

**HEART OF MIDLOTHIAN PLC**

**Report and Financial Statements**

**31 July 2001**

**Deloitte & Touche  
39 George Street  
Edinburgh  
EH2 2HZ**



## FINANCIAL STATEMENTS 2001

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**FINANCIAL STATEMENTS 2001**

**CORPORATE INFORMATION**

**REGISTERED OFFICE**

Tynecastle Stadium  
Gorgie Road  
Edinburgh  
EH11 2NL

**REGISTRARS**

Lloyds TSB Registrars Scotland  
117 Dundas Street  
Edinburgh  
EH3 5ED

**AUDITORS**

Deloitte & Touche  
Chartered Accountants  
39 George Street  
Edinburgh  
EH2 2HZ

**LEGAL ADVISERS**

Henderson Boyd Jackson  
19 Ainslie Place  
Edinburgh  
EH3 6AU

**PRINCIPAL BANKERS**

Bank of Scotland  
1 Ardmillan Terrace  
Edinburgh  
EH11 2JN

**FINANCIAL ADVISERS AND STOCKBROKERS**

Williams De Brøe plc  
7 Forres Street  
Edinburgh  
EH3 6TL

## FINANCIAL STATEMENTS 2001

## DIRECTORS AND OFFICERS

**Christopher Peter Robinson**

Mr Robinson, aged 50, became non-executive Chairman in June 1994 when New Hearts Limited, which he jointly controls, acquired control of Heart of Midlothian Football Club plc. He was appointed as Chief Executive of the Company on 13 March 1997, with effect from 1 April 1997, and he has, and will continue to have, overall responsibility for the management of the Company's operations. Mr Robinson chairs the referee committee of the SFA and is involved in a number of other committees with the SFA and SPL.

**Andrew Stewart Fraser**

Mr Fraser, aged 52, joined the Company in February 1998 as Financial Controller/Company Secretary and was elected to the Board in November 1998. A Fellow of the Institute of Company Accountants, he has brought to the Company an in-depth knowledge of a variety of industry sectors, including Wholesale, Retail, Catering and Manufacturing. He spent 14 years with the Wines & Spirits division of Scottish & Newcastle Plc in a number of senior financial roles. Mr Fraser's most recent position before joining the Company was as Financial Director of Wheatsheaf Catering Limited.

**\* Douglas Andrew Smith**

Mr Smith, aged 55, was appointed a director of the Company in May 1997 and Chairman in May 1999. He has spent his working career in the insurance industry. He is currently UK Chairman of the Private Equity and Mergers & Acquisitions Division of Marsh Ltd.

**\* Brian James Duffin**

Mr Duffin, aged 46, is an Actuary who joined the Scottish Life Assurance Company ("Scottish Life") in 1976. Having spent significant periods at a senior level in the investment and marketing departments, he was appointed a director of Scottish Life in 1996 and has been Group Chief Executive since 1999. Following its acquisition of Scottish Life he became a director of Royal London Mutual Insurance Society Ltd in July 2001. He was appointed as a non-executive director of the Company in May 1997.

**\* David William Archer**

Mr Archer, aged 31, is Corporate Finance Director of SMG plc, 19.9% shareholder in Hearts, and joined the Board of Heart of Midlothian plc in September 2001, replacing Mr Andrew Flanagan as SMG's nominated director. Mr Archer has regularly attended board meetings as Mr Flanagan's alternate during the course of the year under review. Mr Archer has extensive experience of mergers and acquisitions and of corporate governance as part of his role at SMG plc, whose other interests, include Scottish and Grampian Television, Virgin Radio and The Herald and its sister newspapers.

\* non-executive

**CHAIRMAN'S STATEMENT****Introduction**

The last year has seen some significant changes for the Club. We have started a major task of bringing our costs back into line with income. We have also started the process of establishing new policies in terms of the squad cost and its management with the introduction of Head Coach, Craig Levein.

**Financial highlights**

During the year ended 31 July 2001, the Group incurred a pre-tax loss of £3.8 million, including exceptional costs of £1.1 million, on turnover of £7.9 million (2000 – pre-tax loss of £3.7 million on turnover of £7.1 million). The loss per share was 29.9p (2000 – 30.1p).

The Board is not recommending the payment of a dividend.

The Chief Executive, in his statement, provides more information on the results and on the Company's trading position.

**Trading environment**

I would like to put into perspective Hearts' position in relation to both Scottish football and the professional game in Europe. The majority of Scottish Premier League teams are recording substantial trading losses and building up ever greater debt burdens, a trend which is also being experienced by other football clubs and leagues throughout Europe. Neither the Scottish professional game, nor Hearts, can sustain such losses for much longer and there is a strong view amongst the clubs that there has to be a concerted strategy to redress this situation as a matter of urgency.

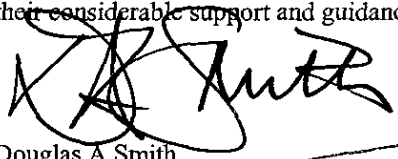
However, this trend, which was initially fuelled by the transfer legislation arising from Bosman and accentuated by complicated transfer regulations introduced by FIFA, should lessen at the end of the current season. The introduction of contracts with parameters that allow players to leave before their contractual end, compensation payments for young players and transfer windows should help to remove the previous uncertainties and encourage a more stable financial climate.

**Youth policy**

Whilst supporters are naturally disappointed to see international players such as Gary Naysmith and, more recently, Colin Cameron leave the Club, the investment made by Hearts in youth development continues to bear fruit and will continue apace in the years ahead.

**People**

In what has been a testing year I would like to thank the staff and everyone else connected with the Club for their unstinting efforts. In particular I would like to thank Fraser Jackson who, after 7 years as non-executive director, retired from the Board during the year and Ian Durie, who has been an adviser to the Club for the last 7 years, for their considerable support and guidance throughout that time.

  
Douglas A Smith  
CHAIRMAN  
10 October 2001

## CHIEF EXECUTIVE'S STATEMENT

## Financial Results

During the year ended 31 July 2001, the Group incurred a pre-tax loss of £3.8 million or 29.9p loss per share (2000 – pre-tax loss of £3.7 million or 30.1p loss per share). Although this figure is much the same as the previous year, it does, however, include £1.1 million of non-recurring compensation costs in respect of contract terminations, and a loss of £0.4 million in relation to the termination of players' registrations. This is partly offset by a non-recurring gain on the transfer of players' registrations of £0.8 million. It also includes the sum of £1.3 million in respect of player amortisation, being the costs of transfer fees and agents' fees, and this is at a similar level to last year. The high level reflects the "investments" which were made in the squad in the last two to three years. Revenue for the 12 month period was £7.9 million an increase of nearly £0.9 million over the preceding year (2000 – revenue was £7.1 million). The main part of this increased turnover was due to our participation in the UEFA Cup.

Whilst these results were anticipated they are nevertheless disappointing. They reflect the high playing squad cost put in place in the "speculate to accumulate" strategy.

## Dividend

The Board is not recommending a dividend for the year.

## Post Balance Sheet Events

On 6 August 2001, the Company held an Extraordinary General Meeting to advise shareholders that the trading activities of the football club would be transferred into a subsidiary company, Heart of Midlothian Football Club Limited. This will allow the plc to more easily enter into potential future commercial developments.

Since the year end the Company has received £2 million from transfer activities relating to Colin Cameron who was transferred to Wolverhampton Wanderers FC on 1 September 2001 and from payments due regarding the transfer of Gary Naysmith.

## Commercial Strategy

As stated in my Interim Statement, major steps have been taken to bring the costs of the football operation more into line with income. The squad size has been reduced and in conjunction with Craig Levein we have identified new guidelines for player costs throughout the squad.

In the financial year under review we took the opportunity to make adjustments in respect of high cost players with the resultant compensation costs. There has been criticism regarding the emphasis on finance rather than football. As has been made clear by the Chairman, the financial problems of Hearts are common to many clubs both in the Scottish Premier League and elsewhere. It is, therefore, simply not possible to separate football from finance. If our decision making structure was based purely on football, then the Club would no longer exist as it currently does.

