(2,520)	25,828	10,069	20,318	53,695

The following is the analysis of the deferred tax balances for financial reporting purposes

£'000	2009	2008	2007
Deferred tax liabilities	(3,325)	-	(2,787)
Deferred tax assets	57,020	-	2,787
	53,695	-	-

At the balance sheet date, the Group has unused tax losses of £75 million (2008 £64 million, 2007 £66 million) available for offset against future profits, representing a potential deferred tax asset on losses of £21 million. A deferred tax asset of £20 million (2008 nil, 2007 £nil) has been recognised in respect of such losses in the current period based on an assessment of the probability that future taxable profits will arise in the foreseeable future against which these losses can be offset. As at 31 December 2009, a potential deferred tax asset of £1m has not been recognised with respect to losses of £2 million (2008 £18 million, 2007 £20 million) as it is not currently anticipated that such losses will be offset in the foreseeable future. The Group expects to utilise approximately £9m of the deferred tax asset 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, short term timing differences and financial derivatives 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.

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20. Obligations under finance leases

£'000	Present value of minimum lease payments		
	2009	2008	2007
Amounts payable under finance leases:			
Within one year	587	566	654
In the second to fifth years inclusive	1,019	781	575
After five years	11	-	775
Present value of lease obligations	1,617	1,347	2,004

£'000	Minimum lease payments		
	2009	2008	2007
Amounts payable under finance leases:			
Within one year	587	566	654
In the second to fifth years inclusive	1,019	781	575
After five years	1,990	-	775
Less future finance charges	(1,979)	-	-
Present value of lease obligations	1,617	1,347	2,004

The Group's finance leases primarily relate to leased vehicles. The average lease term is 4 years (2008 4 years). In 2008, the average borrowing rate on finance leases was 3.5% (2008 3.5%). 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. In 2009, the Group entered into two property finance lease arrangements, each with a term of 1,000 years. In accordance with IAS 17, the Group considers the substance of the each lease to be the acquisition of the freehold interest in each of the properties. Under the terms of the agreement, the Group paid substantially all of the lease payments at the inception of the lease, however a minor annual rent is payable for the remaining term, and this has been recorded on the balance sheet, at present value, as a finance lease creditor.

21. Share capital

	2009		2008		2007	
	Number	Nominal value	Number	Nominal value	Number	Nominal value
	000s	£'000	000s	£'000	000s	£'000
Authorised						
A ordinary shares of £1 each	16,000	16,000	16,000	16,000	16,000	16,000
B ordinary shares of £1 each	5,000	5,000	5,000	5,000	5,000	5,000
Non Voting B ordinary shares of £1 each	5,000	5,000	5,000	5,000	5,000	5,000
C shares of £0.01 each	1,000	10	-	-	-	-
Preference shares of £1 each	15,900	15,900	15,900	15,900	15,900	15,900
Deferred shares of £1 each	417,010	417,010	5,000	5,000	5,000	5,000
Senior A shares of £1 each	375,000	375,000	-	-	-	-
New Investments A ordinary shares of £1 each	88	88	-	-	-	-
New Investments B ordinary shares of £1 each	12	12	-	-	-	-
	835,010	834,020	46,900	46,900	46,900	46,900
Allotted and fully paid						
A ordinary shares of £1 each	14,991	14,991	14,991	14,991	14,991	14,991
B ordinary shares of £1 each	4,000	4,000	4,000	4,000	4,000	4,000
Non Voting B ordinary shares of £1 each	4,800	4,800	4,800	4,800	4,800	4,800
C shares of £0.01 each	1,000	10	-	-	-	-
Senior A shares of £1 each	369,773	369,773	-	-	-	-
	394,564	393,574	23,791	23,791	23,791	23,791
Preference shares (classified as borrowings)	15,900	15,900	15,900	15,900	15,900	15,900

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Ordinary Shares (A Ordinary, B Ordinary and Non-voting B Ordinary)

The holders of A Ordinary Shares and the B Ordinary Shares have the right to attend, speak and vote at general meetings of PIHL such that the holders of A Ordinary Shares shall have 84% of the aggregate number of votes of the A Ordinary Shares and B Ordinary Shares. The holders of B Ordinary Shares shall have 16% of the aggregate number of votes of the A Ordinary Shares and B Ordinary Shares each share having a pro rata voting entitlement.

