

# **Waterstone's Booksellers Limited**

## **Report and Accounts**

**52 weeks ended 26 April 2008**

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**COMPANY INFORMATION**

**DIRECTORS**

S A Blacklock (resigned 31 December 2007)

W E Drinkwater

S R Fox

M W Giffin (appointed 17 September 2007)

N J W Jewsbury

G T Johnson

D P Myers

N J M Williams

**SECRETARY**

E Marriner

**REGISTERED OFFICE**

Capital Court

Capital Interchange Way

Brentford

Middlesex

TW8 0EX

**COMPANY NUMBER**

610095

**AUDITORS**

Ernst & Young LLP

1 Colmore Square

Birmingham

B4 6HQ

**DIRECTORS' REPORT**

The Directors submit their report and audited financial statements for the 52 weeks ended 26 April 2008, which were approved on behalf of the Board on 14 October 2008

**Business review**

During the period under review, the Company operated as a bookseller through a chain of general bookshops in the United Kingdom and through the Waterstones.com e-commerce website

The total UK book market has seen steady but modest growth over the past five years but this accelerated to 8% in 2007/08, of which approximately 2% was due to the publication of *Harry Potter and the Deathly Hallows* in July 2007. The market continues to be highly competitive and promotional, particularly on bestselling new release titles, which resulted in some market share dilution for the Company.

New children's departments and an enhanced gift stationery offer were successfully rolled out, allowing the Company to maximise these growing product categories. Waterstones.com grew by 146% during the period, driven in part by the success of Waterstone's multi-channel loyalty card, which launched in September 2007 and has attracted 1.8m registered members to date.

On 26 April 2008 the Company acquired the trade and net assets relating to 134 bookstores from HMV Overseas Limited (formerly Ottakar's Limited), a subsidiary undertaking, and the trade and net assets relating to 46 bookstores from HMV Music Limited, a fellow group company, for total consideration of £84.7m. This reorganisation of businesses within the HMV Group serves to bring all of the UK bookstores together into one legal entity for the first time. These financial statements therefore include the net assets of the combined businesses at 26 April 2008, but the trading of only the 126 Waterstone's stores that were part of the Company throughout the period under review.

Exceptional operating costs of £2.6m (2007: £8.2m) were incurred in the period, relating to the closure of eight stores as a result of the continuing review of the total store estate.

The profit after deducting taxation amounted to £0.1m (2007: £0.3m). No dividend (2007: £nil) was paid during the period and the Directors recommend that the profit be transferred to reserves. The Company continues to trade successfully and will continue its existing business for the foreseeable future.

**Principal risks and uncertainties**

The Board of the ultimate parent undertaking, HMV Group plc, has a policy of continuous identification and review of key business risks and uncertainties. It oversees the development of processes to ensure that these risks are managed appropriately and operational management are delegated with the tasks of implementing these processes and reporting to the Board on their outcomes. The principal risks identified by the Board relevant to the Company are general sensitivity to changes in economic conditions, monitoring agreements with key suppliers, maintaining and developing information technology systems and attracting, motivating and retaining key staff.

**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.

**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 age, gender, nationality, ethnic or racial origin, non-job related disability, sexual orientation or marital status.

**DIRECTORS' REPORT (CONTINUED)****Employee policies (continued)**

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.

**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. Excluding the trade and net assets of businesses acquired at the end of the period under review, the underlying number of days' purchases outstanding at 26 April 2008 is calculated as 74 days (2007: 69 days).

**Charitable donations**

The Company made charitable donations of £5,000 in the period under review (2007: £8,000). 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.

A statement of the Directors' responsibility for the financial statements can be found on page 4, which is deemed to be incorporated by reference in (and shall be deemed to form part of) this report.

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  
21 October 2008

**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS**

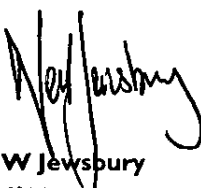
The Directors are responsible for preparing the report and financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union

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 2006 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.

For and on behalf of the Board

  
**N J W Jewsbury**  
Director  
21 October 2008

  
**M W Giffin**  
Director  
21 October 2008

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

We have audited the financial statements of Waterstone's Booksellers Limited for the period ended 26 April 2008, 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 32. These financial statements have been prepared under the accounting policies set out therein.