Our current business and football strategy is to build a platform for the Club to grow and be successful in the years ahead. To do this we have to recognise that our income must increase and our costs must stay relative to that income. We also recognise that to be successful we need to have talented footballers and for them to be well-coached by ambitious and skilled coaching staff. The emphasis on youth has never been more important and it is pleasing to see that the emerging talent at the Club is on as high a level as it has ever been.

The sale of international and star players at the Club is always a controversial issue, and I expect that many people feel we have not achieved the transfer fees which are often attached to a player's market value. It is important that shareholders and supporters alike understand that Hearts as a Club is **not** in the English transfer market. Players in the English market of lesser ability and skill than our stars are moving between English clubs for larger fees than we, as a Scottish club, are able to achieve. Only Rangers and Celtic in recent times have achieved transfer fees higher than Hearts, and then normally only for European or International players. The values achieved for both Gary Naysmith and Colin Cameron reflect the relative structures of English and Scottish professional football and the market position which we are in compared to clubs in England.

This difference also exists in the commercial value of leagues in England and their ability to pay salary packages to players well in excess of what Hearts can pay. There is little wonder that our best players will seek to move to these leagues to better themselves financially in what is a short career. This very fact makes Hearts a selling club. What is important for the future prospects, however, is that we are able to invest sale proceeds in developing Hearts and its playing squad. Along with my Board colleagues we are working very hard to ensure that we can maintain the quality of players at the Club.

## CHIEF EXECUTIVE'S STATEMENT

**Communication**

During the year under review a determined effort has been made to get closer to our fans, communicate effectively, and to help them understand the difficulties facing a modern day football club. This strategy has been helped by the development of a Fans' Forum and earlier in the year we had a series of successful roadshows. Communication and public relations have improved over the period and we aim to continue this process. As we go through a period of transition it has never been more important to share openly with our customers, supporters and shareholders our vision for the Club.

**Business Activities**

As can be seen from the accounts our sales turnover increased by nearly £0.9 million. The main part of this increased turnover was due to our participation in the UEFA Cup. Our home fixture in the first round of the UEFA Cup versus VfB Stuttgart was the highest earning match in the Club's history, with excellent commercial and gate revenues. Television income (from a contract put in place some two years previously) was the most we have earned from any televised match. It is interesting to reflect that this one game earned the Club more money than the whole of our successful Cup run in 1998. Whilst European participation can be a lottery it generally always adds substantially to our turnover and interest in the Club at all levels. It was, therefore, very disappointing for us not to qualify for Europe once again.

Our related business activities of merchandising and corporate hospitality have performed well in difficult market conditions in a difficult season. These areas have held their own against the previous season. The margins in the Superstore have, however, increased due to our direct merchandising deal with Errea. Merchandising in football clubs is, however, generally slowing down and we are looking at all opportunities to improve sales.

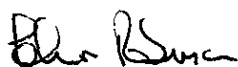
**Outlook**

The outlook for the current year is one of continued transition. On the financial side predicted losses are set to reduce considerably as players leave at the end of their contracts and reduced charges for amortisation from transfers work their way through. The year ahead will see the completion of the restructuring of squad costs, but with no UEFA competition, football income levels will also once again reduce. The membership schemes introduced after consultation with supporters groups have helped us to maintain a healthy level of season tickets and although income will not rise, the membership scheme puts in place a solid foundation for the future.

In looking forward we have to recognise that a possibility exists where both Rangers and Celtic could move to the English Premiership or elsewhere. Whilst this is unlikely to happen for a few years, if ever, we must ensure that Hearts is in a healthy state to be in the forefront of the Scottish game whatever happens.

The Scottish Premier League television and media contracts expire at the end of the current season. Negotiations are under way and there may be increased values flowing from the new contracts. Agreement has been reached internally by the SPL Clubs on the distribution of revenues/broadcasting fees following a lengthy period of negotiation. Increased revenues from this source are an important component of Hearts' overall income.

At last year's Annual General Meeting I outlined the Club's "Vision 2005" strategic plan and much work continues in putting in place the necessary foundations for the future and delivering this vision.



Chris Robinson  
CHIEF EXECUTIVE  
10 October 2001

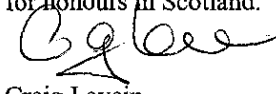
## HEAD COACH'S STATEMENT

After taking over the reins as Head Coach at Tynecastle almost one year ago, I feel we are making progress in all aspects of the football department. We finished last season in the top six in the Premier League and are determined to improve on that position this season.

This past year at Hearts has seen a number of changes on both the financial and playing side of the Club. A new policy on wages has been introduced and part of my remit as Head Coach is to implement this policy. Players' wage costs are too high at present and need to be aligned with income levels. Although we have taken the decision to transfer some players of quality from the squad, such as Colin Cameron, we have been able to bring in some very good young prospects to fill the gaps left by those who have moved on. Andrew Webster, Kevin McKenna, Stephen Simmons, Gary Wales, Andy Kirk and Scott Severin are young lads who have managed to make a first team place their own in this past year and if they continue to develop they point to a very bright future for the Club.

Our youth policy has for a number of years been the envy of many clubs throughout the length and breadth of the country. Our Under-18 youth side, coached by John McGlynn, were League Champions last season in the SPL Under-18 Professional Youth League following on from the same team winning the previous year's Under-18 Youth Cup. We will continue to focus on producing our own talent and recruiting younger players from lower divisions giving them a platform on which to display their abilities.

My ambition for the Club is to develop an exciting, attacking football team with a mixture of experienced professionals and talented enthusiastic youngsters. This combination will put us in a position to be able to challenge for honours in Scotland.



Craig Levein  
HEAD COACH  
10 October 2001



**DIRECTORS' REPORT**

The directors present their report and the audited financial statements of the Company for the financial year ended 31 July 2001.

**Principal activity**

The principal activity of the Company is that of a professional football club.

**Results, developments and future prospects**

The loss for the year after taxation amounted to £3,776,000 (2000 – £3,682,000).

Development and future prospects are described in the Chairman's Statement and Chief Executive's Statement on pages 3 to 5.

**Directors**

The present membership of the Board is set out on page 2.

The interests, including beneficial and family interests of the directors serving during the year to 31 July 2001 in the shares of the Company were as follows:

	Ordinary shares of 10p	
	31.7.01 No	31.7.00 No
C P Robinson	2,476,568	2,476,568
F S Jackson (resigned 20.12.00)	3,700	3,700
B J Duffin	10,000	10,000
D A Smith	5,000	5,000
A S Fraser	1,000	1,000
A Flanagan	-	-

C P Robinson is a director of New Hearts Limited which holds, directly and indirectly through its wholly owned subsidiary, Pentland Securities (Holdings) Limited, 4,226,563 ordinary shares in the Company. C P Robinson and his wife together hold 50% of the equity share capital of New Hearts Limited through their jointly owned company, Chrysalis Scotland Limited. Chrysalis Scotland Limited also holds 363,286 ordinary shares in the Company. The director's beneficial interests in these shares are disclosed in the table above.

On 21 September 2001, A Flanagan resigned as the nominated director for SMG plc and became the alternate. From this date D W Archer became the nominated director, having previously been the alternate to A Flanagan.

There have been no changes in directors' interests between the year end and 10 October 2001.

Details of directors' service contracts with the Company are given in the Board's Report on Directors' Remuneration.

**DIRECTORS' REPORT****Substantial Shareholdings**

As at 3 October 2001 the directors were aware of the following major holdings of the issued ordinary share capital of the Company as notified to them under the provisions of Part VI of the Companies Act 1985, as amended by the Disclosure of Interests in Shares (Amendment) Regulations 1993.

	Shareholding	% Total
SMG (Investments) Limited	2,514,093	19.90
Pentland Securities (Holdings) Limited*	2,502,500	19.81
New Hearts Limited*	1,724,063	13.65
The Governor and Company of the Bank of Scotland	714,300	5.65
James Hay Pension Trustees Limited	559,500	4.43
RBSTB Nominees Limited	545,000	4.31
Phildrew Nominees Limited	460,000	3.64
Robert McGrail	440,000	3.48

\* Directors hold beneficial interests in these shares and these are fully disclosed above.