The Non-voting B Ordinary Shares have the right to attend and speak, but not vote, at general meetings of PIHL.

The A Ordinary Shares, the B Ordinary Shares and Non-voting B Ordinary Shares ("Ordinary Shares") rank equally in respect of any dividend declared and paid by PIHL and any dividend paid to the holders of the Ordinary Shares shall be paid pro rata to the holdings of A Ordinary Shares, the B Ordinary Shares and Non-voting B Ordinary Shares as if they were all one class.

The rights of the holders of Preference Shares, Senior A Shares and C Shares have priority to the Ordinary Shares on a return of capital on a liquidation, reduction of capital or otherwise (other than a redemption or purchase of shares). The balance of any assets available to the holders of Ordinary Shares is to be shared pro rata between the holders of Ordinary Shares according to the number of Ordinary Shares held by them.

C shares

The holders of C Shares are entitled to attend, speak and vote at meetings of PIHL and each holder of C Shares shall have on a poll one vote for every 1,000 C Shares held by them. The holders of C Shares are not entitled to vote at any general meeting in respect of any resolution concerned with a breach of the Group's financing documents.

Dividends may be declared and paid to the holders of C Shares pro rata to the nominal amount of C Shares held provided:

(i) the aggregate dividend paid to the holders of C shares at any date shall not exceed 12% of the aggregate dividend paid to the holders of A Ordinary Shares, the B Ordinary Shares, the Non-voting B Ordinary Shares, the C Shares, the Preference Shares, the Senior A Shares and the Deferred Shares ("Existing Group Shares"), and

(ii) a dividend can be declared and paid to the holders of A Ordinary Shares, B Ordinary Shares and Non-voting B Ordinary Shares without a dividend being declared and paid on the C Shares.

On a return of capital on liquidation, reduction of capital or otherwise (other than on a redemption or purchase of shares) the assets of PIHL available for distribution among the holders of Existing Group Shares shall first pay (in priority to the holders of A Ordinary Shares, B Ordinary Shares and Non-voting B Ordinary Shares) the holders of C Shares their entitlement calculated by reference to article 17.

Senior A Shares

For discussion of the issue of senior A shares in 2009, see note 17.

The holders of Senior A Shares are entitled to attend and speak at meetings of the company but are not entitled to vote. The consent of the holders of the Senior A Shares is required prior to the issue of shares which rank in priority to the Senior A Shares as regards participation in profits and returns.

A cumulative dividend accrues on a daily basis at a rate of the 12 month LIBOR rate at noon on the date of issue of a Senior A Share (as recalculated on each anniversary of issue of the share) plus 10% on the nominal value of the Senior A Shares. Any such dividend is paid to the holders of Senior A Shares pro rata to their holdings. Payment of the dividend is subject to approval in general meeting of the Company, and is therefore at the discretion of the voting shareholders.

On a return of capital on liquidation, reduction of capital or otherwise (other than on a redemption or purchase of shares) the assets of PIHL available for distribution among the holders of Existing Group Shares shall be paid (in priority to the holders of A Ordinary Shares, B Ordinary Shares and Non-voting B Ordinary Shares but after payment to the holders of C Shares of their entitlement under articles 10 and 17) to the holders of Senior A Shares as to the aggregate of the sum of £1 for each Senior A Share held and the amount of any accrued but unpaid dividend on such Senior A Shares. The Senior A Shares do not have any further right to participate on a return of capital on a liquidation, reduction of capital or otherwise.

PIHL may redeem the Senior A Shares at any time with the consent of a majority of the holders of the Senior A Shares.

Preference shares

The holders of Preference Shares are able to attend and speak at meetings of the company but are not entitled to vote but the consent of the holders of the Preference Shares is required prior to the issue of shares which rank in priority to the Preference Shares as regards participation in profits and returns.

The rights of the holders of the Preference Shares are subject to the rights attaching to the C shares and Senior A Shares. The holders of the Preference Shares are not entitled to participate in any dividends declared or paid by PIHL.

On a return of capital on liquidation, reduction of capital or otherwise (other than on a redemption or purchase of shares) the assets of PIHL available for distribution among the holders of Existing Group Shares shall be paid (in priority to the holders of Ordinary Shares but after payment to the holders of C Shares and Senior A Shares) to the holders of Preference Shares as to the aggregate of the sum of the subscription price of each Preference Share and a redemption premium calculated in accordance with article 12. The Preference Shares do not have any further right to participate on a return of capital on a liquidation, reduction of capital or otherwise.