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

**Respective responsibilities of Directors and auditors**

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

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

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

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

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

**Basis of audit opinion**

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

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

**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 26 April 2008 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*

Ernst & Young LLP  
Registered auditor  
Birmingham

*22 October 2008*

**INCOME STATEMENT**
**For the 52 weeks ended 26 April 2008 and 28 April 2007**

		Before exceptional items 2008 £000	Exceptional items 2008 £000	Total 2008 £000
	Notes			
Revenue	3,4	273,423	-	273,423
Cost of sales		(249,349)	(2,632)	(251,981)
Gross profit		24,074	(2,632)	21,442
Administrative expenses		(22,340)	-	(22,340)
Other operating income		2,580	-	2,580
Operating profit	3,5	4,314	(2,632)	1,682
Finance income	10	169	-	169
Finance costs	10	(28)	-	(28)
Profit before taxation		4,455	(2,632)	1,823
Taxation	11	(2,376)	689	(1,687)
Profit for the period		2,079	(1,943)	136

		Before exceptional items 2007 £000	Exceptional items 2007 £000	Total 2007 £000
	Notes			
Revenue	3,4	268,370	-	268,370
Cost of sales		(247,367)	(3,277)	(250,644)
Gross profit		21,003	(3,277)	17,726
Administrative expenses		(16,028)	(4,913)	(20,941)
Other operating income		3,705	-	3,705
Operating profit	3,5	8,680	(8,190)	490
Finance income	10	1,177	-	1,177
Finance costs	10	(1,192)	-	(1,192)
Profit before taxation		8,665	(8,190)	475
Taxation	11	(2,482)	2,257	(225)
Profit for the period		6,183	(5,933)	250

See Accounting Policies on pages 9 to 12 for the description of the 2008 and 2007 reporting periods

For details of the exceptional items included above, see note 7

All results relate to continuing activities

**STATEMENT OF RECOGNISED INCOME AND EXPENSE**
**For the 52 weeks ended 26 April 2008 and 28 April 2007**

		2008 £000	2007 £000
	Notes		
Profit for the period		136	250
Foreign exchange translation differences		2	-
Tax on items recognised directly in equity	11	49	65
Total recognised income and expense for the period		187	315

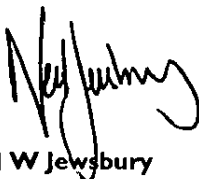
**WATERSTONE'S BOOKSELLERS LIMITED****REPORT AND ACCOUNTS 2008**

Company Number: 610095

**BALANCE SHEET**

	Notes	As at 26 April 2008 £000	As at 28 April 2007 £000
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	13	65,005	39,165
Intangible assets	14	69,347	-
Investments in subsidiaries	15	90,261	90,261
Deferred income tax asset	11	6,219	4,628
		<b>230,832</b>	<b>134,054</b>
<b>Current assets</b>			
Inventories	17	77,962	36,670
Trade and other receivables	16	42,689	26,466
Cash and short-term deposits	18	24,543	6,372
		<b>145,194</b>	<b>69,508</b>
<b>Total assets</b>		<b>376,026</b>	<b>203,562</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Interest bearing loans and borrowings	20	(519)	-
		<b>(519)</b>	<b>-</b>
<b>Current liabilities</b>			
Trade and other payables	19	(297,463)	(127,218)
Current income tax payable		(1,847)	(1,310)
Interest bearing loans and borrowings	20	(243)	-
Provisions	21	(2,629)	(2,411)
		<b>(302,182)</b>	<b>(130,939)</b>
<b>Total liabilities</b>		<b>(302,701)</b>	<b>(130,939)</b>
<b>Net assets</b>		<b>73,325</b>	<b>72,623</b>
<b>Equity</b>			
Share capital	24	71,014	71,014
Retained earnings	26	2,311	1,609
<b>Total equity</b>	26	<b>73,325</b>	<b>72,623</b>

The financial statements were approved by the Board of Directors on 14 October 2008 and were signed on its behalf by

  
**N J W Jewsbury**  
 Director

  
**M W Giffin**  
 Director

**CASH FLOW STATEMENT**

For the 52 weeks ended 26 April 2008 and 28 April 2007

	Notes	2008 £000	2007 £000
<b>Cash flows from operating activities</b>			
Profit before tax		1,823	475
Net finance income (costs)		(141)	15
Depreciation	13	8,707	9,097
Impairment charges	13	-	2,500
Profit on disposal of property, plant and equipment		(44)	(1,811)
Equity-settled share-based payment charge (credit)	9	515	(59)
		<b>10,860</b>	<b>10,217</b>
Movement in inventories		(329)	(558)
Movement in trade and other receivables		2,751	(4,922)
Movement in trade and other payables		6,019	1,543
Movement in provisions		2	837
Cash generated from operations		<b>19,303</b>	<b>7,117</b>
Income tax paid		(790)	(3,926)
<b>Net cash flows from operating activities</b>		<b>18,513</b>	<b>3,191</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	13	(7,385)	(9,301)
Proceeds from sale of property, plant and equipment		188	2,115
Movement in loans to parent and fellow subsidiaries		-	65,000
Acquisition of subsidiary	15	-	(70,261)
Inflow from Group businesses acquired		6,762	-
Interest received		121	1,404
<b>Net cash flows from investing activities</b>		<b>(314)</b>	<b>(11,043)</b>
<b>Cash flows from financing activities</b>			
Interest paid		(28)	(1,115)
<b>Net cash flows from financing activities</b>		<b>(28)</b>	<b>(1,115)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>18,171</b>	<b>(8,967)</b>
Opening cash and cash equivalents	18	6,372	15,339
<b>Closing cash and cash equivalents</b>	18	<b>24,543</b>	<b>6,372</b>