**Employee Involvement**

Within the bounds of commercial confidentiality, staff at all levels are kept informed of matters that affect the progress of the Company and which are of interest to them as employees.

**Disabled Employees**

Disabled persons are given full and fair consideration for all types of vacancy. If an existing employee becomes disabled, such steps as are practical and reasonable are taken to retain the individual in employment. Where appropriate, assistance with rehabilitation and suitable training are given. Disabled persons have equal opportunities for training, career development and promotion, except insofar as such opportunities are constrained by the practical limitations of their disability.

**Supplier Payment Policy**

It is the Company's policy to agree terms of payment with suppliers and to abide by them.

At 31 July 2001 the Company's average creditor payment period was 36 days, calculated in accordance with the requirements set down in the Companies Act 1985. This represents the ratio, expressed in days, between the amounts invoiced to the Company by its suppliers in the year and the amounts due, at the year end, to creditors within one year.

**Donations**

During the year the Company made donations to charitable organisations in the UK totalling £554 (2000 - £1,647).

**Auditors**

A resolution to re-appoint Deloitte & Touche as auditors will be proposed at the Annual General Meeting.

**DIRECTORS' REPORT**

**Annual General Meeting**

Notice of the Annual General Meeting of the Company is set out on pages 37 and 38 of this document. The meeting will be held in the Gorgie Suite at Tynecastle Stadium at 6 pm on 12 November 2001. An explanation of the resolutions being proposed at the meeting, which forms part of the Directors' Report, is set out on page 38.



A S Fraser  
COMPANY SECRETARY  
10 October 2001

## CORPORATE GOVERNANCE

Section 1 of the Combined Code, as appended to the Listing Rules, sets out Principles of Good Corporate Governance and Code provisions which are applicable to listed companies incorporated in the UK.

A narrative statement on how the Company has applied the Principles, and a statement explaining the extent to which the provisions in the Code have been complied with, appear below.

### NARRATIVE STATEMENT

The Code establishes 14 Principles of Good Governance which are split into the four areas described below.

#### Directors

The Company is controlled through the Board of Directors, which comprises two executive and three non-executive directors. As the Chairman is mainly responsible for the running of the Board, he has to ensure that all directors receive sufficient relevant information on financial, business and corporate issues prior to meetings. The Chief Executive's responsibilities focus on co-ordinating the Company's business and implementing Company strategy. All directors are able to take independent financial advice in the furtherance of their duties if necessary.

The non-executive directors are considered to be independent, with the exception of the nominee of SMG plc. On 21 September 2001, the nominee of SMG plc changed from A Flanagan to D W Archer.

The Board has a formal schedule of matters reserved to it and meets monthly. It is responsible for overall Company strategy, approval of major capital expenditure projects and consideration of significant financing matters. The Board also considers environmental and employee issues and key appointments. It also ensures that all directors receive appropriate training on appointment and then subsequently as appropriate. All directors, in accordance with the Code, will submit themselves for re-election at least once every three years.

The Board has established a number of standing committees. Each committee operates within defined terms of reference. The principal committees are the Audit Committee and the Remuneration Committee.

The Board has not operated a Nominations Committee as the Board believes it is a 'small' board per the Code and therefore does not need to establish such a Committee.

#### Directors' Remuneration

The Remuneration Committee measures the performance of the executive directors and key members of senior management as a prelude to recommending their annual remuneration, bonus awards and awards of share options to the Board for final determination. The remuneration of the non-executive directors is a matter for the Board. The final determinations are made by the Board as a whole but no director plays a part in any discussion about his remuneration. The Committee consults the Chief Executive about its proposals and has access to professional advice from inside and outside the Company.

The Report of the Board to the Shareholders on Directors' Remuneration is set out on pages 14 to 16.

#### Relations with Shareholders

The Company encourages two way communication with both its institutional and private investors and responds quickly to all queries received verbally or in writing. The Chief Executive and Finance Director attended meetings with analysts and institutional shareholders during the year. All shareholders have at least twenty working days notice of the Annual General Meeting at which all directors and Committee chairs are introduced and available for questions.

## CORPORATE GOVERNANCE

### Accountability and Audit

#### *Financial Reporting*

A detailed review of the performance and financial position of the Company is included in the Chief Executive's Statement on pages 4 and 5 which, together with the Directors' Report on pages 7 to 9, the Board uses to present a balanced and understandable assessment of the Company's position and prospects. The directors' responsibility for the financial statements is described on page 17.

#### *Internal Control*

The directors are responsible for the Company's system of internal control, including financial, operational and risk management controls. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable assurance but not absolute assurance against material misstatement or loss.

Since 1 January 2001, the Board has progressively implemented formal procedures and reporting processes to establish an ongoing process to identify, evaluate and manage the significant risks faced by the Company. Those procedures have been put in place during the year and remained in place up to the approval date of the Report and Accounts. These procedures are regularly reviewed by the Board and are designed in accordance with the guidance set out in the Internal Control: Guidance for Directors on the Combined Code produced by the Turnbull working party. During the preceding part of the financial year, procedures were being established to meet the requirements of the Board.

In carrying out their review of the effectiveness of internal control in the Company, the Board has considered the following key aspects of the systems of risk management and internal control:

#### *Financial information*

The Company has a comprehensive system for reporting financial results to the Board; monthly results are prepared for each operating unit and compared against budget. The Board reviews these for the Company as a whole and determines appropriate action. Budgets and plans prepared by operating functions are reviewed by the Board before being adopted formally.

#### *Risk management*

Specific responsibilities and procedures have been defined for the reporting and monitoring of key risk factors in the following areas:

- |   |                                       |
|---|---------------------------------------|
| • Real estate and stadium                 | • Human capital and resources         |
| • Financial controls                      | • Capital expenditure and development |
| • Football viewing rights                 | • Legislative framework               |
| • Football related trading activities     | • Specific insured risks schedule     |
| • Non-football related trading activities | • Corporate governance                |

These key risk areas are discussed by the Chief Executive with relevant departmental heads on a regular basis and the Chief Executive in turn reports to the Board. Procedures are being implemented progressively to formalise documentation regarding the review and sign off of detailed risk management reports.

#### *Operating controls*

The executive management has defined the operating and financial controls and procedures with which each operating unit is required to comply. Key controls over business risks include reviews against performance indicators and exception reporting.

## CORPORATE GOVERNANCE

### Computer systems

Much of the Company's financial and management information is processed by and stored on computer systems. Accordingly, the Company has established controls and procedures over the security of the data held on computer systems. Also, the Company has put in place arrangements for computer processing to continue and data to be retained in the event of the complete failure of the Company's own data processing facility.

At the year end, the key risk areas have been reviewed by the Audit Committee and the Board to ensure that, as far as possible, the controls are being operated in line with the established procedures. Steps are being taken to embed internal control and risk management further into the operations of the business and to deal with areas of improvement which come to management's and the Board's attention.

### Audit Committee and Auditors

The Audit Committee, which comprised B J Duffin and D A Smith during the year, has specific terms of reference which deal with its authority and duties. It meets at least twice a year, with the external auditors and executive directors attending by invitation. The Committee oversees the monitoring of the adequacy of the Company's internal controls, accounting policies and financial reporting and provides a forum through which the Company's external auditors report to the non-executive directors. Part of each meeting of the Audit Committee is held between the non-executive directors and external auditors in private.

## GOING CONCERN BASIS

As directors of a public company, the directors have certain obligations if the net assets of the Company fall to a level of half or less than the called up share capital. On 6 August 2001, the Company announced at an Extraordinary General Meeting that the net assets of the Company had fallen to such a level and a restructuring of the Company's activities was to be implemented with effect from 1 August 2001 as part of their action to address this position. This restructuring involves the transfer of trading activities to a subsidiary company. As described in the Chairman's and Chief Executive's Statements, the Club's ongoing strategy is to address the imbalance between costs and revenues and to ensure the adequacy of the long term capital structure of the Company in that context.

