

Waterstone's Booksellers Limited

Report and Accounts

52 weeks ended 29 April 2006



COMPANY INFORMATION

DIRECTORS

S Blacklock (appointed 1 September 2006)

W E Drinkwater (appointed 4 April 2006)

S R Fox (appointed 28 September 2006)

G T Johnson (appointed 5 October 2005)

D P Myers (appointed 10 April 2006)

J R Samols (appointed 9 May 2005)

N J M Williams

S D Carney (resigned 27 March 2006)

S Dormer (resigned 31 March 2006)

A J Giles (appointed 4 April 2006, resigned 28 September 2006)

B F McLaughlin (resigned 31 December 2005)

L J Miles (resigned 6 January 2006)

D Pogrand (resigned 19 May 2005)

D L Roche (resigned 26 August 2005)

SECRETARY

E Marriner

REGISTERED OFFICE

Capital Court

Capital Interchange Way

Brentford

Middlesex

TW8 0EX

COMPANY NUMBER

610095

AUDITORS

Ernst & Young LLP

1 More London Place

London

SE1 2AF

DIRECTORS' REPORT

The Directors submit their report and audited financial statements for the 52 weeks ended 29 April 2006, which were approved on behalf of the Board on 23 October 2006.

Business review

During the period under review, the Company operated as a bookseller through a chain of general bookshops in the United Kingdom. The Company continues to trade successfully and will continue its existing business for the foreseeable future.

The Company's total sales fell by 4.1%, impacted by a highly competitive book market in which the supermarkets and Internet increased their market share of the bestsellers and deep range respectively. Although the UK book market grew by 7.5% in volume (4.9% in value) during the period, this was driven by a small number of widely distributed and discounted titles, including Dan Brown's *The Da Vinci Code* and *Angels and Demons*, *Jamie's Italy* by Jamie Oliver and JK Rowling's *Harry Potter and the Half-Blood Prince*, which led to a fall in the Company's market share. The Company's trading strategy reflected this environment, and during the key Christmas period it successfully responded to these pricing pressures. The total number of discounted titles accounted for a higher proportion of the sales mix than in the prior year, offsetting an underlying trend of gross margin improvements.

Operating profit before exceptional items fell by £3,729,000, reflecting the sales performance combined with product margin decline of 30bps caused by the higher levels of discounting in the market. This was partially offset by very tight control of operating costs.

Exceptional charges of £8,550,000 are primarily due to an impairment charge of £6,749,000 following a review of the carrying value of assets in a small number of mainly Central London stores, reflecting current market trading conditions. In addition, a restructuring of the Waterstone's head office incurred an exceptional cost of £1,801,000.

The profit after deducting taxation amounted to £5,698,000 (2005: £14,747,000). A dividend of £19,000,000 (2005: £20,000,000) was paid during the period.

Gerry Johnson was appointed as Managing Director of Waterstone's in September 2005, and under his leadership the business responded to the competitive environment through continuing operational and systems improvements, including a space optimisation trial, and by improving Waterstone's focus on range, customer appeal and supplier relationships. Since the end of the year, Waterstone's has announced the termination of its agreement with Amazon UK in the autumn of 2006, when it will launch a new online service at waterstones.com.

Acquisition of Ottakar's plc

On 31 May 2006, the immediate parent undertaking, HMV Group plc, announced the terms of a recommended cash offer for the bookseller Ottakar's plc of 285 pence per share, valuing Ottakar's at approximately £62.9m on a fully diluted basis. This offer was declared unconditional on 3 July 2006, with Ottakar's shares then being acquired by the Company, such that from 3 July Ottakar's plc became a subsidiary undertaking. The Group had previously acquired for cash approximately 10% of the share capital of Ottakar's plc at 440 pence per share (£9.7m), in connection with a recommended 440 pence per share cash offer for the company on 13 September 2005, which lapsed on 6 December 2005 when the Office of Fair Trading referred it to the Competition Commission. On 12 May 2006, the Competition Commission inquiry concluded that a merger of Ottakar's and Waterstone's would not lead to a substantial lessening of competition in the market for the retail sale of new books in any part of the UK. The reduction in the final acquisition price from the 440p offer reflects the deterioration in Ottakar's financial performance as a result of the intensifying competition in the book market.

Through this acquisition the Company expects to deliver substantial improvements to the combined Waterstone's and Ottakar's business, primarily through 'hard' cost synergies although there are also further potential revenue synergies from the implementation of Waterstone's Phoenix inventory management system. These cost synergies will be achieved by the phased consolidation of back office functions, the optimisation of supplier terms and from improved financial control. The Company expects to generate total synergies of £3-4m in 2006/07, rising to around £10m in 2007/08 as the full synergy effects flow through. In order to deliver these improvements there will be one-off costs of c.£11.5m and upfront capital expenditure investment of £10m in the roll out of Phoenix 9 and other store investment.

DIRECTORS' REPORT (continued)

Accounting policies

The audited financial statements for the 52 weeks ended 29 April 2006 are produced for the first time in line with International Financial Reporting Standards ('IFRS'). This has required, for comparative purposes, the preparation under IFRS of an opening balance sheet at 24 April 2004, an income statement and a cash flow statement for the 53 weeks ended 30 April 2005 and a balance sheet at 30 April 2005.

Further details of the accounting policy changes and reconciliation from UK GAAP of previously reported financial information can be found in note 26 to the financial statements.

Directors

The names of the Directors as at the date of this Report are shown on page 1.

None of the Directors had any interests in the shares of the Company. Directors' interests in the Company's ultimate parent undertaking, HMV Group plc, are as follows:

	Ordinary Shares		Share Incentive Plan		Options over Ordinary Shares				
	At 29 April 2006	At 30 April 2005 ¹	At 29 April 2006	At 30 April 2005 ¹	At 29 April 2006	Granted during the year	Lapsed during the year	Exercised during the year	At 30 April 2005 ¹
W Drinkwater ¹	-	-	5,944	5,796	48,445	-	-	-	48,445
G Johnson ¹	18,000	-	282	-	154,958	154,958	-	-	-
D Myers ¹	-	-	-	-	-	-	-	-	-
J Samols ¹	3,347	3,347	6,270	4,593	79,798	37,190	-	-	42,608
N Williams	-	-	-	-	168,661	53,119	-	-	115,542

¹ on appointment

During the period under review Mr Giles was a Director of HMV Group plc and his interests are disclosed in the financial statements of that company.

Employee policies

The Company is a decentralised organisation with the aim of employing and developing the best people, putting them in the right positions with a significant level of delegated authority and supporting them with the infrastructure and technology required to perform at the highest levels and at the lowest costs with the quickest response time.