**NOTES TO THE FINANCIAL STATEMENTS****1. Authorisation of financial statements and statement of compliance with IFRS**

The financial statements of Waterstone's Booksellers Limited for the period ended 26 April 2008 were authorised for issue by the Board on 14 October 2008 and the Balance Sheet was signed on the Board's behalf by N J W Jewsbury and M W Giffin. 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.

**2. Accounting policies****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 26 April 2008, whilst the comparative period covered the 52 weeks ended 28 April 2007. 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. They are prepared on the historical cost basis, except for certain share-based payments that have been measured at fair value.

The Company is exempt from preparing group financial statements as it is itself a subsidiary undertaking under Section 228 of the Companies Act 1985. These financial statements present information about the Company as an individual undertaking and not about its Group.

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates.

**Investments in subsidiaries**

Investments in subsidiaries are recognised at cost less impairments booked. 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 Group presents as exceptional items on the face of the income statement those material items of income and expense which, because of the nature or 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. Exceptional items recognised in arriving at operating profit include (but are not limited to) those costs associated with integrating a newly acquired business, impairment losses and costs associated with restructuring the business.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****2. Accounting policies (continued)****Goodwill**

Positive goodwill is capitalised, classified as an asset on the balance sheet and is not amortised. Goodwill is calculated as the excess of the cost of the business combination over the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. All capitalised goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

**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

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. Useful lives and residual values are reviewed annually and where adjustments are required these are made prospectively.

**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, which is expenses in the period in which it is incurred.

Assets held under finance leases, which transfer to the Company substantially all the risks and benefits of ownership of the leased assets, are capitalized at the inception of the lease, with a corresponding liability being recognised for the lower of the fair value of the leased asset and the present value of the minimum lease payments. Lease payments are apportioned between the reduction of the lease liability and finance charges in the income statement so as to achieve a constant rate of interest on the remaining balance of the liability. Assets held under finance leases are depreciated over the shorter of the estimated useful life of the asset and the lease term.

**Impairment of assets**

The Company assesses at each reporting date whether there are indicators that an asset may be impaired. Assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other groups of assets (cash generating units). If any indicator of impairment 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 inflows expected to be derived from the asset. Where the asset does not generate cash inflows 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 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.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****2. 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 is 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.

**Interest bearing loans and borrowings**

Interest bearing loans and borrowings are initially recognised at fair value less directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method.

**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.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****2. 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.

**Customer loyalty schemes**

The fair value of loyalty points awarded is deferred until the awards are redeemed, after adjustment for the number of points expected never to be redeemed. Fair value is determined by reference to the value for which the points can be redeemed.

**New accounting standards**

The Company has adopted the following new accounting standard, which is mandatory for the first time for the financial year ending 26 April 2008:

- IFRS 7 Financial Instruments Disclosures, effective for periods beginning on or after 1 January 2007. This new accounting standard had no effect on reported income or net assets and liabilities. The additional required disclosures are given in Notes 16 and 22 to the accounts.

The following have been adopted but have no material impact on the Company:

- IAS 1 Amendment – Presentation of Financial Statements Capital Disclosures (1 January 2007)
- IFRIC 8 Scope of IFRS 2 (1 May 2006)
- IFRIC 9 Reassessment of Embedded Derivatives (1 June 2006)
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions (1 March 2007)
- IFRIC 13 Customer Loyalty Programmes (1 July 2008)

The following are not yet effective and have not been adopted early:

- Amendment to IFRS 2 Share-based payment vesting conditions and cancellations (1 January 2009)
- IFRS 3 Business Combinations (revised 2008) (1 July 2009)
- IFRS 8 Operating Segments (1 January 2009)
- IAS 1 Presentation of Financial Statements (revised 2007) (1 January 2009)
- IAS 23 Borrowing Costs (1 January 2009)
- IAS 27 Consolidated and Separate Financial Statements (revised 2008) (1 July 2009)
- IFRIC 12 Service Concession Arrangements (1 January 2008)
- IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset Minimum Funding Requirements and their interaction (1 January 2008)

The Directors do not anticipate that the adoption of the above will have a material impact on the financial statements.