As a further element of that strategy, the Board is currently in negotiations with the Company's bankers regarding the long-term financing of activities. Currently, as disclosed in Notes 13 and 14 of the financial statements, the Company finances its operations by a mixture of bank overdraft and other long term loans. The current bank overdraft facility was offered for renewal in August 2001 and the Board is currently negotiating the terms of that renewal in the context of the Company's anticipated short to medium term requirements and of the long term capital and financing structure of the Company. The Board expects that these discussions will be concluded satisfactorily.

After making enquiries, and on the basis that the negotiations with the Company's bankers referred to above are satisfactorily concluded, the directors have formed a judgement that, at the time of approving the financial statements, there is a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements. The financial statements do not include any adjustments which would result from the going concern basis no longer being appropriate.

**CORPORATE GOVERNANCE****COMPLIANCE STATEMENT**

The Listing Rules require the Board to report on compliance with the forty-five Code provisions throughout the accounting period. Save the limited exceptions outlined below, the Company has complied throughout the accounting period ended 31 July 2001 with the provisions set out in Section 1 of the Code:

A.2.1 There was no Senior Independent Director during the period given the present size of the Board. All decisions rest with the Board as a whole, which comprises two executive directors and three independent non-executive directors.

B.1.4 The remuneration of the executive directors does not include elements which are directly variable based on specific performance criteria as set out in the Code, although the level of salary is approved annually by the Remuneration Committee based on overall performance.

D.3.1 The Audit Committee did not comprise of at least three non-executive directors following the resignation of F S Jackson. It is intended that D W Archer will be appointed to the Committee.

## CORPORATE GOVERNANCE

## REPORT OF THE BOARD TO THE SHAREHOLDERS ON DIRECTORS' REMUNERATION

## Remuneration Committee

The Committee consisted solely of two non-executive directors during the year: B J Duffin and D A Smith. None of the Committee members has any personal financial interests (other than as shareholders), conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. The Committee consults the Chief Executive about its proposals and has access to professional advice from inside and outside the Company. The Committee makes recommendations to the Board. No director plays a part in any discussion about his own remuneration.

## Remuneration Policy

It is the aim of the Committee to reward the executive directors not only competitively but to encourage team effectiveness. With the exception of the share option scheme, under which no options have been granted in the current or prior years, there are no long term incentive schemes.

## Remuneration Summary

The various elements of remuneration received by each director for the year from their date of appointment or to their date of resignation are summarised below:-

					2001	2000
	Fees	Salary	Benefits	Pension	Total	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Executive</b>						
C P Robinson	-	121.0	15.1	12.0	148.1	142.9
A S Fraser	-	45.4	8.5	4.8	58.7	44.2
	-	166.4	23.6	16.8	206.8	187.1
<b>Non-Executive</b>						
L G Deans (resigned 3.9.99)	-	-	-	-	-	1.2
C G Wilson (resigned 25.11.99)	-	-	-	-	-	2.5
F S Jackson (resigned 20.12.00)	-	-	-	-	-	-
B J Duffin	7.5	-	-	-	7.5	7.5
D A Smith	15.0	-	-	-	15.0	13.8
A Flanagan	-	-	-	-	-	-
	22.5	-	-	-	22.5	25.0

F S Jackson and A Flanagan waived their rights to remuneration for the financial period.

The pension element of remuneration for A S Fraser represents amounts paid into the Group Personal Pension Scheme during the year. Pension contributions for C P Robinson represent amounts payable to a Personal Pension Scheme under his service contract. All pension contributions relate to defined contribution schemes.



## CORPORATE GOVERNANCE

### Share Options

The Company operates a share option scheme which provides for the grant of options under (a) an Inland Revenue approved share option scheme and (b) an unapproved share option scheme. The unapproved scheme is intended primarily for executives who have, or are to be granted options in excess of the individual limit permitted under the approved scheme. Save to the extent required in order to obtain Inland Revenue approval, the two sections of the scheme are in all respects identical.

Options may only be granted (i) within 90 days following the date of adoption of the scheme or (ii) within the 42 day period immediately following the preliminary announcement of the final or interim results of the Company.

The aggregate number of ordinary shares which might be issued upon the exercise of options granted under the scheme may not exceed 5% of the Company's issued ordinary share capital.

No option may be granted to an individual under the approved option scheme if the aggregate market value as at the respective dates of grant of ordinary shares would exceed £30,000 or any such limit as may apply under Schedule 9 to the Taxes Act.

No option may be granted to an individual under the unapproved option scheme if, as a result, the aggregate market value (as at the respective dates of grant) of ordinary shares which might fall to be or have been acquired by him upon the exercise of options granted under any share option scheme established by the Company in the immediately preceding ten years, would exceed four times his earnings.

No payment is required for the grant of options.

The exercise price per ordinary share is the greater of (a) its market value of an ordinary share on the date of grant determined by taking the arithmetical average of middle market quotations on three dealing days preceding the related date of the grant and (b) the nominal amount of an ordinary share.

The option price may be adjusted in the event of a rights issue, capitalisation issue or upon consolidation, sub-division or reduction of the Company's share capital.

An option may only be exercised between the third and tenth anniversaries of the date of grant and provided that any performance condition subject to which it is granted has been satisfied.

Options will normally lapse on cessation of employment. Until options are exercised, option holders will have no voting rights in respect of the ordinary shares. Options are not transferable.

No options have been granted under the scheme during the current year, or in any prior year.

## **CORPORATE GOVERNANCE**

### **Pension Scheme**

In May 1999, the Company introduced a group personal pension scheme for certain executive directors and senior employees. The Company's contributions were between 5% and 10% of basic salary per annum.

The Company has also contracted with certain individual employees to make payments to their personal pension plans.

### **Service Contracts**

It is the Company's policy that contracts for the employment or for the services of all executive directors provide for periods of notice of termination of not less than six months.

All non-executive directors agreed the terms relating to their appointment by the Company on 13 March 1997 or, if later, the date of appointment and these are reviewed annually.

The Committee is firmly of the view that the contractual arrangements are the minimum necessary to attract and retain executives of the appropriate calibre.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit or loss of the Company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act. 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 AUDITORS' REPORT TO THE MEMBERS OF HEART OF MIDLOTHIAN PLC**

We have audited the financial statements of Heart of Midlothian Plc for the year ended 31 July 2001 which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes 1 to 24. These financial statements have been prepared under the accounting policies set out therein.

### **Respective responsibilities of directors and auditors**

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards, and the Listing Rules of the Financial Services Authority.

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 if, in our opinion, the directors' report is not consistent with the financial statements, if 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 or the Listing Rules regarding directors' remuneration and transactions with the Company is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules and we report if it does not. We are not required to consider whether the Board's statement on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

### **Basis of audit opinion**

We conducted our audit in accordance with United Kingdom auditing standards 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 judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company, 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.

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF  
HEART OF MIDLOTHIAN PLC**

*Going Concern*

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the adoption of the going concern basis in the light of the discussions in progress with the Company's bankers, the renewal of the current borrowing facilities and the restructuring of the Company's trading operations announced to shareholders at an Extraordinary General Meeting in August 2001 following the reduction in net assets to a level below half of the called-up share capital. In view of the significance of this uncertainty, we consider that this matter should be drawn to your attention, but our opinion is not qualified in this respect.

**Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 July 2001 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Chartered Accountants and Registered Auditors  
Edinburgh  
10 October 2001

## PROFIT AND LOSS ACCOUNT

Year ended 31 July 2001

	Note	Operations excluding player trading £'000	Player trading £'000	2001 Total £'000	2000 (as restated) £'000
<b>TURNOVER</b>	2				
Gate receipts		4,091	-	4,091	3,599
Other income		3,856	-	3,856	3,461
		<u>7,947</u>	<u>-</u>	<u>7,947</u>	<u>7,060</u>
Staff costs (including £1.1 million exceptional items)	3	(7,184)	-	(7,184)	(5,586)
Depreciation and other amounts written off tangible and intangible fixed assets, net of grant release		(289)	(1,321)	(1,610)	(1,778)
Other operating charges		<u>(2,805)</u>	<u>-</u>	<u>(2,805)</u>	<u>(2,991)</u>
		<u>(10,278)</u>	<u>(1,321)</u>	<u>(11,599)</u>	<u>(10,355)</u>
<b>OPERATING LOSS</b>		<u>(2,331)</u>	<u>(1,321)</u>	<u>(3,652)</u>	<u>(3,295)</u>
Gain on sale of players' registrations		-	408	408	53
		<u>-</u>	<u>408</u>	<u>408</u>	<u>53</u>
<b>LOSS ON ORDINARY ACTIVITIES BEFORE INTEREST</b>		<u>(2,331)</u>	<u>(913)</u>	<u>(3,244)</u>	<u>(3,242)</u>
Interest payable and similar charges	4			(532)	(440)
				<u>(532)</u>	<u>(440)</u>
<b>LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	5			(3,776)	(3,682)
Tax on loss on ordinary activities	6			-	-
				<u>-</u>	<u>-</u>
<b>RETAINED LOSS FOR THE FINANCIAL PERIOD</b>	20			<u>(3,776)</u>	<u>(3,682)</u>
<b>Basic loss per ordinary share</b>	7			<u>(29.9)p</u>	<u>(30.1)p</u>
<b>Diluted loss per ordinary share</b>	7			<u>(22.7)p</u>	<u>(23.9)p</u>

All of the activities of the Company are classified as continuing operations.

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**  
Year ended 31 July 2001

	2001 £'000	2000 £'000
Loss for the financial period	(3,776)	(3,682)
Unrealised deficit on revaluation of fixed assets	-	(431)
Total recognised gains and losses relating to the financial period	<u>(3,776)</u>	<u>(4,113)</u>

**NOTE OF HISTORICAL COST PROFITS AND LOSSES**

Reported loss on ordinary activities before taxation	(3,776)	(3,682)
Difference between historical cost depreciation charge and actual depreciation charge for the period calculated on the revalued amount	<u>29</u>	<u>38</u>
Historical cost loss on ordinary activities before taxation	<u>(3,747)</u>	<u>(3,644)</u>
Historical cost loss for the financial period	<u>(3,747)</u>	<u>(3,644)</u>

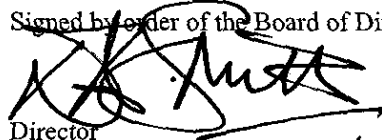
## BALANCE SHEET

31 July 2001

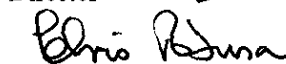
	Note	2001 £'000	2000 £'000
<b>FIXED ASSETS</b>			
Intangible assets	8	1,383	2,459
Tangible assets	9	11,435	11,640
		<u>12,818</u>	<u>14,099</u>
<b>CURRENT ASSETS</b>			
Stock		183	71
Debtors	11	2,380	3,411
		<u>2,563</u>	<u>3,482</u>
<b>CREDITORS: amounts falling due within one year</b>	12	<u>(10,245)</u>	<u>(7,878)</u>
<b>NET CURRENT LIABILITIES</b>		<u>(7,682)</u>	<u>(4,396)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>5,136</u>	<u>9,703</u>
<b>CREDITORS: amounts falling due after more than one year</b>			
Convertible loan stock	13	(4,754)	(4,526)
Other creditors	13	(2,967)	(3,986)
		<u>(7,721)</u>	<u>(8,512)</u>
		<u>(2,585)</u>	<u>1,191</u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	17	1,263	1,263
Share premium account	18	3,147	3,173
Revaluation reserve	19	993	1,022
Profit and loss account - deficit	20	(7,988)	(4,267)
<b>EQUITY SHAREHOLDERS' FUNDS</b>	21	<u>(2,585)</u>	<u>1,191</u>

These financial statements were approved by the Board of Directors on 10 October 2001.

Signed by order of the Board of Directors



Director



Director



**CASH FLOW STATEMENT**

Year ended 31 July 2001

	Note	2001 £'000	2000 £'000
Net cash outflow from operating activities	i	(2,950)	(2,244)
Returns on investments and servicing of finance	ii	(304)	(440)
Capital expenditure and financial investment	ii	43	(1,521)
		<u>(3,211)</u>	<u>(4,205)</u>
Financing	ii	(236)	7,524
(Decrease)/increase in cash in the period		<u>(3,447)</u>	<u>3,319</u>

**RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT (NOTE iii)**

	2001 £'000	2000 £'000
(Decrease)/increase in cash in the period	(3,447)	3,319
Cash flow from movement in debt and hire purchase financing	236	(4,100)
	<u>(3,211)</u>	<u>(781)</u>
Change in net debt resulting from cash flows		
Amortisation of finance costs	(26)	-
Interest accrual capitalised into debt	(202)	-
	<u>(3,439)</u>	<u>(781)</u>
Opening net debt	(6,799)	(6,018)
Closing net debt	<u>(10,238)</u>	<u>(6,799)</u>

## NOTES TO THE CASH FLOW STATEMENT

Year ended 31 July 2001

## i RECONCILIATION OF OPERATING LOSS TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	2001 £'000	2000 £'000
Operating loss	(3,652)	(3,295)
Depreciation	325	336
Amortisation	1,321	1,480
(Increase)/decrease in stocks	(112)	48
Decrease/(increase) in debtors	1,031	(1,698)
(Decrease)/increase in creditors	(1,863)	885
	<u>(2,950)</u>	<u>(2,244)</u>

## ii GROSS CASH FLOWS

	2001 £'000	2000 £'000
<b>Returns on investments and servicing of finance</b>		
Interest paid	<u>(304)</u>	<u>(440)</u>
<b>Capital expenditure and financial investment</b>		
Payments to acquire players' registrations	(827)	(1,684)
Payments to acquire tangible fixed assets	(120)	(73)
Receipts from sales of players' registrations	990	190
Receipts of grants from Football Trust and 500 Club	-	46
	<u>43</u>	<u>(1,521)</u>
<b>Financing</b>		
Hire purchase repayments	(144)	(149)
Loan repayments	(92)	(277)
Loan advances	-	4,642
Expenses paid in connection with share issue	-	(116)
Issue of ordinary share capital	-	3,519
Expenses paid in connection with share issue	-	(95)
	<u>(236)</u>	<u>7,524</u>

## iii ANALYSIS OF CHANGES IN NET DEBT

	At 1 August 2000 £'000	Cash flows £'000	Other non- cash changes £'000	At 31 July 2001 £'000
Bank overdraft	(1,740)	(3,447)	-	(5,187)
Debt due after 1 year	(4,721)	75	(228)	(4,874)
Debt due within 1 year	(93)	17	-	(76)
Hire purchase liabilities	(245)	144	-	(101)
	<u>(6,799)</u>	<u>(3,211)</u>	<u>(228)</u>	<u>(10,238)</u>

**NOTES TO THE FINANCIAL STATEMENTS****Year ended 31 July 2001****1 ACCOUNTING POLICIES****Basis of Preparation**

The financial statements have been prepared in accordance with applicable accounting standards and the historical cost convention as modified to incorporate the revaluation of certain tangible fixed assets.

In adopting FRS 18 during the financial year there has been no impact on the financial results for the current or previous year.

**Going Concern**

After making the enquiries referred to in the statement on the going concern basis set out in the Board's Report on Corporate Governance on page 12, the directors have adopted the going concern basis in preparing the financial statements.

**Restatement**

In the year ended 31 July 2000, the amortisation of players' registrations was shown separately on the face of the profit and loss account. To accord with industry best accounting practice, the presentation has been amended within these financial statements to include the amortisation charge within depreciation and other amounts written off fixed assets. Comparatives for the year ending 31 July 2000 have been amended accordingly and are set out in detail below:

	<b>Operations excluding player trading £'000</b>	<b>Player trading £'000</b>	<b>2000 Total £'000</b>
<b>TURNOVER</b>			
Gate receipts	3,599	-	3,599
Other income	3,461	-	3,461
	<hr/> 7,060 <hr/>	<hr/> - <hr/>	<hr/> 7,060 <hr/>
Staff costs	(5,586)	-	(5,586)
Depreciation and other amounts written off tangible and intangible fixed assets, net of grant release	(298)	(1,480)	(1,778)
Other operating charges	(2,991)	-	(2,991)
	<hr/> (8,875) <hr/>	<hr/> (1,480) <hr/>	<hr/> (10,355) <hr/>
<b>OPERATING LOSS</b>	<hr/> (1,815) <hr/>	<hr/> (1,480) <hr/>	<hr/> (3,295) <hr/>
Gain on sale of players' registrations	-	53	53
	<hr/> - <hr/>	<hr/> 53 <hr/>	<hr/> 53 <hr/>
<b>LOSS ON ORDINARY ACTIVITIES BEFORE INTEREST</b>	<hr/> (1,815) <hr/>	<hr/> (1,427) <hr/>	<hr/> (3,242) <hr/>

**Consolidated Financial Statements**

Consolidated financial statements have not been prepared as the subsidiary undertakings, as listed in Note 10, were dormant throughout the current and preceding periods and their assets and liabilities are wholly immaterial. Consequently there would be no material difference between the parent Company financial statements and the consolidated financial statements.