Responsibility for employment matters therefore rests primarily with each business operation under the general guidance of central policy and procedural guidelines. The Company is committed to the maintenance of a work environment free of discrimination on the grounds of gender, nationality, ethnic or racial origin, non-job related disability, sexual orientation or marital status.

The Company gives full consideration to applications from disabled persons where a disabled person can adequately fulfil the requirements of the job. Where existing employees become disabled, it is the Company's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide training, career development and promotion to disabled employees wherever appropriate.

In order to promote employee involvement in the Company, regular meetings are held between local management and employees to allow a free flow of information and ideas.

The Company encourages staff involvement in the performance of its immediate parent undertaking, HMV Group plc, via a combination of employee bonus and share schemes. HMV Group plc has established a Share Incentive Plan in which all the Company's employees are entitled to participate provided they meet certain service conditions.

DIRECTORS' REPORT (continued)

Policy on payment of creditors

The Company does not impose standard payment terms on its suppliers but agrees specific terms with each and ensures that each supplier is made aware of such terms. It is the Company's policy to pay its suppliers in accordance with the terms that they have agreed. The number of days' purchases outstanding at 29 April 2006 is calculated as 77 days (2005: 59 days).

Charitable donations

The Company made charitable donations of £11,000 in the period under review (2005: £2,000). It is Company policy not to make donations to political parties and therefore no political donations were made during the period.

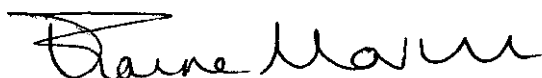
Auditors

The Directors who were members of the Board at the time of approving the Directors' Report are listed on page 1. Having made enquiries of fellow Directors and of the Company's auditors, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each Director has taken all steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Pursuant to Section 379A of the Companies Act 1985, elective resolutions have been passed dispensing with the requirement to appoint auditors annually and to dispense with the requirement to hold annual general meetings. Therefore Ernst & Young LLP are deemed to continue as auditors of the Company.

By order of the Board



E Marriner

Secretary

23 October 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the report and financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

The Directors are required to prepare financial statements for each financial year that present fairly the financial position of the Company and the financial performance and the cash flows of the Company for that period. In preparing those financial statements, the Directors are required to:

- (i) select suitable accounting policies and then apply them consistently;
- (ii) present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- (iii) provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance;
- (iv) state that the Company has complied with IFRS, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF WATERSTONE'S BOOKSELLERS LIMITED

We have audited the Company's financial statements for the period ended 29 April 2006, which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of recognised income and expense and the related notes 1 to 26. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view, are properly prepared in accordance with the Companies Act 1985 and whether the information given in the Directors' Report is consistent with the financial statements.

We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

Basis of audit opinion

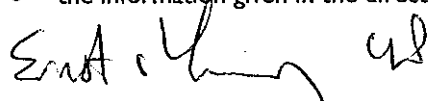
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 29 April 2006 and of its profit for the period then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.



Ernst & Young LLP
Registered auditor
London

24/10/06

Income statement

For the 52 weeks ended 29 April 2006 and the 53 weeks ended 30 April 2005

		Before exceptional items 2006	Exceptional items 2006	Total 2006
	Notes	£000	£000	£000
Revenue	1,2	272,389	-	272,389
Cost of sales		(243,754)	(7,148)	(250,902)
Gross profit		28,635	(7,148)	21,487
Administrative expenses		(14,720)	(1,402)	(16,122)
Other operating income		198	-	198
Operating profit	1,3	14,113	(8,550)	5,563
Finance income	8	3,537	-	3,537
Finance cost	8	(11)	-	(11)
Profit before taxation		17,639	(8,550)	9,089
Taxation	9	(5,647)	2,256	(3,391)
Profit for the period attributable to the parent company		11,992	(6,294)	5,698

		Before exceptional items 2005	Exceptional items 2005	Total 2005
	Notes	£000	£000	£000
Revenue	1, 2	283,966	-	283,966
Cost of sales		(249,712)	-	(249,712)
Gross profit		34,254	-	34,254
Administrative expenses		(16,525)	-	(16,525)
Other operating income		113	-	113
Operating profit	1, 3	17,842	-	17,842
Finance income	8	3,756	-	3,756
Finance costs	8	-	-	-
Profit before taxation		21,598	-	21,598
Taxation	9	(6,851)	-	(6,851)
Profit for the period attributable to the parent company		14,747	-	14,747

See Accounting Policies on pages 10 to 13 for the description of the 2006 and 2005 reporting periods.

For details of the exceptional items included above, see note 5.

All results relate to continuing activities.

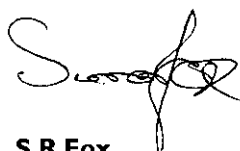
Statement of recognised income and expense

		52 weeks ended 29 April 2006	53 weeks ended 30 April 2005
	Notes	£000	£000
Profit for the period		5,698	14,747
Tax on items recognised directly in equity	9	(200)	81
Total recognised income and expense for the period		5,498	14,828

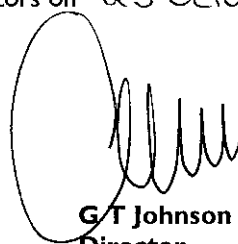
Balance sheet

		As at 29 April 2006 £000	As at 30 April 2005 £000
	Notes		
Assets			
Non-current assets			
Property, plant and equipment	11	41,765	50,419
Investments in subsidiaries	12	20,000	20,000
Deferred income tax asset	9	4,251	3,551
		66,016	73,970
Current assets			
Inventories	14	36,112	32,875
Trade and other receivables	13	86,771	88,915
Cash and short-term deposits		15,339	13,113
		138,222	134,903
Total assets		204,238	208,873
Liabilities			
Current liabilities			
Trade and other payables	15	(125,598)	(115,390)
Current income tax payable		(4,699)	(7,378)
Provisions	16	(1,574)	(63)
		(131,871)	(122,831)
Total liabilities		(131,871)	(122,831)
Net assets		72,367	86,042
Equity			
Share capital	19	71,014	71,014
Retained earnings	19	1,353	15,028
Total equity	19	72,367	86,042

The financial statements were approved by the Board of Directors on 23 October 2006 and were signed on its behalf by:



S R Fox
Director



G T Johnson
Director

Cash flow statement

		52 weeks ended 29 April 2006	53 weeks ended 30 April 2005
	Notes	£000	£000
Cash flows from operating activities			
Operating profit		5,563	17,842
Depreciation		10,008	8,831
Impairment charges		6,749	-
(Profit) loss on disposal of property, plant and equipment		(226)	819
Equity-settled share-based payment (credit) expense		(173)	387
		21,921	27,879
Movement in inventories		(3,237)	1,915
Movement in trade and other receivables		(2,778)	(1,904)
Movement in trade and other payables		10,208	8,173
Movement in provisions		1,511	(1,216)
Cash generated from operations		27,625	34,847
Income tax paid		(6,970)	(7,340)
Net cash flows from operating activities		20,655	27,507
Cash flows from investing activities			
Purchase of property, plant and equipment	11	(8,076)	(15,776)
Proceeds from sale of property, plant and equipment		199	73
Movement in loans to parent and fellow subsidiaries		5,000	-
Interest received		3,459	3,842
Net cash flows from investing activities		582	(11,861)
Cash flows from financing activities			
Interest paid		(11)	-
Dividends paid	10	(19,000)	(20,000)
Net cash flows from financing activities		(19,011)	(20,000)
Net increase (decrease) in cash and cash equivalents		2,226	(4,354)
Opening cash and cash equivalents		13,113	17,467
Closing cash and cash equivalents		15,339	13,113

ACCOUNTING POLICIES

Authorisation of financial statements and statement of compliance with IFRS

The financial statements of Waterstone's Booksellers Limited for the period ended 29 April 2006 were authorised for issue by the Board on 23 October 2006 and the Balance Sheet was signed on the Board's behalf by S R Fox and G T Johnson. Waterstone's Booksellers Limited is incorporated and domiciled in England and Wales.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 1985.

Basis of preparation

These financial statements are made up to the Saturday on or immediately preceding 30 April each year. Consequently, the financial statements for the current period cover the 52 weeks ended 29 April 2006, whilst the comparative period covered the 53 weeks ended 30 April 2005. The financial statements are prepared in accordance with applicable accounting standards and specifically in accordance with the accounting policies set out below. The financial statements are presented in Pounds Sterling and are rounded to the nearest thousand except where otherwise indicated. The Company is exempt from preparing group financial statements as it is itself a subsidiary undertaking under S228 of the Companies Act 1985. These financial statements present information about the Company as an individual undertaking and not about its Group.

The financial statements for the 52 weeks ended 29 April 2006 are the first to be prepared under IFRS as adopted by the European Union. Consequently a number of the accounting policies adopted in the preparation of these financial statements are different to those adopted in the annual financial statements for the 53 weeks ended 30 April 2005 which were prepared under UK Generally Accepted Accounting Practice (UK GAAP).

Details of the changes in accounting policies arising from the adoption of IFRS and the reconciliations to IFRS from the previously published UK GAAP financial statements are detailed in note 26.

The accounting policies set out below have been consistently applied to all periods presented in these financial statements.

Investments in subsidiaries

Investments in subsidiaries are recognised at cost. Income is recognised from these investments only in relation to distributions received from post-acquisition profits. Distributions received in excess of post-acquisition profits are deducted from the cost of the investment.

Revenue

Revenue represents the value of goods supplied, less discounts given, and is recognised when goods are delivered and title has passed. It also includes commission earned on ticket sales and similar activities. Revenue excludes value added tax ("VAT") and similar sales-related taxes.

Interest income is accrued on a time basis, by reference to the principal outstanding and the applicable effective interest rate. Dividend income is recognised when the right to receive payment is established. Rental income from sub-let properties is recognised on a straight line basis over the period of the sublease.

Foreign currencies

Transactions denominated in foreign currencies are recorded at the rates of exchange ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into sterling at period end rates. The resulting foreign exchange differences are dealt with in the determination of profit (loss) for the period.

Exceptional items

The Company presents as exceptional items on the face of the income statement those material items of income and expense which, because of the nature and expected infrequency of the events giving rise to them, merit separate presentation to allow shareholders to better understand the elements of financial performance in the year, so as to facilitate comparison with prior periods and to better assess trends in financial performance.

ACCOUNTING POLICIES (continued)**Property, plant and equipment**

The capitalised cost of property, plant and equipment includes only those costs that are directly attributable to bringing an asset to its working condition for its intended use.

Depreciation of property, plant and equipment is calculated on cost, at rates estimated to write off the cost, less the estimated residual value, of the relevant assets by equal annual amounts over their estimated useful lives.

The annual rates used are:

Leasehold improvements	Period of the lease
Plant, equipment and vehicles	10 to 33 $\frac{1}{3}$ %

The carrying values of property, plant and equipment are reviewed for material impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Leased assets

In respect of property operating leases, benefits received and receivable as an incentive to sign a lease, such as rent-free periods, premiums payable and capital contributions, are spread on a straight line basis over the lease term. All other operating lease payments are charged directly to the income statement on a straight line basis over the lease term. The Company has a number of lease agreements in which the rent payable is contingent on revenue.

Impairment of assets

The Company assesses at each reporting date whether there are indicators that an asset may be impaired. If any such indicator exists, or when annual impairment testing is required, the Company makes an estimate of the asset's recoverable amount, being the higher of its fair value less costs to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the asset does not generate cash flows that are independent from other assets, the recoverable amount of the cash-generating unit to which the asset belongs is estimated. Where the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, an impairment loss is recognised in the income statement.

If there is an indication at the reporting date that previously recognised impairment losses no longer exist or may have decreased, the recoverable amount is again estimated. To the extent that the recoverable amount has increased, the previously recognised impairment loss is reversed. An impairment loss in respect of goodwill is not reversed.

Inventories

Inventories, which represent finished goods and goods for resale, are stated at the lower of cost and net realisable value on a first-in, first-out basis. Net realisable value is based on estimated selling prices less further costs to be incurred to disposal.

ACCOUNTING POLICIES (continued)**Taxation***Current tax*

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred income tax is recognised on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are generally recognised for all temporary differences and deferred income tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. The carrying amount of deferred income tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability settled, based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and is not discounted.

Taxation is charged or credited directly to equity if it relates to items that are themselves charged or credited directly to equity, otherwise it is recognised in the income statement.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Cash and cash equivalents

Cash and short-term deposits comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purposes of the cash flow statement, cash and cash equivalents consist of cash and short-term deposits less bank overdrafts that are payable on demand.

Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Pension costs

The Company's employees participate in the HMV Group Pension Scheme (the "Scheme"). The Scheme has two sections – the Pension Benefit Section and the Pension Saver Section.

The Pension Benefit Section of the Scheme provides benefits to a number of Group companies. There is no contractual agreement or stated policy for allocating a share of the defined benefit obligation to each participating entity. Consequently, in accordance with the Amendments to IAS 19 Employee Benefits, the Parent Company, HMV Group plc, recognises the net pension obligation for the Scheme as the sponsoring entity of the defined benefit scheme. The Company, as a participating member of the Scheme, accounts for its relevant pension costs on a defined contribution basis.