**3. 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.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****4. Revenue**

Revenue disclosed in the income statement is analysed as follows

	2008	2007
	£000	£000
Sale of goods	273,423	268,370
Sublease rental income	588	425
Revenue	274,011	268,795
Finance income (see Note 10)	169	1,177
Total	274,180	269,972

**5. Operating profit**

	2008	2007
	£000	£000
Operating profit is stated after charging (crediting)		
Depreciation of property, plant and equipment	8,707	9,097
Cost of inventories recognised as expense	155,972	152,155
Write down of inventories	628	257
Auditor remuneration	49	58
Operating lease rentals		
Minimum rentals	29,915	31,708
Percentage rentals	706	228
Sublease rentals	(588)	(425)
	30,033	31,511

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.

**6. Fees to auditors**

	2008	2007
	£000	£000
Audit of the financial statements	22	48

The audit fee disclosed above represents the statutory audit fee for the Company. However, the Company also bore the cost of the audit of another Group company, resulting in the higher amount disclosed as auditor remuneration in Note 5.

Fees to auditors for other non-audit services have not been disclosed in accordance with the Companies (disclosure of Auditor Remuneration) Regulations 2005 (Statutory Instrument 2005/2417). This information is disclosed in the consolidated accounts of the parent company, HMV Group plc.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 7. Exceptional items

	2008	2007
	£000	£000
Recognised in arriving at operating profit		
Impairment of property, plant and equipment	-	2,500
Costs of Ottakar's integration	-	4,913
Restructuring and store closure costs	2,632	777
	<b>2,632</b>	<b>8,190</b>

During the year the Company incurred exceptional operating costs of £2,632,000 relating to the closure of eight stores, which have been included within cost of sales. A tax credit of £689,000 arose in respect of these costs. In the prior period the Company incurred exceptional operating costs of £8,190,000. An impairment charge of £2,500,000 relating to property, plant and equipment were included within cost of sales (see Note 14). Costs of integrating the Ottakar's acquisition of £4,913,000 were included within administrative expenses, with related store closure costs of £777,000 included within cost of sales. A tax credit of £2,257,000 arose in respect of these costs.

## 8. Directors' emoluments

	2008	2007
	£000	£000
Emoluments	1,712	1,372
Pension contributions	33	-
Termination benefits	80	132
	<b>1,825</b>	<b>1,504</b>

Mr Fox and Mr Myers were paid by other Group companies for their services to the Group as a whole.

Retirement benefits are accruing to all of the Directors under defined benefit pension schemes (2007: seven). None of the Directors exercised options over Ordinary Shares in the parent company, HMV Group plc (2007: none). 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:

	2008	2007
	£000	£000
Aggregate emoluments	671	381
Pension contributions	33	16
	<b>704</b>	<b>397</b>

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

	2008	2007
	£000	£000
Accumulated total accrued pension	10	3

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**9. Employee costs**

	2008	2007
	£000	£000
Employee costs, including Directors' emoluments		
Wages and salaries	38,476	35,002
Social security costs	3,078	2,616
Other pension costs (see Note 28)	924	909
	<b>42,478</b>	<b>38,527</b>

Included in wages and salaries is a total charge for equity-settled share-based payments of £515,000 (2007 credit of £59,000). A credit arose in the prior period as performance conditions for awards vesting had not been met and management 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 in retail was 2,373 (2007 2,387).

**10. Net finance costs**

	2008	2007
	£000	£000
Total finance income		
From parent and fellow subsidiary undertakings	169	1,177
Total finance costs		
Bank loans and overdrafts	(28)	(36)
To parent and fellow subsidiary undertakings	-	(1,156)
<b>Total net finance income (costs)</b>	<b>141</b>	<b>(15)</b>

**11. Taxation**

	2008	2007
	£000	£000
Taxation recognised in the income statement:		
United Kingdom, current year		
Corporation tax	1,328	537
Deferred tax		
United Kingdom	359	(312)
<b>Total taxation expense in the income statement</b>	<b>1,687</b>	<b>225</b>

The tax expense in the current year includes a credit of £689,000 (2007 £2,257,000) in relation to the exceptional operating costs of £2,632,000 (2007 £8,190,000), details of which can be found in Note 7. The effective tax rate on ordinary activities is 53.3% (2007 28.6%).

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****11. Taxation (continued)**

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

	2008	2007
	£000	£000
Profit before taxation	1,823	475
Corporation tax at UK average statutory rate of 29.83% (2007: 30%)	544	143
Effects of		
Permanent disallowables	223	(258)
Permanent disallowables on exceptional items	96	200
Temporary differences relating to prior year periods	516	140
Deferred tax rate change	308	-
Total tax charge	1,687	225

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

	2008	2007
	£000	£000
Deferred taxation relating to share-based payments	(49)	(65)
Tax credit in the statement of recognised income and expense	(49)	(65)

**Deferred Tax**

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

	2008	2007
	£000	£000
Accelerated depreciation for tax purposes	6,297	4,504
Other temporary differences	(78)	124
	6,219	4,628

*Unrecognised tax losses*

The Company has capital losses of £Nil (2007: £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