**NOTES TO THE FINANCIAL STATEMENTS****Year ended 31 July 2001****1. ACCOUNTING POLICIES - CONTINUED****Depreciation**

No depreciation is provided on land. Freehold buildings are depreciated at a rate of 2% per annum with the exception of those parts of Tynecastle Stadium which had not been redeveloped as at the period end. These are depreciated at a rate of 4% per annum to reflect more accurately the estimated useful lives of those assets. In adopting FRS 15, the directors have elected to continue to carry freehold property at valuation.

For other tangible fixed assets (principally plant and equipment), depreciation is calculated to write down their cost or valuation over their estimated lives, which are considered to be between 4 and 10 years.

**Deferred Taxation**

Deferred taxation is provided at the anticipated tax rates on differences arising from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

**Players' Registrations**

Players' registrations and ancillary costs are capitalised and amortised over the respective contract periods. Any permanent diminution in the value of registrations is charged to the profit and loss account when identified.

**Grants Receivable**

Grants receivable in respect of tangible fixed assets, including the stadium redevelopment, are treated as a deferred credit and are released to the profit and loss account over the estimated useful life of the assets concerned. Revenue grants received from the Football Trust towards police charges are included in the profit and loss account on an accrual basis as a deduction from operating expenses.

**Stock**

Stock consists of goods held for resale and is valued at the lower of cost and net realisable value.

**Leasing and Hire Purchase**

Assets held under finance leases and hire purchase contracts and the related obligations are recorded in the balance sheet at the fair value of the assets at the inception of the agreements. The excess of payments over the recorded obligations are treated as finance charges in the profit and loss account.

Rental costs under operating leases are charged to the profit and loss account in equal annual amounts over the periods of the leases.

**Pension Costs**

Pension costs are charged to the profit and loss account as they become payable in accordance with the rules of the Company group personal pension scheme, which is a defined contribution scheme, and other individual contractual arrangements.

**2. TURNOVER**

Turnover is the amount derived from all trading activities, exclusive of value added tax. Sales of players' registrations are not included within turnover in accordance with FRS 3 Reporting Financial Performance and industry practice.

The directors consider that all turnover and operating losses arise from a single business segment.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 3. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	2001 £'000	2000 £'000
<b>Staff costs including directors' emoluments</b>		
Wages and salaries	5,468	5,235
Pension contributions	25	22
Social security costs	583	655
Exceptional items – compensation payments to players and coaching staff	1,108	-
	<u>7,184</u>	<u>5,912</u>
	<b>No</b>	<b>No</b>
<b>Average number employed excluding directors</b>		
Players and coaching staff	72	64
Administration and commercial department staff	23	22
Other staff	10	9
	<u>105</u>	<u>95</u>

Disclosure of individual directors' remuneration, pension contributions and pension entitlements required by the Companies Act 1985 and those specified for audit by the UK Listing Authority are shown in the Board's Report on Directors' Remuneration on pages 14 to 16 and form part of the financial statements.

## 4. INTEREST PAYABLE AND SIMILAR CHARGES

	2001 £'000	2000 £'000
Bank loan, overdraft and other loans	463	395
Amortisation of finance costs	26	-
Hire purchase	43	45
	<u>532</u>	<u>440</u>

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 5. LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

	2001 £'000	2000 £'000
Loss on ordinary activities before taxation is		
after charging/(crediting):		
Auditors' remuneration		
- audit fees	20	20
- other services	11	25
Depreciation of tangible fixed assets		
- owned assets	288	299
- assets held under hire purchase	37	37
Operating lease rentals		
- plant and machinery	11	15
- other	111	41
Release of grants	(36)	(38)
Exceptional item (other operating charges)		
- bad debt charge	-	182

The exceptional bad debt charge in the prior year related to the Company's former strip manufacturer and supplier, Olympic Sportswear, who went into receivership during the year.

The auditors also received remuneration of £47,000 in the prior year in relation to non-audit services, which was set against the share premium account.

## 6. TAXATION

There is no taxation charge on the loss for the year or arising from the sale of players' registrations due to the availability of losses (see Note 15).

## 7. LOSS PER ORDINARY SHARE

Basic	2001	2000
Calculated on the basis of 12,633,636		
(2000 – weighted average 12,214,621) shares in issue and		
loss after tax for the year of £3,776,000 (2000 – £3,682,000)	(29.9)p	(30.1)p
<b>Diluted</b>		
Calculated as above but taking into account the potential conversion of		
loan stock of £4,480,270 issued on 11 October 1999 plus accrued interest		
to 31 July 2001, into 3,125,656 ordinary shares (resulting in a diluted		
15,759,292 (2000 – weighted average 14,750,129) shares in issue) and a		
loss after tax of £3,574,000 (2000 – £3,520,000)	(22.7)p	(23.9)p

The difference between the loss for the year after taxation in the basic and diluted calculations presented above represents interest charged on convertible debt of £202,000 (2000 – £162,000).

NOTES TO THE FINANCIAL STATEMENTS  
Year ended 31 July 2001

## 8. INTANGIBLE FIXED ASSETS

	Players' Registrations £'000
<b>Cost</b>	
At 1 August 2000	5,376
Additions	827
Disposals	(2,035)
At 31 July 2001	4,168
<b>Accumulated depreciation</b>	
At 1 August 2000	2,917
Charge for the year	1,321
Disposals	(1,453)
At 31 July 2001	2,785
<b>Net book value</b>	
At 31 July 2001	1,383
At 31 July 2000	2,459

## 9. TANGIBLE FIXED ASSETS

	Freehold Land and Buildings £'000	Memor- abilia £'000	Plant and Equipment £'000	Total £'000
<b>Cost or valuation</b>				
At 1 August 2000	11,200	159	1,135	12,494
Additions	71	-	49	120
Disposals	-	-	(5)	(5)
At 31 July 2001	11,271	159	1,179	12,609
<b>Accumulated depreciation</b>				
At 1 August 2000	-	-	854	854
Charge for the year	223	-	102	325
Disposals	-	-	(5)	(5)
At 31 July 2001	223	-	951	1,174
<b>Net book value</b>				
At 31 July 2001	11,048	159	228	11,435
At 31 July 2000	11,200	159	281	11,640

The net book value of assets held under hire purchase contracts at 31 July 2001 is £547,000 (2000 - £584,000).

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 9. TANGIBLE FIXED ASSETS (continued)

Ryden, Chartered Surveyors, valued the land and buildings as at 31 July 2000 on a Depreciated Replacement Cost basis at £11.2 million on the basis of the Practice Statements contained within the Royal Institution of Chartered Surveyors Appraisal & Valuation manual. The directors have reviewed the carrying value of land and buildings at the year end and have not identified any material changes to circumstances or to any valuation assumptions which would materially affect the carrying value.

**Land and buildings**

If stated under historical cost principles, the comparable amounts would be:

	2001 £'000	2000 £'000
Cost	11,541	11,470
Accumulated depreciation	(1,327)	(1,133)
	<u>10,214</u>	<u>10,337</u>

During the period to 31 July 1998, Mark Medcalf Associates, valued memorabilia owned by the Company at £159,000 on the basis of open market value and this revaluation has been incorporated in the financial statements. On the historic cost basis, these items were previously carried at £Nil cost and £Nil net book value. Under the transitional arrangements of FRS 15 the directors elected to 'freeze' the carrying value of these revalued assets in the prior year.