PIHL is required to redeem the Preference Shares in full on the date the last of the PIHL loan notes and Senior A Shares are redeemed in full. PIHL may redeem some or all of the Preference Shares at any time with the consent of a majority of the holders of the Senior A Shares and a majority of the investors.

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22. Retained loss

£'000

At 1 January 2008	(185,453)
Loss for the year	(60,606)
Purchase of own shares	(4,842)
At 31 December 2008	(250,901)
Loss for the year	(639)
At 31 December 2009	(251,540)

Own shares represent the cost of shares in PIHL purchased and held by the Priory Investments Holdings Limited Employee Incentive Trust ('the Trust') and the Priory Investments Holdings Limited Second Employee Incentive Trust ('the Second Trust'). The cost deducted from retained earnings excludes consideration paid for preference shares. The trusts allow employees to purchase shares in the Group. The number of shares in which each trust holds a beneficial interest is set out in the tables below.

Beneficial interest in shares held by the Trust

	'B' ordinary Shares Number	Non Voting 'B' ordinary Shares Number	Preference Shares Number	Consideration £'000
At 1 January 2007	53,700	61,000	299,284	442
Acquired in the year	72,600	55,100	208,146	356
Disposed in the year	(53,700)	(61,000)	(215,000)	(367)
At 31 December 2007	72,600	55,100	292,430	431
Purchased from leaving employees	162,500	144,500	463,706	811
At 31 December 2008 and 2009	235,100	199,600	756,136	1,242

Beneficial interest in shares held by the Second Trust

	'B' ordinary Shares Number	Non Voting 'B' ordinary Shares Number	Preference Shares Number	Consideration £'000
At 1 January 2008	-	-	-	-
Purchased from key management	2,864,212	3,660,535	10,851,263	15,638
At 31 December 2008 and 2009	2,864,212	3,660,535	10,851,263	15,638

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.

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24. Operating lease arrangements

£'000	2009	2008
Minimum lease payments under operating leases recognised as an expense in the year	1,165	1,287

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

	2009		2008	
£'000	Land and buildings	Other	Land and buildings	Other
Within one year	1,565	465	842	356
Two – five years inclusive	5,488	544	1,925	636
After five years	49,379	-	15,568	-

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.

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 cash equivalents and trade receivables. Cash and cash equivalents are deposited only with major financial institutions that satisfy certain credit criteria.

Management has a credit policy in place and exposure to credit risk is monitored on an on-going basis. Credit evaluations are carried out on all significant prospective customers and all existing customers requiring credit beyond a certain threshold. Varying approval levels are set on the extension of credit depending on the value of the sale.

The Group provides credit to customers in the normal course of business and the balance sheet is net of allowances of £3.0m (2008: £3.1m) for doubtful receivables. The Group does not require collateral in respect of financial assets. In 2009, £0.6m was charged to the income statement in respect of bad and doubtful debts (2008: £1.7m), within operating costs. Trade receivables are measured at amortised cost.

The average credit period taken on the provision of services is 26 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 general provision based on the age of the trade receivable in respect of certain types of trade receivables.

Of the trade receivables balance at the end of the year, £12.9m (2008: £16.3m, 2007: £15.5m) was due from the Group's largest customer.

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

£'000	2009	2008	2007
Current	14,566	14,945	13,678
30-60 days	15,877	9,692	11,354
60-150 days	1,965	956	2,668
150 days +	2,089	2,688	1,112
	34,497	28,281	28,812

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

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

£'000	2009	2008	2007
60-150 days	865	419	761
150 days +	2,089	2,688	1,112
	2,954	3,107	1,873

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The movement in allowance for doubtful debts in 2009, 2008 and 2007 was as follows

£'000	2009	2008	2007
Balance at beginning of year	3,107	1,873	1,790
Impairment losses recognised	646	1,743	440
Amounts written off during the year as uncollectible	(713)	(100)	(258)
Amounts recovered during the year	(86)	(409)	(99)
Balance at end of year	2,954	3,107	1,873

Apart from the Group's largest customer, 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 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.