	2008	2007
	£000	£000
Accelerated depreciation for tax purposes	53	(416)
Other	306	104
	359	(312)

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 12. Acquisition of businesses

On 26 April 2008 the Company acquired the trade and assets relating to 134 bookstores of HMV Overseas Limited (formerly Ottakar's Limited), a subsidiary undertaking, and the trade and assets relating to 46 bookstores from HMV Music Limited, a fellow group company. The fair value of the net assets acquired equated to the book values, which are as follows

	From HMV Overseas Limited £000	From HMV Music Limited £000	Total £000
Property, plant and equipment	20,274	8,001	28,275
Trade and other receivables	11,625	7,349	18,974
Deferred income tax	517	1,385	1,902
Inventories	25,226	15,737	40,963
Cash and short-term deposits	6,762	-	6,762
Trade and other payables	(55,702)	(22,775)	(78,477)
Interest bearing loans and borrowings	(762)	-	(762)
Provisions	(1,125)	(60)	(1,185)
Intercompany balances	(1,068)	-	(1,068)
	5,747	9,637	15,384
Goodwill arising on acquisition	69,347	-	69,347
Consideration	75,094	9,637	84,731

## 13. Property, plant and equipment

	Plant, equipment and vehicles £000
Cost at 29 April 2006	122,762
Disposals	(2,476)
Additions	9,301
Cost at 28 April 2007	129,587
Disposals	(5,037)
Acquisition of businesses (see Note 12)	28,275
Additions	7,385
<b>Cost at 26 April 2008</b>	<b>160,210</b>
Depreciation at 29 April 2006	80,997
Charge for period	9,097
Impairment loss	2,500
Disposals	(2,172)
Depreciation at 28 April 2007	90,422
Charge for period	8,707
Disposals	(3,924)
<b>Depreciation at 26 April 2008</b>	<b>95,205</b>
<b>Net book value at 26 April 2008</b>	<b>65,005</b>
Net book value at 28 April 2007	39,165
Net book value at 29 April 2006	41,765

The carrying value of plant and equipment held under finance leases at 26 April 2008 was £762,000 (2007 £nil). Leased assets are pledged as security for the related finance lease.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****13. Property, plant and equipment (continued)**

In the prior period the Company's property, plant and equipment were written down by £2,500,000 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% (2006 10%). The cash flows reflected management's best estimates of revenue, margin and operating costs over the forecast period.

**14. Intangible assets**

	Goodwill £000
Cost and net book value at 29 April 2006 and 28 April 2007	-
Additions	69,347
<b>Cost and net book value as at 26 April 2008</b>	<b>69,347</b>

On 26 April 2008 the Company acquired the trade and assets of its subsidiary undertaking, Ottakar's Limited. Cash consideration of £75,094,000 was paid for net assets of £5,747,000 giving rise to goodwill of £69,347,000 (see Note 12). The 134 stores transferred have been trading under the Waterstone's brand name and it is expected that they will continue to do so for the foreseeable future.

The carrying value of the goodwill is subject to an annual impairment review so as to ensure that the carrying amount is not greater than the recoverable amount. The recoverable amount is determined from a value in use calculation with regard to the portfolio of stores acquired. The value in use incorporates cash flow projections based on budgets approved by senior management over a five year period. The calculation of value in use is sensitive to assumptions made with respect to sales forecasts, gross margin and discount rates. Cash flows beyond the five years have been extrapolated using a 1% growth rate. This rate does not exceed the average long term growth rate of the relevant market. The pre-tax discount rate applied to cash flow projections is 10%. On the basis of the impairment review undertaken, no impairment of the capitalised goodwill was required.

**15. Investments: subsidiaries**

	Cost £000	Provision £000	Net book value £000
At 29 April 2006	20,000	-	20,000
Additions	70,261	-	70,261
<b>At 26 April 2008 and 28 April 2007</b>	<b>90,261</b>	<b>-</b>	<b>90,261</b>

The Company's principal subsidiary undertakings, which are 100% directly owned, are as follows:

Name of undertaking	Country of incorporation	Activity
HMV Overseas Limited (formerly Ottakar's Limited) <sup>1</sup>	England	Retailing of books
Fine Recordings Club Limited	England	Non-trading

<sup>1</sup> On 3 July 2006 the Company acquired for cash the entire share capital of Ottakar's Limited. On 26 April 2008 the Company acquired the trade and net assets relating to 134 bookstores of Ottakar's Limited (see Note 12). On 19 August 2008, Ottakar's Limited changed its name to HMV Overseas Limited.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**16. Trade and other receivables**

	2008	2007
	£000	£000
Current:		
Trade receivables	3,314	2,369
Amounts owed by parent and fellow subsidiary undertakings	2,990	750
Other receivables	6,804	6,792
Prepayments and accrued income	29,581	16,555
	<b>42,689</b>	<b>26,466</b>

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

Trade receivables are stated net of a provision for impairment of £464,000 (2007 £517,000). Credit risk is limited due to the nature of the Company's retailing business. See Note 22 for further details of credit risk.