For the defined contribution scheme, contributions are charged in the income statement as they become payable in accordance with the rules of the scheme.

ACCOUNTING POLICIES (continued)

Share-based payments

A number of share-based payment schemes are operated by the ultimate parent undertaking, HMV Group plc, in which the Company's employees participate. The Company recognises the transfer of equity instruments to its employees as share-based payment transactions within the scope of IFRS 2 *Share-based Payments*.

The cost of equity-settled transactions with employees granted on or after 7 November 2002, which had not vested by 1 January 2005, is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by using an appropriate pricing model.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market performance conditions, and hence the number of equity instruments that will ultimately vest. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity. No expense is recognised for awards that do not ultimately vest.

NOTES TO THE FINANCIAL STATEMENTS**1. Segmental information**

In the opinion of the Directors, the Company operates in only one business segment – retailing. All revenue and operating profit arises in the UK.

2. Revenue

Revenue disclosed in the income statement is analysed as follows:

	2006	2005
	£000	£000
Sale of goods	272,389	283,966
Sublease rental income	498	427
Revenue	272,887	284,393
Finance income	3,537	3,756
Total revenue	276,424	288,149

3. Operating profit

	2006	2005
	£000	£000
Operating profit is stated after charging (crediting):		
Depreciation of property, plant and equipment	10,008	8,831
Cost of inventories recognised as expense	153,224	159,127
Write down of inventories	(8)	263
Operating lease rentals		
Minimum rentals	29,285	27,934
Percentage rentals	768	741
Sublease rentals	(498)	(427)
	29,555	28,248

The Company leases stores under non-cancellable operating lease agreements that are generally subject to periodic rent review. These agreements provide for either or both minimum rentals and percentage rentals based on sales performance.

4. Fees to auditors

	2006	2005
	£000	£000
Audit-related fees	59	55
Non-audit fees	-	2
	59	57

NOTES TO THE FINANCIAL STATEMENTS (continued)**5. Exceptional items**

	2006	2005
	£000	£000
Recognised in arriving at operating profit:		
Impairment of property, plant and equipment	6,749	-
Restructuring and store closure costs	1,801	-
	8,550	-

During the year the Company incurred exceptional operating costs of £8,550,000. This included a £6,749,000 impairment charge within cost of sales following a review of the carrying value of certain retail assets based on current market trading conditions (see note 11). In addition, £1,801,000 was incurred in head office restructuring and store closures, of which £399,000 is included in cost of sales and £1,402,000 is within administrative expenses. A tax credit of £2,256,000 arose in respect of these costs.

6. Directors' emoluments

	2006	2005
	£000	£000
Emoluments	979	1,404
Amounts (excluding shares) receivable under long-term incentive schemes	-	95
Pension contributions	16	24
Termination benefits	296	449
	1,291	1,972

Retirement benefits are accruing to all of the Directors under defined benefit pension schemes. In addition, the Company contributes to a separate money purchase plan in respect of four of the Directors (2005: five).

Four of the Directors exercised options over Ordinary Shares in the parent company, HMV Group plc. All of the Directors are entitled to receive shares in HMV Group plc under a long-term incentive scheme.

The amounts in respect of the highest paid Director were as follows:

	2006	2005
	£000	£000
Aggregate emoluments	175	668
Pension contributions	-	-
	175	668

The pension entitlements of the highest paid Director were as follows:

	2006	2005
	£000	£000
Accumulated total accrued pension	1	-

NOTES TO THE FINANCIAL STATEMENTS (continued)**7. Employee costs**

	2006	2005
	£000	£000
Employee costs, including Directors' emoluments:		
Wages and salaries	33,419	35,718
Social security costs	2,466	2,835
Other pension costs (see note 21)	1,018	932
	36,903	39,485

Included in wages and salaries is a total credit for equity-settled share-based payments of £173,000 (2005: charge of £387,000). A credit has arisen in the current period as performance conditions for awards vesting have not been met and management have revised their estimate of the achievability of performance conditions relating to awards vesting in future periods.

The average number of people employed by the Company during the period was 2,733 (2005: 2,667).

8. Net finance income

	2006	2005
	£000	£000
Bank interest receivable	-	36
From parent and fellow subsidiary undertakings	3,537	3,720
Total finance income	3,537	3,756
Bank loans and overdrafts	(11)	-
Total finance costs	(11)	-
Total net finance income	3,526	3,756

NOTES TO THE FINANCIAL STATEMENTS (continued)**9. Taxation**

	2006	2005
	£000	£000
Taxation recognised in the income statement:		
United Kingdom, current year:		
Corporation tax	4,346	6,639
Deferred tax:		
United Kingdom	(955)	212
Total taxation expense in the income statement	3,391	6,851

The tax expense in the current year includes a credit of £2,256,000 in relation to the exceptional operating costs of £8,550,000, details of which can be found in note 5. The effective tax rate on ordinary activities is 32% (2005: 32%).

The tax charge is reconciled with the standard rate of UK corporation tax as follows:

	2006	2005
	£000	£000
Profit before taxation	9,089	21,598
Corporation tax at UK statutory rate of 30%	2,727	6,479
Effects of:		
Permanent disallowables	510	361
Permanent disallowables on exceptional items	309	-
Temporary differences relating to prior year periods	(155)	11
Total tax charge	3,391	6,851

Tax relating to items charged or credited directly to equity is as follows:

	2006	2005
	£000	£000
Current taxation relating to share-based payments	(55)	(14)
Deferred taxation relating to share-based payments	255	(67)
Tax charge (credit) in the statement of recognised income and expense	200	(81)

Deferred Tax

The deferred income tax asset included in the balance sheet is as follows:

	2006	2005
	£000	£000
Accelerated depreciation for tax purposes	4,088	1,974
Other temporary differences	140	23
Share-based payments	23	381
Leases	-	1,173
	4,251	3,551

NOTES TO THE FINANCIAL STATEMENTS (continued)**9. Taxation (continued)***Unrecognised tax losses*

The Company has capital losses of £644,000 (2005: £644,000) that are available indefinitely for offset against future chargeable gains. Deferred tax assets have not been recognised in respect of these losses as it is not expected that chargeable gains will arise against which these losses can be offset for some time.