## 10. INVESTMENTS

The Company owns the entire issued share capital of Heart of Midlothian Commercial Limited and Heart of Midlothian Publishing Limited which are dormant subsidiary undertakings, each of which is carried at cost of £100 and has net assets of £100. Both subsidiary companies are registered in Scotland.

## 11. DEBTORS

	2001 £'000	2000 £'000
Trade debtors	737	992
Sundry debtors	46	137
Prepayments and accrued income	1,597	2,282
	<u>2,380</u>	<u>3,411</u>

Prepayments include signing on fees of £248,000 (2000 - £1,321,000) which will reverse after more than one year.

## 12. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2001 £'000	2000 £'000
Bank loan and overdraft (Note 13)	5,187	1,755
Deferred income (Note 16)	2,206	2,886
Trade creditors	440	798
Other creditors and accruals	1,752	1,557
Taxation and social security	488	649
Finance lease and hire purchase creditors	96	155
Other loans (Note 13)	76	78
	<u>10,245</u>	<u>7,878</u>



## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 13. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2001 £'000	2000 £'000
Other loans	120	195
Finance lease and hire purchase creditors	5	90
Other creditors and accruals	813	1,622
Deferred income (Note 16)	2,029	2,079
	<u>2,967</u>	<u>3,986</u>
The bank loan is repayable in instalments as follows:		
Within one year	-	15
Other loans are repayable in instalments as follows:		
Within one year (Note 12)	76	78
Between one and two years	15	75
Between two and five years	45	45
After more than five years	60	75
	<u>196</u>	<u>273</u>

Interest on the bank loan and overdraft is payable at 1.5% over the Bank of Scotland base rate. Bank borrowings are secured by a bond and floating charge over all the assets of the Company, a first ranking standard security over Tynecastle Stadium and a second ranking standard security over land at Wheatfield Street yard, Edinburgh.

Other loans include £61,000 bearing interest at 5% over the Bank of Scotland base rate and secured by means of a first ranking standard security over Wheatfield Street yard. Other loans also include £135,000 payable to Scottish & Newcastle plc bearing interest at 2% over base rate and secured by means of a standard security over Tynecastle Stadium and a bond and floating charge over all the assets of the Company, both ranking second behind those granted in favour of Bank of Scotland.

Obligations under finance lease and hire purchase contracts are secured by the related assets. All amounts are repayable within five years.

Convertible loan stock was issued to SMG Investments Limited on 11 October 1999. The stock bears interest at 4.5% per annum and is secured by a bond and floating charge over the assets of the company. On the second, third and fourth anniversaries of the subscription date the holder is entitled to convert all or part of the convertible loan stock at a rate of 66.6667 ordinary shares per £100 nominal of convertible loan stock. In addition, the holder is entitled to convert the accrued interest on the convertible loan stock into ordinary shares on such dates at the rate of 68.7617 ordinary shares per £100 of interest.

	2001 £'000	2000 £'000
Convertible loan stock	4,844	4,642
Less: finance costs	(90)	(116)
	<u>4,754</u>	<u>4,526</u>

If the option to convert to ordinary shares is not exercised the loan stock, together with accrued interest, falls due for repayment in four equal instalments on 31 March 2006, 30 September 2006, 31 March 2007 and 30 September 2007.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 14. FINANCIAL INSTRUMENTS

The Company does not trade in financial instruments or hold derivative instruments or any assets or liabilities denominated in foreign currencies.

The Company finances its operations by a mixture of bank borrowings and long term loans. The Company borrows at both fixed and floating rates of interest to generate the desired interest profile and to manage the Company's exposure to interest rate fluctuations. At the year end 47.4% of the Company's borrowings were at fixed rates.

*Short term debtors and creditors have been omitted from all disclosures given below.*

## Maturity of borrowings and facilities

	Bank borrowings and loans	Other	2001 Total	Bank borrowings and loans	Other	2000 Total
	£'000	£'000	£'000	£'000	£'000	£'000
Within one year or less or on demand	5,187	172	5,359	1,755	233	1,988
More than one year but not more than two years	-	20	20	-	160	160
More than two years but not more than five years	-	1,233	1,233	-	50	50
More than five years	-	3,626	3,626	-	4,601	4,601
	<u>5,187</u>	<u>5,051</u>	<u>10,238</u>	<u>1,755</u>	<u>5,044</u>	<u>6,799</u>

In the maturity analysis of the Company's financial liabilities, 'Other' includes liabilities shown as other loans, finance lease and hire purchase creditors.

The Company had no undrawn committed borrowing facilities at 31 July 2001 or 31 July 2000.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 14. FINANCIAL INSTRUMENTS (continued)

## Interest rate profile

	Total £'000	Floating rate financial liabilities £'000	Fixed rate financial liabilities £'000	Financial liabilities on which no interest is paid £'000
<b>Currency</b>				
At 31 July 2001				
Sterling	10,238	5,383	4,855	-
At 31 July 2000				
Sterling	6,799	2,028	4,771	-

Interest on floating rate liabilities is based on the relevant national inter-bank rates.

	Weighted average interest rate	Weighted average period for which the rate is fixed	Weighted average period until maturity
<b>Currency</b>			
At 31 July 2001			
Sterling	4.7%	73 months	-
At 31 July 2000			
Sterling	5.1%	82 months	-

## Fair values of financial liabilities

	2001		2000	
	Carrying Amount £'000	Estimated fair value £'000	Carrying amount £'000	Estimated fair value £'000
Primary financial instruments held or issued to finance the Company's operations				
Bank borrowings	5,187	5,187	1,755	1,755
Convertible loan stock	4,754	4,113	4,526	3,746
Finance lease and hire purchase creditors	101	101	245	245
Other liabilities	196	196	273	273
Gross financial liabilities	10,238	9,597	6,799	6,019

The fair value of the liabilities other than convertible loan stock have been calculated by discounting expected cash flows at prevailing interest rates at the year end. The directors consider that there were no significant differences between carrying value and fair value at 31 July 2001 and 31 July 2000.

The fair value of convertible loan stock is calculated with reference to the company's marginal borrowing rate and on the basis that conversion rights are not exercised.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 15. DEFERRED TAX

Unrecognised deferred tax asset	2001 £'000	2000 £'000
Tax value of available losses	4,731	4,067
Revaluation	(47)	(47)
Short term timing differences	6	-
Accelerated capital allowances	461	224
	<u>5,151</u>	<u>4,244</u>

No deferred tax has been provided in the financial statements or included in the table above in respect of the revaluation surplus arising on Tynecastle Stadium as it is estimated that no tax charge would arise on a disposal at the revalued amount.

## 16. DEFERRED INCOME

	2001 £'000	2000 £'000
<b>Grants receivable from the Football Trust</b>		
At 1 August 2000	1,810	1,802
Amounts receivable during year	-	46
Released to profit and loss account	(36)	(38)
At 31 July 2001	<u>1,774</u>	<u>1,810</u>
<b>Deferred income from "500 Club" and "New 500 Club"</b>		
At 1 August 2000	437	615
Released to profit and loss account	(126)	(178)
At 31 July 2001	<u>311</u>	<u>437</u>
<b>Other deferred income</b>	<u>2,150</u>	<u>2,718</u>
	<u>4,235</u>	<u>4,965</u>
Deferred income is disclosed as follows:		
Amounts falling due within one year (Note 12)	2,206	2,886
Amounts falling due after more than one year (Note 13)	2,029	2,079
	<u>4,235</u>	<u>4,965</u>

The Company has agreed to give future discounts on season tickets and the purchase of club merchandise to members of the "500 Club", an independent entity. In return for this concession, the "500 Club" provided funds for the development of Tynecastle Stadium. Monies received from the "500 Club" are released to the profit and loss account over six years.

Funds raised, through the "New 500 Club", which were for the development of the Gorgie Road End of Tynecastle Stadium, are released to the profit and loss account over six years commencing in the year to 31 July 1998.