Interest rate risk

The Group finances its operations through called up share capital, retained earnings, bank borrowings, shareholder loans and the sale of assets, if appropriate. The Group is exposed to interest rate risk because entities in the Group borrow funds at both fixed and floating interest rates. The risk is managed by the Group by maintaining an appropriate mix between fixed and floating rate borrowings, and by the use of interest rate swap contracts. Group policy is that deposits will only be made, and derivatives and other financial instruments entered into, with bank counter-parties which have been approved by the board.

The Group does not enter into financial instruments for trading purposes. The Group will borrow from and enter into financial instruments with, well-established financial institutions with high credit ratings.

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 available bank and overdraft facilities, sufficient, with cash flows from profits, to fund current commitments. Term facilities are used to fund capital expenditure and short term flexibility is achieved through the use of overdraft facilities. The following table shows the contractual cash flow maturities of financial liabilities.

2009

£'000	Total	0-1 years	2-5 years	5 years and over
Trade and other payables	65,682	65,682	-	-
Bank loans	740,070	104,888	635,182	-
Other loans	278,392	-	-	278,392
Preference shares	23,690	-	-	23,690
Finance lease liabilities	1,617	587	1,019	11
	1,109,451	171,157	636,201	302,093

2008

£'000	Total	0-1 years	2-5 years	5 years and over
Trade and other payables	53,710	53,710	-	-
Bank loans	708,539	48,269	660,270	-
Other loans	933,658	-	-	933,658
Preference shares	23,690	-	-	23,690
Finance lease liabilities	1,347	566	781	-
	1,720,944	102,545	661,051	957,348

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2007

£'000	Total	0-1 years	2-5 years	5 years and over
Trade and other payables	49,708	49,708	-	-
Bank loans	816,379	45,886	770,493	-
Other loans	933,384	-	-	933,384
Preference shares	23,690	-	-	23,690
Finance lease liabilities	2,004	654	1,350	-
	1,825,165	96,248	771,843	957,074

Capital risk management

The Group manages its capital 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's capital structure is as follows

£'000	2009	2008	2007
Cash and cash equivalents	14,117	29,348	9,559
Borrowings	(788,967)	(1,113,839)	(1,062,344)
Equity (deficit)	116,145	(264,265)	(155,159)

The Group is not subject to any externally imposed capital requirements. Debt is defined as long-term and short-term borrowings (excluding derivatives and financial guarantee contracts) as detailed in note 17. Equity includes all capital and reserves of the Group that are managed as capital.

Foreign currency risk

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

Sensitivity analysis

In managing interest rate risks the Group aims to reduce the impact of short term fluctuations on the Group's earnings. Over the long term, however, permanent changes in interest rates would have an impact on consolidated earnings.

At 31 December 2009, it is estimated that a general increase of one percentage point in interest rates would decrease the Group's profit before tax by approximately £1.2m (2008: £nil, 2007: £nil). Hedging instruments have been included in this calculation.

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 fixed rate debt is not considered to be significantly different to the book value, therefore book value is considered to be a reasonable proxy.

£'000	2009		2008		2007	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables						
Cash and cash equivalents	14,117	14,117	29,348	29,348	9,559	9,559
Trade receivables	34,268	34,268	27,082	27,082	27,852	27,852
	48,385	48,385	56,430	56,430	37,411	37,411
Amortised cost						
Trade and other payables	(65,682)	(65,682)	(53,710)	(53,710)	(49,708)	(49,708)
Bank loans	(614,382)	(614,382)	(627,668)	(627,668)	(617,237)	(617,237)
Other loans	(157,967)	(157,967)	(472,678)	(472,678)	(421,910)	(421,910)
Preference shares	(15,001)	-	(12,146)	-	(21,193)	-
Finance lease liabilities	(1,617)	(1,617)	(1,347)	(1,347)	(2,004)	(2,004)
	(854,649)	(839,648)	(1,167,549)	(1,155,403)	(1,112,052)	(1,090,859)
Held at fair value						
Financial instruments	(35,958)	(35,958)	(37,155)	(37,155)	9,290	9,290

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Financing facilities

£'000	2009	2008	2007
Secured bank loans			
- amount used	599,111	613,835	621,341
- amount unused	5,000	48,503	64,553
	604,111	662,338	685,894
Unsecured bank loans			
- amount used	15,638	15,638	-
- amount unused	-	-	-
	15,638	15,638	-