Deferred tax in the income statement

The deferred tax included in the income statement is as follows:

	2006	2005
	£000	£000
Accelerated depreciation for tax purposes	(2,114)	240
Other	(117)	(10)
Leases	1,173	61
Share-based payments	103	(79)
	(955)	212

10. Dividends

	2006	2005
	£000	£000
Ordinary dividend of 26.76p per share for 2006 (2005: 28.16p)	19,000	20,000
	19,000	20,000

NOTES TO THE FINANCIAL STATEMENTS (continued)**11. Property, plant and equipment**

	Plant, equipment and vehicles
	£000
Cost at 25 April 2004	108,342
Disposals	(7,963)
Additions	15,776
Cost at 30 April 2005	116,155
Disposals	(1,469)
Additions	8,076
Cost at 29 April 2006	122,762
Depreciation at 25 April 2004	63,976
Charge for period	8,831
Disposals	(7,071)
Depreciation at 30 April 2005	65,736
Charge for period	10,008
Impairment loss	6,749
Disposals	(1,496)
Depreciation at 29 April 2006	80,997
Net book value at 29 April 2006	41,765
Net book value at 30 April 2005	50,419
Net book value at 25 April 2004	44,366

At 29 April 2006, the Company's property, plant and equipment have been written down by £6,749,000 (2005: £nil) following an impairment review of the carrying value of certain retail assets based on current market trading conditions. The recoverable amounts of assets were determined from value in use calculations that incorporated five-year cash flow estimates discounted at an appropriate pre-tax discount rate of 10%. The cash flows reflected management's best estimates of revenue, margin and operating costs over the forecast period.

12. Investments: subsidiaries

	Cost £000	Provision £000	Net book value £000
At 29 April 2006 and 30 April 2005	20,000	-	20,000

The Company's principal subsidiary undertaking, which is 100% directly owned is as follows:

Name of undertaking	Country of incorporation	Activity
Fine Recordings Club Limited	England	Non-trading

In the opinion of the Directors, the aggregate value of the assets of the company, consisting of shares in the Company's subsidiary, is not less than the aggregate of the amounts at which those assets are stated in the balance sheet.

NOTES TO THE FINANCIAL STATEMENTS (continued)**13. Trade and other receivables**

	2006	2005
	£000	£000
Current		
Trade receivables	1,703	1,371
Amounts owed by parent and fellow subsidiary undertakings	65,297	70,860
Other receivables	4,056	3,212
Prepayments and accrued income	15,715	13,472
	86,771	88,915

The carrying value of trade and other receivables approximates to fair value.

14. Inventories

Inventories primarily comprise finished goods and goods for resale. The replacement cost of inventories is considered to be not materially different from the balance sheet value.

15. Trade and other payables

	2006	2005
	£000	£000
Current		
Trade payables	32,506	24,839
Amounts owed to parent and fellow subsidiary undertakings	66,783	62,700
Other payables	13,433	19,709
Accruals and deferred income	12,876	8,142
	125,598	115,390

The carrying value of trade and other payables approximates to fair value.

16. Provisions

	Total
	£000
At 30 April 2005	63
Charged during the year	1,511
At 29 April 2006	1,574

Provisions almost entirely consist of amounts in respect of store closures and restructuring. The £1,511,000 provision created in the year was in respect of store closure and restructuring activity.

All provisions are expected to be utilised in the forthcoming year.

17. Share capital

	2006	2005	2006	2005
	Number '000	Number '000	£000	£000
Authorised				
Ordinary Shares of £1 each	121,014	121,014	121,014	121,014
Allotted, called up and fully paid				
Ordinary Shares of £1 each	71,014	71,014	71,014	71,014

NOTES TO THE FINANCIAL STATEMENTS (continued)**18. Share-based payments**

Equity-settled share option plan

Certain of the Company's employees participate in an equity-settled share option plan of the ultimate parent undertaking, HMV Group plc.

Until the Initial Public Offering of HMV Group plc in 2002 the Group operated the HMV Group plc Senior Executive Share Option Scheme (the '1998 Scheme'). All grants made under the 1998 scheme were subject to performance targets, as follows:

- Outstanding grants made on 22 January 1999 remain exercisable following the achievement of the relevant EBITDA targets for the 1998/99, 1999/00 and 2000/01 financial years.
- Grants made on 7 September 2001 and 26 February 2002 became exercisable in tranches upon and following the Initial Public Offering of the Company in May 2002 (achievement of the Initial Public Offering being the performance target). The first tranche of these options became exercisable upon the Initial Public Offering. The second tranche became exercisable on the first anniversary of the date of Initial Public Offering (May 2003) and the third tranche became exercisable on the second anniversary of the date of Initial Public Offering (May 2004).

Prior to the Initial Public Offering a new executive share option scheme, the HMV Group plc 2002 Executive Share Option Scheme (the '2002 Scheme') was adopted. This scheme has been used for grants of options since 2002.

Options to acquire shares under the 2002 Scheme have been granted on an annual basis thus ensuring reward is spread over a number of years and is allied to the long-term growth in shareholder value. Options are granted at the five day average of the market value of the HMV Group plc's shares on the date of grant. The options can normally only be exercised after three years and then subject to the achievement of earnings per share targets imposed at the date of grant. These allow that 40% of the option shall be exercisable if the HMV Group plc's adjusted basic earnings per share exceeds the growth in the Retail Prices Index by at least 3% per annum. 100% of the option shall be exercisable if the HMV Group plc's adjusted basic earnings per share growth exceeds the growth in the Retail Prices Index by at least 7% per annum. For all options granted to date, earnings per share performance will be assessed on an adjusted UK GAAP basis. Vesting will occur on a straight-line basis between these two points. If the options remain unexercised after a period of 10 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Group before the option vests.

The credit for share options in respect of employee services during the period ended 29 April 2006 was £117,000 (2005: charge of £247,000). A credit has arisen in the current period as performance conditions for awards vesting have not been met and management have revised their estimate of the achievability of performance conditions relating to awards vesting in future periods.

NOTES TO THE FINANCIAL STATEMENTS (continued)**18. Share-based payments (continued)**

The movements in the number of share options during the year are detailed in the table below. The options outstanding at 29 April 2006 had a weighted average exercise price of 167p (2005: 177p) and a weighted average remaining contractual life of 7.6 years (2005: 7.8 years). The weighted average share price at the date of exercise for share options exercised during the period was 223p (2005: 240p).

	2006	2006	2005	2005
	Options	Weighted	Options	Weighted
	Number	average	Number	average
		exercise price		exercise price
		Pence		Pence
Outstanding at beginning of period	3,468,689	177	3,236,981	157
Granted during the period	1,144,826	242	944,138	237
Exercised during the period	(1,050,992)	167	(106,665)	23
Lapsed during the period	(632,737)	202	(605,765)	180
Outstanding at end of the period ¹	2,929,786	201	3,468,689	177
Exercisable at end of the period	375,990	167	-	-

¹ Included within this balance are options over 1,984,217 (2005: 4,681,641) shares that have not been recognised in accordance with IFRS 2 as the options were granted on or before 7 November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with IFRS 2.