**17. 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.

**18. Cash and short-term deposits**

For the purposes of the cash flow statement, cash and cash equivalents comprise the following:

	2008	2007
	£000	£000
Cash at bank and in hand	24,543	6,372
	<b>24,543</b>	<b>6,372</b>

Cash at bank earns interest at floating rates based on daily bank deposit rates.

**19. Trade and other payables**

	2008	2007
	£000	£000
Current:		
Trade payables	64,169	28,416
Amounts owed to parent and fellow subsidiary undertakings	173,160	67,110
Other payables	30,986	13,574
Accruals and deferred income	29,148	18,118
	<b>297,463</b>	<b>127,218</b>

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

**20. Interest bearing loans and borrowings**

	2008	2007
	£000	£000
Obligations under finance leases (see Note 30)		
Non-current	519	-
Current	243	-
	<b>762</b>	<b>-</b>

The carrying value of interest bearing loans and other borrowings approximates to fair value.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****21. Provisions**

	<b>Total</b>
	<b>£000</b>
At 28 April 2007	2,411
Provisions utilised	(3,599)
Acquired from group undertakings	1,185
Charged during the year	2,632
<b>At 26 April 2008</b>	<b>2,629</b>

Provisions almost entirely consist of amounts in respect of store closures and restructuring. The utilisation of provisions in the year largely reflects store closures and the integration of Ottakar's. The provision created in the year was in respect of further store closures. All provisions are expected to be utilised in the forthcoming year.

**22. Financial risk factors**

The Company's business exposes it to certain limited financial risks, such as liquidity risk, interest rate risk, credit risk and foreign exchange risk. The risks are managed by the HMV Group ("the Group") Treasury department, which applies policies approved by the Group Board of Directors to the Company.

*Liquidity risk*

The Group has sufficient funds and facilities available to satisfy its current requirements. The Company is a Guarantor to the Group's £260m revolving credit facility (see Note 27). The Company has access to intra-group funding if and when required. However, the Company had a positive cash balance at 26 April 2008 (see Note 18).

Under the Group's banking arrangements, overdraft and cash balances of the Company and certain other Group companies are pooled or offset and cross-guaranteed.

*Interest rate risk*

The Company is exposed to interest rate risk from its borrowings and cash deposits. However, the strong seasonality to the Company's trading pattern provides a natural hedge against interest rate risk. The net exposure is monitored on a regular basis.

*Credit risk*

The Company's credit risk arises from its cash and outstanding receivables.

The Company deposits cash balances with counter parties that have a strong credit rating, with an agreed limit for each counter party, so as to limit the risk of loss arising from a failure.

Due to the nature of the Company's retailing business, credit risk from trade receivables is limited. Allowances are made for doubtful debts based on the age of the debt and the customer's financial circumstances.

*Foreign exchange risk*

Forward foreign exchange contracts are used to hedge the foreign exchange risk of imports where volumes are significant. No speculative positions are entered into. No foreign currency contracts were outstanding at 26 April 2008 (2007: £nil).

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 23. Additional cash flow information

Movements in the Company's net debt position are as follows

	At 28 April 2007 £000	Transfer in from other Group companies £000	Cash flow £000	At 26 April 2008 £000
Cash and cash equivalents	6,372	6,762	11,409	24,543
Finance leases	-	(762)	-	(762)
	6,372	6,000	11,409	23,781

	At 29 April 2006 £000	Cash flow £000	At 28 April 2007 £000
Cash and cash equivalents	15,339	(8,967)	6,372

## 24. Share capital

	2008 Number '000	2007 Number '000	2008 £000	2007 £000
<b>Authorised</b>				
Ordinary Shares of £1 each	121,014	121,014	121,014	121,014
<b>Allotted, called up and fully paid</b>				
Ordinary Shares of £1 each	71,014	71,014	71,014	71,014

## 25. 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, the HMV Group plc 2002 Executive Share Option Scheme (the '2002 Scheme'). This scheme was used for grants of options from 2002 until the financial year ended 28 April 2007, when it was replaced with the HMV Performance Share Plan (PSP).

Options to acquire shares were granted on an annual basis thus ensuring reward was spread over a number of years and was allied to the long-term growth in shareholder value. Options were 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.

There was no charge for share options in the year ended 26 April 2008 (2007 credit of £156,000). A credit arose in the prior year as performance conditions for awards vesting had not been met and management revised their estimate of the achievability of performance conditions relating to awards vesting in future periods.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 25. 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 26 April 2008 had a weighted average exercise price of 224p (2007: 230p) and a weighted average remaining contractual life of 6.5 years (2007: 7.5 years). The weighted average share price at the date of exercise for share options exercised during the prior year was 171p.