26. Events after the balance sheet date

On 11 January 2010, the Company issued 12,350 New Investments B ordinary shares in exchange for 15,000 ordinary shares in Priory New Investments Limited (PNIL), representing 100% of the ordinary share capital of PNIL. On 18 March 2010, Priory New Investments 3 Limited, a subsidiary of PNIL, acquired 100% of the share capital of Affinity Healthcare Holdings Limited (Affinity). In connection with the acquisition, the Company issued £48,085 loan notes convertible into 48,085 New Investments A ordinary shares and PNIL issued 48,085 ordinary shares, £16,046,750 loan notes and 16,046,750 £1 preference shares. Affinity is a specialist provider of complex adult and young people's mental health services, operating over 250 beds in 2 hospitals across Northern England.

On 22 February 2010, the company acquired 100% of the ordinary share capital of SP Cockerham Limited for cash consideration of £4.8m.

27. Related party transactions

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 remuneration of key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*.

£'000	2009	2008
Short-term employee benefits	2,113	1,301
Post-employment benefits	29	30
Termination payments	-	269
	2,142	1,600

The emoluments of the highest paid director of the Company were £30,000 (2008: £30,000). No pension contributions were paid on his behalf (2008: *Nil*).

During the year, the Group entered into agreements to lease with Zest Investments in respect of three elderly care homes and one learning disability unit with a total aggregate initial annual rent payable by the Group of £1,326,818. The Group also entered into an operating lease with Sistine Properties in respect of a special education school under which the initial annual rent is £300,000 of which £75,000 was paid during the year. Philip Scott, a director of Priory Investment Holdings Limited is also a shareholder in Zest Investments. Sistine Properties is a party to certain trust arrangements, the beneficiaries of which are Mr Scott's family.

28. Adoption of IFRS

In preparing the opening IFRS balance sheet, the Group has adjusted amounts previously reported in financial statements prepared in accordance with UK GAAP. An explanation of how the transition from UK GAAP to IFRS has affected the Group's financial position and financial performance is set out below and in the following tables.

The following are the most significant adjustments arising on transition to IFRS.

Presentation adjustments

a) Accrued interest

In accordance with IAS 39, 'Financial Instruments - Recognition and Measurement', interest accrued but not yet paid at the balance sheet date is reflected within borrowings. Under UK GAAP, interest accrued on borrowings where the interest is capitalised rather than paid is reflected within borrowings, however interest accrued on borrowings where the interest is settled on a regular basis is reflected within accruals. An adjustment has therefore been made in the opening IFRS balance sheet to reclassify accrued interest reflected within accruals to borrowings.

Priory Investments Holdings Limited

Notes to the consolidated financial statements

b) Non current assets held for sale

In accordance with IFRS 5, 'Non current assets held for sale and discontinued operations', assets and disposal groups for which the carrying value will be recovered primarily through sale rather than through continuing use are classified on the balance sheet as held for sale when the following conditions are met: 1) the asset is available for sale in its present condition, and, 2) the sale is highly probable. Under UK GAAP, no such reclassification is made.

At 31 December 2008, the Group has therefore reclassified certain of its property assets (classified as fixed assets in the UK GAAP balance sheet) to 'Assets held for Sale' on the IFRS balance sheet. The change in classification had no impact on the carrying value of the assets, compared with their carrying value under UK GAAP.

c) Cash flow statement

The presentation of the cash flow statement in accordance with IAS 7, 'Cash Flow Statements', differs from UK GAAP in the presentation and categorisation of individual line items. Under IFRS, cash flows are presented in three categories, cash from operating activities, cash from investing activities and cash from financing activities, whereas under UK GAAP the cash flow statement is presented with a greater number of statutory headings. The change in presentation has no impact on the cash flows of the Group.

Accounting adjustments

d) Interest rate swaps

In accordance with IAS 39, 'Financial Instruments – Recognition and Measurement', derivative financial instruments are recognised in the balance sheet at fair value. Under UK GAAP, no value was recognised in respect of the Group's derivative financial instruments (interest rate swaps).