	2006	2006	2005	2005
	Options	Weighted	Options	Weighted
	outstanding	average	outstanding	average
	Number	remaining	Number	remaining
		contractual		contractual
		life		life
		Years		Years
2002 Executive Share Option Scheme				
Exercise price 167p	375,990	6.1	1,431,295	7.1
Exercise price 143p	896,658	7.5	1,141,918	8.2
Exercise price 219p	39,571	7.9	39,571	9.0
Exercise price 237p	662,440	8.2	855,905	9.2
Exercise price 242p	955,127	9.2	-	-
	2,929,786	7.6	3,468,689	7.8

The 2002 Executive Share options with an exercise price of 143p would be exercisable from 8 July 2006 subject to vesting conditions based on the Group's financial performance for the three years to 29 April 2006. As the minimum performance conditions have not been met, these options will lapse in the 2006/07 financial year.

The fair value of equity-settled share options granted is estimated as at the date of grant using the Black Scholes model. The inputs into the Black Scholes model are as follows:

	2006	2005
Dividend yield (%)	2.5	2.5
Expected volatility (%)	25.0	25
Expected life (years)	5.4	5.4
Risk-free interest rate (%)	4.5	4.5
Weighted average share price (pence)	242	237
Weighted average exercise price (pence)	242	237
Weighted average fair value (pence)	57	56

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

Equity-settled deferred annual bonus

Certain of the Company's Directors and senior management are eligible for a deferred annual bonus that is equity-settled in the shares of the ultimate parent undertaking, HMV Group plc. This is the HMV Group plc Incentive Plan for Senior Executives (HIPS). Under this arrangement, a deferred annual bonus is awarded in shares, with the number of shares determined by reference to the market value of shares at the time the award is made, not when it is paid. No adjustment to value is made for expected dividend income during the vesting period. The deferred award normally vests following the third anniversary of the end of the financial year in which the award is made, subject to the achievement of certain profit related targets and the performance of the individual over the vesting period.

The credit in respect of deferred awards during the period ended 29 April 2006 was £551,000 (2005: charge of £490,000). A credit has arisen in the current period as performance conditions for deferred awards vesting have not been met and management have revised their estimate of the achievability of performance conditions relating to deferred awards vesting in future periods.

The number and weighted average grant prices of, and movements in, deferred share awards during the year are as follows:

	2006	2006	2005	2005
	Share awards	Weighted average grant price	Share awards	Weighted average grant price
	Number	£	Number	£
Outstanding at beginning of period	315,631	1.85	205,202	1.51
Granted during the period	81,940	2.42	144,840	2.37
Vested during the period	(119,862)	1.60	(15,909)	-
Forfeited during the period	(159,851)	2.14	(18,502)	-
Lapsed during the period	(29,129)	1.55	-	-
Outstanding at end of the period	88,729	2.28	315,631	1.85

Of the outstanding balance, the assessment of performance conditions at April 2006 will result in 7,345 share awards lapsing after the period end, whilst a further 2,448 share awards will vest.

NOTES TO THE FINANCIAL STATEMENTS (continued)

19. Reconciliation of movements in equity

	Share capital	Retained earnings	Total
	£000	£000	£000
At 25 April 2004	71,014	19,813	90,827
Total recognised income and expense for the period	-	14,828	14,828
Ordinary dividend	-	(20,000)	(20,000)
Charge for share-based payments	-	387	387
At 30 April 2005	71,014	15,028	86,042
Total recognised income and expense for the period	-	5,498	5,498
Ordinary dividend	-	(19,000)	(19,000)
Credit for share-based payments	-	(173)	(173)
At 29 April 2006	71,014	1,353	72,367

20. Contingent liabilities

The management of Waterstone's Booksellers Limited is not aware of any legal or arbitration proceedings pending or threatened against the Company which may result in any liabilities significantly in excess of provisions in the financial statements.

There were the following contingent liabilities at 29 April 2006:

- (i) HMV Group plc has a syndicated bank Senior Facility Agreement, which at 29 April 2006 consisted of a £260 million revolving credit facility and an undrawn £80 million term loan. The borrowings under the Facility Agreement are secured by the Guarantors, which include Waterstone's Booksellers Limited. Security comprising first ranking fixed and floating charges in favour of the lenders under the Facility Agreement has been granted over all assets and undertakings of the Guarantors.
- (ii) As principal in an agency relationship with certain subsidiary and fellow subsidiary undertakings, the Company has agreed to indemnify each of these undertakings against liabilities that may arise under the agency agreements.

NOTES TO THE FINANCIAL STATEMENTS (continued)**21. Pension arrangements**

Waterstone's Booksellers Limited's employees participate in the HMV Group Pension Scheme (the "Scheme"). The Scheme has two sections – the Pension Saver Section and the Pension Benefit Section. In respect of the Pension Benefit Section, there is no contractual agreement or stated policy for charging the net defined benefit cost measured in accordance with IAS 19 to individual group entities. As a consequence, the Company recognises a pension cost equivalent to the contribution payable during the financial period. Information in respect of the Pension Benefit Section as a whole is given below.

Pension Saver Section

The Pension Saver Section is of the defined contribution type and is open to all permanent and temporary staff of the Group aged between 18 and 64 years. Members can choose to pay from 2% to 5% of pensionable pay. The Group matches the amount paid by the member up to a maximum of 5% of pensionable pay. Members have a choice of ways to invest their and the Group's contributions in an individual fund to buy pension benefits of their choice. The Company's actual employer contributions to the Pension Saver Section for the year ended 29 April 2006 were £0.2m (2005: £0.3m).

Pension Benefit Section

The Pension Benefit Section is of the defined benefit type and is an Inland Revenue exempt approved scheme for the purpose of the Income and Corporation Taxes Act 1988. It is contracted out of SERPS. The benefits it provides are based on final pensionable pay and are guaranteed to increase in payment by 5% per annum or by the increase in the cost of living, if less. Members contribute at the rate of 5% of pensionable pay.

A qualified actuary made an actuarial valuation as at 30 June 2004. The valuation was based on an assumed investment return of 6.5% a year, salary increases of 4.25% a year, and annual pension increases of 2.75%, and used the projected unit method. The result of the valuation was a level of asset cover of 79%, representing a funding deficit of £11.5m. The market value of the assets of the Pension Benefit Scheme at 30 June 2004 was about £43.9m. In order to eliminate the past service deficit, the Group decided to make three special contributions of £4.4m each on 31 March 2005, 31 May 2005 and 31 May 2006. In addition, the funding rate was set at 19.9% of pensionable pay (including an allowance for administrative expenses). Therefore from 1 July 2005, the Group has been contributing at a rate of 14.9% of pensionable pay, with the members contributing at 5% of pensionable pay.