	2008	2008	2007	2007
	Options	Weighted	Options	Weighted
	Number	average exercise price	Number	average exercise price
		Pence		Pence
Outstanding at beginning of period	1,388,390	230	2,929,786	201
Exercised during the period	-	-	(4,640)	156
Lapsed during the period	(761,003)	235	(1,198,630)	171
Transferred from (to) other Group companies	77,526	220	(338,126)	184
Outstanding at end of the period <sup>1</sup>	704,913	224	1,388,390	230
Exercisable at end of the period	169,649	167	181,937	167

<sup>1</sup> Included within this balance are options over 169,649 (2007: 181,937) 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.

	2008	2008	2007	2007
	Options	Weighted	Options	Weighted
	outstanding	average remaining contractual life	outstanding	average remaining contractual life
	Number	Years	Number	Years
2002 Executive Share Option Scheme				
Exercise price 167p	169,649	4.1	181,937	5.1
Exercise price 237p	-	-	482,693	7.2
Exercise price 242p	535,264	7.2	723,760	8.3
	704,913	6.5	1,388,390	7.5

The 2002 Executive Share options with an exercise price of 242p were exercisable from 8 July 2008 subject to vesting conditions based on the Group's financial performance for the three years to 26 April 2008. As the minimum performance conditions were not met, these options will lapse in the 2008/09 financial year.

The fair value of equity-settled share options granted is estimated as at the date of grant using the Black Scholes model. No options were granted in the financial year under review or in the previous financial year.

**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.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****25. Share-based payments (continued)**

The charge in respect of deferred awards during the period ended 26 April 2008 was £3,000 (2007 £nil). The number and weighted average grant prices of, and movements in, deferred share awards during the year are as follows

	2008	2008	2007	2007
	Share awards	Weighted average grant price	Share awards	Weighted average grant price
	Number	Pence	Number	Pence
Outstanding at beginning of period	34,251	239	88,729	228
Vested during the period	(4,618)	237	(2,448)	143
Lapsed during the period	(13,853)	237	(7,345)	143
Transferred to other Group companies	-	-	(44,685)	239
Outstanding at end of the period	15,780	242	34,251	239

Of the outstanding balance, the assessment of performance conditions at April 2008 will result in 11,835 share awards lapsing after the period end, whilst a further 3,945 share awards will vest.

**Equity-settled Performance Share Plan**

The HMV Performance Share Plan (PSP) was introduced during the previous financial year and replaced the 2002 Executive Share Option Scheme. Under the PSP certain employees are granted an award of shares, which vest after three years provided that preset performance criteria are met. The number of shares awarded is determined by reference to the market value of shares. The charge in respect of the PSP during the year ended 26 April 2008, which is adjusted for expected dividend income during the vesting period was £512,000 (2007 £97,000).

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

	2008	2008	2007	2007
	Share awards	Weighted average grant price	Share awards	Weighted average grant price
	Number	Pence	Number	Pence
Outstanding at beginning of period	807,455	162	-	-
Granted during the period	1,642,203	115	860,566	162
Exercised during the period	(437)	162	(324)	162
Transfers from other Group companies	227,509	162	-	-
Lapsed during the period	(260,699)	132	(52,787)	162
Outstanding at end of the period	2,416,031	133	807,455	162

**26. Reconciliation of movements in equity**

	Share capital	Retained earnings	Total
	£000	£000	£000
At 29 April 2006	71,014	1,353	72,367
Total recognised income and expense for the period	-	315	315
Credit for share-based payments	-	(59)	(59)
At 28 April 2007	71,014	1,609	72,623
Total recognised income and expense for the period	-	187	187
Charge for share-based payments	-	515	515
At 26 April 2008	71,014	2,311	73,325

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****26. Reconciliation of movements in equity (continued)**

The capital of Waterstone's Booksellers Limited is the total equity on the Company's balance sheet. The objective of the Company's capital management is to grow its retailing business and deliver improving returns for its parent company, HMV Group plc. The management of the Company's capital is performed by the Board of Directors. There are no externally imposed capital requirements.

**27. 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.

HMV Group plc has a syndicated bank Facility Agreement, which at 26 April 2008 consisted of a £260m revolving credit facility. 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.

After the end of the period under review, HMV Group plc entered into a new syndicated bank Facility Agreement, replacing that noted above, which consists of a £220m revolving credit facility effective from 10 October 2008. The Guarantors, which include Waterstone's Booksellers Limited, continue to secure the borrowings under the Agreement as noted above.

**28. 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 26 April 2008 were £0.3m (2007: £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 valuation is undertaken on at least a triennial basis by a qualified actuary. The most recently completed actuarial valuation was 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 actuarial valuation as at 30 June 2007 is now close to completion. Following this, the next actuarial review will take place no later than 30 June 2010.