At the date of transition to IFRS, the fair value of the Group's interest rate swaps was a net asset of £9.3m, comprising an asset of £9.8m and a liability of £0.5m. At 31 December 2008, the fair value of the interest rate swaps was a liability of £37.2m. In accordance with IAS 39, the Group has applied hedge accounting to its interest rate swaps and therefore the movement in the fair value of interest rate swaps has been recognised within other comprehensive income.

e) Taxation

IAS 12, 'Income Taxes', differs from UK GAAP by using a balance sheet methodology. Changes in the accounting treatment of a number of balance sheet items will therefore impact deferred tax balances. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited to equity, in which case the deferred tax is also reflected within equity. Changes in the accounting treatment of a number of balance sheet items will impact deferred tax balances.

f) Goodwill

In accordance with IFRS 3, 'Business Combinations', goodwill is not amortised to the income statement. Instead, goodwill is carried at cost and is reviewed for impairment annually and also when there is any indication that an impairment may have occurred. Under the transitional arrangements of IFRS, 'First time adoption of IFRS', the Group has decided to apply IFRS 3 prospectively from 1 January 2008. Consequently, periodic amortisation of goodwill to the income statement has ended. Under UK GAAP, goodwill was amortised over its useful economic life.

Priory Investments Holdings Limited

Notes to the consolidated financial statements

Reconciliation of equity at 31 December 2007 (transition date)

£'000	Note	UK GAAP previously reported	Presentation adjustments	Accounting adjustments	Restated in accordance with IFRS
Non-current assets					
Goodwill		216,191	-	-	216,191
Property, plant and equipment		693,925	-	-	693,925
Derivative financial instruments	d)	-	-	9,843	9,843
Deferred tax	e)	-	-	2,787	2,787
		910,116	-	12,630	922,746
Current assets					
Inventories		76	-	-	76
Trade and other receivables		27,852	-	-	27,852
Cash and bank balances		9,559	-	-	9,559
		37,487	-	-	37,487
Total assets		947,603	-	12,630	960,233
Current liabilities					
Trade and other payables	a)	(79,835)	30,127	-	(49,708)
Borrowings	a)	(8,375)	(1,618)	-	(9,993)
		(88,210)	28,509	-	(59,701)
Net current liabilities		(50,723)	28,509	-	(22,214)
Non current liabilities					
Borrowings	a)	(1,023,842)	(28,509)	-	(1,052,351)
Deferred tax	e)	-	-	(2,787)	(2,787)
Derivative financial instruments	d)	-	-	(553)	(553)
		(1,023,842)	(28,509)	(3,340)	(1,055,691)
Net liabilities		(164,449)	-	9,290	(155,159)
Equity attributable to the owners of the parent					
Share capital		23,791	-	-	23,791
Cash flow hedge reserve	d)	-	-	6,503	6,503
Retained earnings	e)	(188,240)	-	2,787	(185,453)
Total deficit		(164,449)	-	9,290	(155,159)

Priory Investments Holdings Limited

Notes to the consolidated financial statements

Reconciliation of equity at 31 December 2008

£'000	Note	UK GAAP previously reported	Presentation adjustments	Accounting adjustments	Restated in accordance with IFRS
Non-current assets					
Goodwill	f)	203,840	-	12,351	216,191
Property, plant and equipment	b)	667,708	(7,415)	-	660,293
		871,548	(7,415)	12,351	876,484
Current assets					
Inventories		16	-	-	16
Trade and other receivables		27,082	-	-	27,082
Cash and bank balances		29,348	-	-	29,348
Assets held for sale	b)	-	7,509	-	7,509
		56,446	7,509	-	63,955
Total assets		927,994	94	12,351	940,439
Current liabilities					
Trade and other payables	a)	(90,464)	36,754	-	(53,710)
Borrowings	a)	(63,883)	(2,048)	-	(65,931)
Derivative financial instruments	d)	-	-	(1,655)	(1,655)
		(154,347)	34,706	(1,655)	(121,296)
Net current liabilities		(97,901)	42,215	(1,655)	(57,341)
Borrowings	a)	(1,013,202)	(34,706)	-	(1,047,908)
Derivative financial instruments	d)	-	-	(35,500)	(35,500)
		(1,013,202)	(34,706)	(35,500)	(1,083,408)
Net liabilities		(239,555)	94	(24,804)	(264,265)
Equity attributable to the owners of the parent					
Share capital		23,791	-	-	23,791
Cash flow hedge reserve	d)	-	-	(37,155)	(37,155)
Retained loss	b), f)	(263,346)	94	12,351	(250,901)
Total deficit		(239,555)	94	(24,804)	(264,265)