The Scheme was generally closed to new members with effect from 1 January 2002, with the exception of 543 members who transferred into the Scheme on 31 May 2003 from the EMI Group Pension Fund as a result of the Group's flotation on the London Stock Exchange. The next actuarial review will take place no later than 30 June 2007. Total Group employer contributions to the Pension Benefit Section for the year ended 29 April 2006 were £7.7m (2005: £7.2m), inclusive of a £4.4m special contribution in each year. Of this the Company contributed £0.8m (2005: £0.7m). The total Group contributions to the defined benefit plans for the financial year commencing on 30 April 2006 are expected to be £7.5m, inclusive of the final £4.4m special contribution. Of this the Company is expected to contribute £0.7m.

Amounts reflected in the financial statements in respect of the defined benefit pension scheme are determined with the advice of independent qualified actuaries, Watson Wyatt LLP, on the basis of annual valuations using the projected unit funding method. Scheme assets are stated at their market value at the respective balance sheet dates. The major assumptions used in the calculations are as follows:

	As at 29 April 2006 % per annum	As at 30 April 2005 % per annum
Rate of price inflation	2.85	2.75
Rate of salary increase	4.35	4.25
Rate of increase for pensions in payment	2.85	2.75
Rate used to discount scheme liabilities	5.10	5.30
Expected rate of return on equities	7.80	8.00
Expected rate of return on bonds	5.10	5.40
Expected rate of return on index-linked bonds	4.40	4.50

NOTES TO THE FINANCIAL STATEMENTS (continued)**21. Pension arrangements (continued)**

Expected rate of return on Scheme assets are based on consistent assumptions with the previous year, adjusted to reflect changes in market conditions since that date.

The main non-financial assumptions are consistent with those used for the last formal actuarial valuation of the Scheme as at 30 June 2004. The post-retirement mortality assumptions adopted in 2004 were the standard PM/FA92 series with allowance for future improvements in mortality, which imply the following life expectancies for someone age 60:

Life expectancy (years)	At age 60 for someone currently aged 60	At age 60 for someone currently aged 40
Male	23.7	24.9
Female	26.9	28.3

The assets and liabilities of the Scheme at the end of the period were:

	As at 29 April 2006 £m	As at 30 April 2005 £m
Equities	44.9	35.1
Bonds	14.0	9.0
Index-linked bonds	13.0	8.6
Other	1.1	1.2
Total market value of assets	73.0	53.9
Actuarial value of scheme liabilities	(97.8)	(83.0)
Deficit in the Scheme	(24.8)	(29.1)
Deferred tax	7.4	8.7
Net pension liability	(17.4)	(20.4)

The pension plans have not invested in any of the Group's own financial instruments nor in properties or other assets used by the Group.

Changes in the fair value of the assets are analysed as follows:

	2006 £m	2005 £m
Total market value of assets at the beginning of the period	53.9	43.3
Employer contributions	7.5	7.1
Employee contributions	1.0	0.9
Benefits paid	(1.8)	(0.2)
Expected return of plan assets	4.1	3.2
Actuarial gain (loss)	8.3	(0.4)
Total market value of assets at the end of the period	73.0	53.9

Changes in the present value of the Scheme liabilities are analysed as follows:

	2006 £m	2005 £m
Defined benefit pension obligations at the beginning of the period	(83.0)	(60.2)
Current service cost	(4.6)	(4.4)
Interest on pension scheme liabilities	(4.3)	(3.4)
Employee contributions	(1.0)	(0.9)
Benefits paid	1.8	0.2
Actuarial loss	(6.7)	(14.3)
Defined benefit pension obligations at the end of the period	(97.8)	(83.0)

NOTES TO THE FINANCIAL STATEMENTS (continued)

22. Capital commitments

	2006	2005
	£000	£000
Capital expenditure: contracted but not provided	607	1,162

23. Obligations under operating leases

The Company operates entirely from properties in respect of which commercial operating leases have been entered into. These leases have an average remaining duration of 10 years. At the end of the period, future minimum rentals payable under non-cancellable operating leases were as follows:

	2006	2005
	£000	£000
Not later than one year	33,359	31,083
Between two and five years inclusive	119,116	114,272
After five years	146,522	162,512
	298,997	307,867

The Company has also sublet space in certain properties. The future minimum sublease payments expected to be received under non-cancellable sublease agreements as at 29 April 2006 is £4,356,000 (2005: £3,624,000).

24. Related party transactions

During the period the Company entered into transactions in the ordinary course of business with related parties. Transactions entered into and balances outstanding at the end of the period are as follows:

	Services received from related party	Services rendered to related party	Amounts owed by related party	Amounts owed to related party
		£000	£000	£000
With parent and fellow subsidiaries				
2006	324	522	65,297	66,783
2005	359	472	70,860	62,700

The Company's employees participate in the HMV Group Pension Scheme, which has two sections – the Pension Saver Section and the Pension Benefit Section. In respect of the Pension Benefit Section, there is no contractual agreement or stated policy for charging the net defined benefit cost measured in accordance with IAS 19 to individual Group entities. As a consequence, the Company recognises a pension cost equivalent to the contributions payable during the financial period. Further details are given in note 21.

A number of share-based payment schemes are operated by the ultimate parent undertaking, HMV Group plc, in which the Company's employees participate. The Company recognises the transfer of equity instruments to its employees as share-based payment transactions within the scope of IFRS 2 *Share-based Payments*. Further details are given in note 18.

Remuneration of key management personnel

The remuneration of the Directors of the Company is set out in note 6.

25. Ultimate parent undertaking

The immediate and ultimate parent undertaking of the Company for which Group financial statements are drawn up and of which the Company is a member is HMV Group plc. Copies of these financial statements can be obtained from the Company Secretary, HMV Group plc, Shelley House, 2-4 York Road, Maidenhead, Berkshire, SL6 1SR.

NOTES TO THE FINANCIAL STATEMENTS (continued)**26. Transition to IFRS**

For all periods up to and including the period ended 30 April 2005, the Company prepared its financial statements in accordance with UK GAAP. These financial statements for the 52 weeks ended 29 April 2006 are the first that the Company has been required to prepare under IFRS as adopted by the EU.

Accordingly the Company has prepared financial statements that comply with IFRS applicable for the current accounting period and the significant accounting policies are disclosed on pages 10 to 13. In preparing these financial statements, the Company has restated its opening balance sheet at 25 April 2004, the Company's date of transition to IFRS, and made those changes in accounting policies required by IFRS 1 *First Time Adoption of International Financial Reporting Standards*.

This note explains the adjustments made by the Company in restating the UK GAAP balance sheet as at 24 April 2004 and the financial statements for the period ended 30 April 2005.