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

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. Total Group employer contributions to the Pension Benefit Section for the year ended 26 April 2008 were £2.5m (2007 £7.2m inclusive of a £4.4m special contribution). Of this the Company contributed £0.6m (2007 £0.7m). The total Group contributions to the defined benefit plans for the financial year commencing on 27 April 2008 are expected to be £3.1m. Of this the Company is expected to contribute £0.6m.

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 26 April 2008 % per annum	As at 28 April 2007 % per annum
Rate of price inflation	3.5	3.1
Rate of salary increase	5.0	4.6
Rate of increase for pensions in payment	3.3	3.1
Rate used to discount scheme liabilities	6.2	5.4
Expected rate of return on equities	8.1	7.8
Expected rate of return on bonds	6.2	5.4
Expected rate of return on index-linked bonds	4.6	4.4

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 post-retirement mortality assumptions used as at 26 April 2008 are in line with the proposed basis of the draft actuarial funding valuation as at 30 June 2007. They reflect the pensioner mortality 00 series tables rated up one year and based on year of use with allowance for medium cohort improvements applying from 2000 subject to a minimum of 1% per annum. The post-retirement mortality assumptions used as at 28 April 2007 were the standard PM/FA92 series tables with allowance for future improvements in mortality. These bases imply the following life expectancies:

Life expectancy (years)	2008 At age 65 for someone currently age 65	2008 At age 65 for someone currently age 50	2007 At age 60 for someone currently age 60	2007 At age 60 for someone currently age 40
Male	21.3	23.1	23.9	25.9
Female	23.6	25.5	27.2	29.0

Other non-financial assumptions are consistent with those used in the last complete actuarial valuation of the Scheme as at 30 June 2004.

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

	As at 26 April 2008 £m	As at 28 April 2007 £m
Equities	42.4	44.5
Bonds	20.3	19.1
Index-linked bonds	20.3	19.1
Other	0.2	1.4
Total market value of assets	83.2	84.1
Actuarial value of scheme liabilities	(99.1)	(106.1)
Deficit in the Scheme	(15.9)	(22.0)
Deferred tax	4.5	6.6
Net pension liability	(11.4)	(15.4)

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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

## 28. Pension arrangements (continued)

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

	2008 £m	2007 £m
Total market value of assets at the beginning of the period	84.1	73.0
Employer contributions	2.5	7.2
Employee contributions	0.8	1.0
Benefits paid	(4.6)	(1.0)
Expected return of plan assets	5.6	5.2
Actuarial loss	(5.2)	(1.3)
Total market value of assets at the end of the period	83.2	84.1

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

	2008 £m	2007 £m
Defined benefit pension obligations at the beginning of the period	(106.1)	(97.8)
Current service cost	(3.8)	(4.6)
Interest on pension scheme liabilities	(5.7)	(5.0)
Employee contributions	(0.8)	(1.0)
Benefits paid	4.6	1.0
Actuarial gain	12.7	1.3
Defined benefit pension obligations at the end of the period	(99.1)	(106.1)

## 29. Capital commitments

	2008 £000	2007 £000
Capital expenditure contracted but not provided	2,520	1,799

## 30. Obligations under leases

*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:

	2008 £000	2007 £000
Not later than one year	58,163	32,274
Between two and five years inclusive	194,344	113,157
After five years	264,647	139,129
	517,154	284,560

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 26 April 2008 is £7,227,000 (2007: £3,938,000).

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****30. Obligations under leases***Obligations under finance leases*

On the acquisition of 134 bookstores from HMV Overseas Limited (see Note 12) the Company acquired certain plant and equipment with related finance lease liabilities. These leases have no terms of renewal, purchase options or escalation clauses. At the end of the period, future minimum payments under finance leases were as follows:

	2008	2007
	£000	£000
Not later than one year	269	-
Between two and five years inclusive	563	-
	832	-
Less finance charges allocated to future periods	(70)	-
Present value of minimum lease payments	762	-
Present value of minimum lease payments		
Not later than one year	243	-
Between two and five years inclusive	519	-
	762	-

**31. 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	£000
2008 – with ultimate parent company	885	-	-	20,184
2008 – with fellow subsidiaries	-	3,421	2,990	152,976
2007 – with ultimate parent company	250	-	-	233
2007 – with fellow subsidiaries	-	2,382	750	66,877

Included within amounts owed to related parties is £20.0m (2007: nil) of intercompany loans, repayable on demand, on which interest is charged at the Bank of England base rate prevailing at the date of inception and £84.7m (2007: nil) relating to the acquisition of various trade and assets from other Group companies (see note 12). The remaining amounts owed by and to related parties related to intercompany trading balances which are settled regularly with no interest charge.

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 28.

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 25.

**Remuneration of key management personnel**

The remuneration of the Directors of the Company is set out in Note 8.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

**32. 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.