Priory Investments Holdings Limited

Notes to the consolidated financial statements

Reconciliation of profit for the year – year ended 31 December 2008

£'000	Note	UK GAAP previously reported	Presentation adjustments	Accounting adjustments	Restated in accordance with IFRS
Revenue		242,173	-	-	242,173
Operating costs		(206,095)	(7,057)	12,420	(200,732)
Operating profit		36,078	(7,057)	12,420	41,441
EBITDA/ EBITDAR		69,200	215	-	69,415
Rent	b)	-	(215)	-	(215)
Depreciation		(20,771)	-	69	(20,702)
Amortisation of goodwill	f)	(12,351)	-	12,351	-
Permanent diminution in value of properties		-	(6,345)	-	(6,345)
Loss on termination of an operation		-	(1,453)	-	(1,453)
Profit on disposal of fixed assets		-	741	-	741
Group operating profit		36,078	(7,057)	12,420	41,441
Permanent diminution in value of properties		(6,345)	6,345	-	-
Loss on termination of an operation		(1,453)	1,453	-	-
Profit on disposal of fixed assets		741	(741)	-	-
Profit before interest and tax		29,021	-	12,420	41,441
Net finance costs		(99,235)	-	25	(99,210)
Loss before taxation		(70,214)	-	12,445	(57,769)
Taxation	e)	(50)	-	(2,787)	(2,837)
Loss for the year		(70,264)	-	9,658	(60,606)

29. Subsidiaries

The principal undertakings in which the Group's interest at the year end is more than 20% are as follows

Subsidiary undertakings	Principal activities	Class and percentage of shares held
Priory Health No 1 Limited *	Intermediate holding company	100% ordinary
Priory Health No 2 Limited	Intermediate holding company	100% ordinary
Priory Healthcare Investments Limited	Intermediate holding 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 Holdings Company No 4 Limited *	Property company	100% ordinary
Priory Healthcare Limited	Psychiatric and other 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 Elderly Care Holdings Limited	Elderly care services	100% ordinary
Priory Elderly Care Limited	Elderly care services	100% ordinary
Priory Ben Madigan Limited	Elderly care services	100% ordinary
Priory Finance Company Limited	Financing company	100% ordinary

* Interests held directly by the company. A full list of subsidiaries can be obtained by writing to the Company Secretary at Priory House, Randalls Way, Leatherhead, Surrey KT22 7TP

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

- 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 Cayman Islands
- Priory Services for Young People (IOM) Limited (non-trading) is registered in the Isle of Man

Priory Investments Holdings Limited

Independent auditors' report – parent company

INDEPENDENT AUDITORS' REPORT TO THE DIRECTORS OF PRIORY INVESTMENTS HOLDINGS LIMITED

We have audited the parent company financial statements of Priory Investments Holdings Limited for the year ended 31 December 2009 which comprise the Company balance Sheet, the Company reconciliation of movements in shareholders' funds and the related notes. The financial reporting framework that has been applied in the preparation of these financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of the directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 6 the directors are responsible for the preparation of the parent company financial statements in accordance with Companies Act 1985 applicable to overseas companies and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for and only for the directors to meet their stewardship obligations and fiduciary responsibilities in respect of the company pursuant to section 401 of the Companies Act 2006 in order that the company's subsidiary undertakings are exempt from the requirement to prepare group financial statements in accordance with our engagement letter dated 18 December 2009 and for no other purpose. We do not, in giving this opinion, 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 including without limitation under any contractual obligations of the company, 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 parent company financial statements sufficient to give reasonable assurance that the parent company 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 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 parent company financial statements.

Opinion on financial statements

In our opinion the parent company financial statements

- give a true and fair view of the state of the parent company's affairs as at 31 December 2009,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been properly prepared in accordance with the Companies Act 1985 applicable to overseas companies.

Other matter

We have reported separately on the group financial statements of Priory Investments Holdings Limited for the year ended 31 December 2009.