Summary of impact

	UK GAAP £000	IFRS £000
Opening balance sheet at 25 April 2004		
Net assets	73,813	90,827
53 weeks ended 30 April 2005		
Operating profit	17,987	17,842
Profit before tax	21,743	21,598
Profit after tax	14,888	14,747
Balance sheet at 30 April 2005		
Net assets	73,841	86,042

The adoption of IFRS represented an accounting change only and does not affect the operations or cash flows of the Company. The effect of the accounting change on the result of the Company is to reduce both operating profit and profit before tax for the 53 weeks ended 30 April 2005 by £145,000.

The accounting policy changes that had the most significant impact on the restated figures are as follows, and are explained in further detail below:

- The recognition in the income statement of operating lease incentives and capital contributions from landlords over the full life of the lease rather than a shorter period to the first rent review;
- The recognition of a fair value charge for share-based payments over the three year vesting period of share options;
- The timing of the recognition of dividends;
- Related tax adjustments.

NOTES TO THE FINANCIAL STATEMENTS (continued)

26. Transition to IFRS (continued)

Reconciliation of equity at 24 April 2004

	UK GAAP £000	Leases £000	Share- based payments £000	Dividends £000	Effect of transition to IFRS £000	Restated under IFRS £000
Assets						
Non-current assets						
Property, plant and equipment	42,355	2,011			2,011	44,366
Investment in subsidiaries	20,000					20,000
Deferred income tax asset	2,226	1,233	236		1,469	3,695
	64,581					68,061
Current assets						
Inventories	34,790					34,790
Trade and other receivables	87,097					87,097
Cash and cash equivalents	17,467					17,467
	139,354					139,354
Total Assets	203,935					207,415
Liabilities						
Current liabilities						
Trade and other payables	(120,751)	(6,466)		20,000	13,534	(107,217)
Current income tax payable	(8,092)					(8,092)
Provisions	(1,279)					(1,279)
	(130,122)					(116,588)
Total Liabilities	(130,122)					(115,355)
Net Assets	73,813	(3,222)	236	20,000	17,014	90,827
Equity						
Share capital	71,014					71,014
Retained earnings	2,799	(3,222)	236	20,000	17,014	19,813
Total equity	73,813	(3,222)	236	20,000	17,014	90,827

NOTES TO THE FINANCIAL STATEMENTS (continued)

26. Transition to IFRS (continued)

Reconciliation of profit for the 53 weeks ended 30 April 2005

	UK GAAP £000	Leases £000	Share-based payments £000	Effect of transition to IFRS £000	Restated under IFRS £000
Revenue	283,966				283,966
Cost of sales	(249,657)	102	(157)	(55)	(249,712)
Administrative expenses	(16,435)		(90)	(90)	(16,525)
Other operating Income	113				113
Operating profit	17,987				17,842
Financial income	3,756				3,756
Financial costs	-				-
Net finance charges	3,756				3,756
Profit before tax	21,743				21,598
Tax	(6,855)	(61)	65	4	(6,851)
Profit for the period	14,888	41	(182)	(141)	14,747

NOTES TO THE FINANCIAL STATEMENTS (continued)

26. Transition to IFRS (continued)

Reconciliation of equity at 30 April 2005

	UK GAAP £000	Opening balance sheet adjustments £000	Leases £000	Share- based payments £000	Dividends £000	Effect of transition to IFRS £000	Restated under IFRS £000
Assets							
Non-current assets							
Property, plant and equipment	48,143	2,011	265			2,276	50,419
Investment in subsidiaries	20,000						20,000
Deferred income tax asset	1,997	1,469	(60)	145		1,554	3,551
	70,140						73,970
Current assets							
Inventories	32,875						32,875
Trade and other receivables	88,915						88,915
Cash and cash equivalents	13,113						13,113
	134,903						134,903
Total Assets	205,043						208,873
Liabilities							
Current liabilities							
Trade and other payables	(123,761)	13,534	(163)		(5,000)	8,371	(115,390)
Current income tax payable	(7,378)						(7,378)
Provisions	(63)						(63)
	(131,202)						(122,831)
Total Liabilities	(131,202)						(122,831)
Net Liabilities	73,841	17,014	42	145	(5,000)	12,201	86,042
Equity							
Share capital	71,014						71,014
Retained earnings	2,827	17,014	42	145	(5,000)	12,201	15,028
Total equity	73,841	17,014	42	145	(5,000)	12,201	86,042

NOTES TO THE FINANCIAL STATEMENTS (continued)**26. Transition to IFRS (continued)**

Explanation of IFRS adjustments**1 Leases (IAS 17)**

Under UK GAAP, operating lease incentives (capital contributions and rent free periods) were recognised in the profit and loss account over the period to the first rent review. In accordance with IAS 17, as interpreted by SIC 15, lease incentives will now be recognised in the income statement over the full term of the lease. This change is therefore a timing difference that will reverse over the term of each lease.

2 Share-based payments (IFRS 2)

Under IFRS 2, the charge recognised in the income statement for share options, long-term incentive plans and other share-based payments will be based on the 'fair value' of the awards at the date of grant, calculated using an option pricing model. This contrasts to UK GAAP, where the charge recognised was based on the 'intrinsic value' of awards, being the difference between the market value of the shares at the date of the award and the option exercise price.

The Company has utilised the IFRS 2 exemption in accordance with IFRS 1, and has therefore applied the fair value model to all grants of equity instruments after 7 November 2002 that had not vested as at 1 January 2005.

For share-based payments, the fair value determined at the date of grant is expensed through the income statement on a straight line basis over the vesting period (usually three years), based on the Company's estimate of the number of shares that will eventually vest. At the vesting date, an adjustment is made to take into account the actual number of shares that vested. Fair value is measured by use of a Black-Scholes model.

3 Dividends (IAS 10)

Dividends will now be recognised only when they are declared and approved, rather than accrued for in the period to which they relate. In addition, dividends will be shown as a movement directly in equity instead of through the income statement.

4 Deferred taxation (IAS 12)

IAS 12 takes a balance sheet approach to deferred tax whereby deferred tax is recognised in the balance sheet by applying the appropriate tax rate to the temporary differences arising between the carrying value of assets and liabilities and their tax base. This contrasts with UK GAAP (FRS 19), which considers timing differences arising in the income statement.

Adjustments made to the financial statements on the transition to IFRS result in related adjustments to deferred tax, particularly with regard to lease incentives, share-based payments and post-retirement benefits.

Furthermore, under IFRS, deferred tax assets and liabilities are always recognised as being non-current. Previously under UK GAAP, the Company had split its deferred tax balances between those due in less than one year and those due in greater than one year. Consequently an adjustment has been made to reclassify all deferred tax assets and liabilities to being non-current.