Other deferred income principally represents amounts received from the sale of season tickets and sponsorship income.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 17. CALLED UP SHARE CAPITAL

	2001		2000	
	Number of shares	£'000	Number of shares	£'000
<b>Authorised</b>				
Ordinary shares of 10p each	13,000,000	1,300	13,000,000	1,300
<b>Allotted, called up and fully paid</b>				
Ordinary shares of 10p each	12,633,636	1,263	12,633,636	1,263

## 18. SHARE PREMIUM ACCOUNT

	£'000
At 1 August 2000	3,173
Transfer of finance costs amortised	(26)
At 31 July 2001	3,147

## 19. REVALUATION RESERVE

	£'000
At 1 August 2000	1,022
Transfer to profit and loss account	(29)
At 31 July 2001	993

## 20. PROFIT AND LOSS ACCOUNT – DEFICIT

	£'000
At 1 August 2000	(4,267)
Loss for the financial period	(3,776)
Transfer of finance costs amortised	26
Transfer from revaluation reserve	29
At 31 July 2001	(7,988)

## 21. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2001 £'000	2000 £'000
Loss for the financial period	(3,776)	(3,682)
New share capital subscribed	-	251
Share premium on issue	-	3,173
Deficit on revaluation of fixed assets	-	(431)
Opening shareholders' funds	1,191	1,880
Closing shareholders' funds	(2,585)	1,191

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 July 2001

## 22. FINANCIAL COMMITMENTS AND CONTINGENCIES

At 31 July 2001, the Company had annual commitments under operating leases as follows:

	2001		2000	
	Land & Buildings £'000	Other £'000	Land & Buildings £'000	Other £'000
Expiring within one year	45	1	45	18
Expiring between two and five years	9	34	9	62
Expiring after five years	30	-	30	-
	<u>84</u>	<u>35</u>	<u>84</u>	<u>80</u>

In the course of acquiring players' registrations from other football clubs and securing the services of its playing and coaching staff, the Company enters into agreements which may require future payments based on the acquired players' achievements or the future income receivable by the Company upon the sale of registrations and agreements which may require payments in the form of compensation on termination of contracts. No provision has been made for the potential liability as it relates to player appearances and other events subsequent to the year end and cannot be quantified in full. Commitments totalling £Nil (2000 - £794,500) have been identified and further potential liabilities cannot currently be quantified.

## 23. PENSION SCHEME

The Company operates a group personal pension scheme for certain employees and also makes payments to the personal pension plans of certain other employees. Pension contributions amounting to £25,000 (2000 - £22,000) were paid by the Company during the period. As at 31 July 2001 £Nil was accrued in respect of contributions due (2000 - £20,400).

## 24. POST BALANCE SHEET EVENTS

On 6 August 2001 the Company held an Extraordinary General Meeting to advise shareholders that the net assets of the Company had fallen to a level of half or less than the called up share capital, as required under the Companies Act. It was announced that the trading activities of the football club would be transferred into a subsidiary company, Heart of Midlothian Football Club Limited. This will allow the plc to more easily enter into potential future commercial developments.

On 1 September 2001 the player registration of Colin Cameron was sold for £1,750,000. The proceeds give rise to a gain over the net book value, after deduction of ancillary costs, of £1,527,000.

**NOTICE OF ANNUAL GENERAL MEETING**

Tynecastle Stadium  
Gorgie Road  
Edinburgh  
EH11 2NL

10 October 2001

**NOTICE IS HEREBY GIVEN** that the Ninety-sixth Annual General Meeting of Heart of Midlothian plc will be held in the Gorgie Suite, Tynecastle Stadium, Gorgie Road, Edinburgh on 12 November 2001 at 6pm for the following purposes:-

**Ordinary Business**

As ordinary business:-

- 1 To receive and consider the Report of the Directors, the Accounts for the year ending 31 July 2001 and the Report of the Auditors thereon.
- 2 To re-appoint Douglas Smith as a Director.
- 3 To re-appoint Deloitte & Touche as auditors and to authorise the Directors to determine the auditors' remuneration.

**Special Business**

As special business, to consider, and if thought fit, to pass the following resolutions:-

- 4 THAT the Directors be empowered pursuant to section 95(1) of the Companies Act 1985 ("the Act") during the period expiring on the commencement of the next Annual General Meeting or in any event 31 December 2002, to allot equity securities (within the meaning of section 94(2) of the Act) as if section 89 (1) of the Act did not apply to such allotment, provided that the Company may at any time before such power expires make an offer or agreement which would or might require equity securities (as so defined) to be allotted after such power has expired and the Directors may allot equity securities (as so defined) as if such power had not expired and provided further that such power shall be limited:-
  - a. to the allotment (otherwise than pursuant to sub-paragraph b of this resolution) of equity securities (as so defined) which are, or are to be, wholly paid in cash up to aggregate nominal amount of £63,168and
  - b. to the allotment (otherwise than pursuant to sub-paragraph a of this resolution) of equity securities (as so defined) in connection with a rights issue or open offer in favour of shareholders where the equity securities (as so defined) respectively attributable to the interests of the shareholders are proportionate (as nearly as may be) to the respective numbers of Ordinary Shares of 10p each in the Company held by them but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of, or requirements of any recognised body in, any territory.

and shall be in substitution for any existing authority granted to the Directors to make any such allotment.

- 5 That the Articles of Association of the Company be and are hereby amended by deleting the reference to "£9 million" in the last sentence of Article 18.2 and substituting "£12 million" therefor.

By order of the Board

Andrew Stewart Fraser  
Secretary

**NOTICE OF ANNUAL GENERAL MEETING****Explanation of Resolutions Proposed**

As part of the ordinary business of the meeting the re-appointment of Deloitte & Touche will be moved.

As part of the special business at the meeting:

**Allotment of shares and waiver of pre-emption rights**

In resolution 4 it is proposed, by way of an ordinary resolution, to authorise the Directors to allot unissued share capital up to a nominal amount of £421,121 (representing just under one third of the nominal value of issued ordinary shares) for a five year period as stated last year. As stated last year it is the intention of the Board to continue the practice of renewing this authority annually.

At last year's Annual General Meeting the Directors were empowered to make limited issues of Ordinary Shares for cash without first being required to offer such shares to Shareholders in accordance with the provisions of the Companies Act. *The authority sought in Resolution 4 which will be proposed as a special resolution, will permit the Directors to allot up to £63,168 in nominal value of ordinary shares (representing just under 5% of the issued share capital) for cash and to issue shares offered by way of rights in either case during the period expiring on the date of the Annual general Meeting to be held in 2002.*

The Directors have no plan at present to issue new shares but they believe it is in the interests of the Company for these authorities to be renewed. The authorities sought, conform with guidelines issued by the investor protection bodies to ensure shareholders' interests are safeguarded on such new issues.

**Amendment to Articles of Association**

Resolution 5 has the effect of increasing the borrowing powers of the Directors from the current £9 million which was put in place at the time of the investment by SMG plc to an increased figure of £12 million (subject to prior approval of SMG plc). The additional borrowings limit will assist the Company.

**Notes:**

1. Any member of the Company entitled to attend and vote at the meeting may appoint one or more proxies to attend and vote at the meeting instead of him. A proxy need not be a member of the Company. A form of proxy is enclosed and to be effective must be returned to Lloyds TSB Registrar's Department 117 Dundas Street Edinburgh so as to be received not later than 48 hours prior to the time of the meeting.
2. Members attending should bring this notice and some form of identification with them as this may be requested on admission.
3. The registration of shares will be suspended from 10 October 2001 until 12 November 2001 (both dates inclusive).
4. Copies of the service contracts for each of the Directors of the Company are available for inspection during normal business hours (9am to 5pm) Monday to Friday until the date of the meeting at the Company's registered office and will be available for inspection 15 minutes before and during the meeting.
5. The company pursuant to resolution 34 of the Uncertificated Securities Regulations 1995 specifies that only those members registered in the register of members of the Company as at 6pm on 10 November 2001 or in the event that this meeting is adjourned, in the register of members 48 hours prior to the time of the adjourned meeting shall be entitled to attend the vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries to the register of members after 6pm on 10 November 2001 or in the event that this meeting is adjourned, in the register of members 48 hours prior to the time of the adjourned meeting shall be disregarded in determining the rights of any person to attend or vote at the meeting.