PricewaterhouseCoopers LLP

Chartered Accountants

Manchester

28 May 2010

Priory Investments Holdings Limited

Parent company balance sheet and reconciliation of movement in shareholders' funds

Company balance sheet

£'000	Note	2009	2008
Fixed assets			
Investments	3	2,474	18,844
		<u>2,474</u>	<u>18,844</u>
Current assets			
Debtors due within In one year	4	52,113	48,142
Debtors due after more than one year	4	532,119	476,152
Deferred tax	5	25,151	-
Cash at bank and in hand		1,699	1,699
		<u>611,082</u>	<u>525,993</u>
Current liabilities			
Creditors amounts falling due within one year	6	(89,554)	(99,653)
		<u>521,528</u>	<u>426,340</u>
Net current assets			
		521,528	426,340
Total assets less current liabilities		524,002	445,184
Creditors amounts falling due after more than one year	7	(155,745)	(462,862)
Net assets (liabilities)		<u>368,257</u>	<u>(17,678)</u>
Capital and reserves			
Called up share capital	8	393,574	23,791
Profit and loss reserve		(25,317)	(41,469)
Total shareholders' funds		<u>368,257</u>	<u>(17,678)</u>

Company reconciliation of movement in shareholders' funds

£'000	Note	Called up share capital	Profit and loss reserve	Total equity
As at 1 January 2008		23,791	(31,261)	(7,470)
Loss for the year		-	(10,208)	(10,208)
As at 1 January 2009		23,791	(41,469)	(17,678)
Profit for the year		-	16,152	16,152
Issue of shares	8	369,783	-	369,783
As at 31 December 2009		393,574	(25,317)	368,257

The financial statements of Priory Investments Holdings Limited were approved by the board of directors and authorised for issue on 28 May 2010. They were signed on its behalf by



Mark Danby
Chairman



Philip Scott
Director

Priory Investments Holdings 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. The consolidated financial statements of Priory Investments Holdings Limited contain a consolidated cash flow statement and therefore the Company has taken advantage of the exemption in FRS 1, 'Cash Flow Statements' and not presented its own cash flow statement. The consolidated financial statements of Priory Investments Holdings Limited contain related party disclosure, therefore the Company has taken advantage of the exemption in FRS 8, 'Related Party Disclosures' to not disclose transactions with other subsidiaries of the Group.

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.

c) Taxation

Full provision is made for deferred taxation on all timing differences which have arisen but not reversed at the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded more likely than not that there will be sufficient taxable profits from which the underlying timing differences can be deducted. Deferred tax balances are not discounted.

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 profit for the year was £16.2m (2008: loss of £10.2m). The auditors' remuneration for audit and other services is disclosed in note 5 to the consolidated financial statements. The company had no employees during the year (2008: none). Details of directors' emoluments are given in note 27 to the consolidated financial statements.

3. Investments

Cost and net book value	£'000
At 1 January 2009	18,844
Additions	430
Disposals	(16,800)
At 31 December 2009	2,474
At 31 December 2008	18,844

The addition in the year relates to costs incurred in respect of the company's investment in Priory New Investments Limited (see note 26 to the consolidated financial statements). In the year the company disposed of its investment in Priory Holdings No. 4 Limited to a fellow group undertaking at net book value.

4. Debtors

£'000	2009	2008
Amounts due after more than one year		
Amounts owed by group undertakings	532,119	476,152
Amounts due less than one year		
Amounts owed by group undertakings	36,407	32,504
Other debtors	15,638	15,638
Prepayments	68	-
	52,113	48,142

Amounts due to group undertakings due more than one year are unsecured, bear interest at LIBOR plus 2.25% per annum and are repayable on demand.

Priory Investments Holdings Limited

Notes to parent company financial statements

5. Deferred tax

£'000

At 1 January 2009	-
Recognised in year	25,151
At 31 December 2009	25,151

Deferred tax arises on the following timing differences

£'000	2009	2008
Short term timing differences	25,151	-
	25,151	-

6. Creditors: amounts falling due within one year

£'000	2009	2008
Amounts due to group undertakings	50,405	55,072
Accruals and deferred income	29,365	33,569
Group relief payable	9,784	11,012
	89,554	99,653

Amounts due to group undertakings are unsecured, bear interest at LIBOR plus 2 25% per annum and are repayable on demand

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

£'000	2009	2008
Other loans	139,845	446,962
Preference shares	15,900	15,900
	155,745	462,862

Details of loans and preference shares are included in note 17 to the consolidated financial statements

8. Called up share capital

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

9. 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 (2008: *Nil*).