Close Brothers Group plc

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**CLOSE BROTHERS GROUP plc**

**The specialist merchant banking group**

**FINAL RESULTS 2006**
**(under International Financial Reporting Standards)**

**Financial Highlights**

| | 2005 | **2006** | |
|---|---|---|---|
| * Profit before goodwill and taxation | £129m | **£157m** | +21% |
| * Earnings per share before goodwill | 62.0p | **74.1p** | +19% |
| * Profit before taxation | £112m | **£157m** | +41% |
| * Earnings per share | 49.8p | **74.1p** | +49% |
| * Dividends per share | 28.5p | **32.5p** | +14% |
| * Shareholders' funds | £578m | **£662m** | +15% |
| * Total assets | £4.8bn | **£4.8bn** | |

**Operational Highlights**

* **Asset Management** profit up 21% to £38 million. FuM up 16% to £8.2 billion.
* **Corporate Finance** record profit of £17 million.
* **Securities** profit up 34% to £48 million.
* **Banking** record profit of £74 million and bad debts remained well contained.

Colin Keogh, Chief Executive, commenting on the results said:

"We achieved a record profit in 2006 in a year in which the economic climate was relatively benign and stock markets performed well.

Looking forward, the general UK political and economic outlook is becoming somewhat opaque, with risks perhaps more on the downside (interest rates, inflation and consumer debt) than the upside.

All our businesses have started the new year in good shape and, regardless of the short term economic climate, our confidence in our long term growth prospects remains strong."

Enquiries to:


| | | |
|---|---|---|
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Webcast video interview with Colin Keogh, Chief Executive, Close Brothers Group plc at www.closebrothers.co.uk and www.cantos.com

**CLOSE BROTHERS GROUP plc**
**PRELIMINARY ANNOUNCEMENT OF AUDITED GROUP RESULTS**
**AND CHAIRMAN'S AND CHIEF EXECUTIVE'S STATEMENT**
**FOR THE YEAR ENDED 31ST JULY, 2006**

The following is the full text of the preliminary announcement of results for the financial year ended 31st July, 2006. The financial information in relation to 31st July, 2006 has been extracted from the statutory accounts of the company, which have yet to be adopted by shareholders at general meeting and have yet to be filed with the Registrar of Companies.

## CHAIRMAN'S AND CHIEF EXECUTIVE'S STATEMENT

2006 was an excellent year for Close Brothers with group profit before goodwill and taxation of **£157 million** (2005: £129 million), up **21%**, and earnings per share before goodwill up **19%** to **74.1p** (2005: 62.0p). There was no goodwill impairment this year (2005: £18 million).

In the light of these results, the board, which continues to pursue a progressive dividend policy, recommends an increased final dividend of 22.0p per share which, together with the interim dividend, makes a total dividend for the year of 32.5p per share (2005: 28.5p).

These financial statements reflect for the first time the application of International Financial Reporting Standards. Comparative figures have been adjusted accordingly. The effect on our opening balance sheet was not material. Our profit now includes a charge for share-based remuneration of £3 million (2005: £2 million) but no charge for goodwill amortisation.

**OVERVIEW**

After four consecutive years of earnings growth we were delighted to achieve the group's best ever profit. Asset management, corporate finance and banking all exceeded previous records whilst the securities division produced its highest contribution since the dot com era. Operating income increased 20%, operating margin remained high at 29% and costs remained under firm control with the expense/income ratio steady at 67%. Overall pre-tax return before goodwill impairment on opening capital was 27% (2005: 24%).

In broad terms, market conditions were favourable for our investment banking businesses but were more challenging for banking although the credit quality of our loan book remained good.

The divisional mix of our operating profit before central costs is shown in the table below.

| | 04 | 05 | **06** |
|---|---|---|---|
| | % | % | **%** |
| Asset Management | 13 | 21 | **22** |
| Corporate Finance | 7 | 7 | **9** |
| Securities | 28 | 24 | **27** |
| Banking | 52 | 48 | **42** |
| | 100 | 100 | **100** |

To continue to achieve our goal of delivering long term profit and dividend growth to our shareholders, we have continued to invest in new initiatives.

Our asset management division is implementing a major re-shaping and re-branding exercise following some significant recruitment. The banking division has also recruited further specialist teams and is developing new products to exploit the mortgages market.

On the acquisition front, after an active 2005, this year has been quieter, the only transaction completed being the purchase of a 70% holding in Fortune, a London based fund of hedge funds business, from its management. Whilst a number of opportunities became available during the year, we maintain a disciplined approach to valuation and will only invest where we see real future value. We were encouraged this year by the successful integration of, and strong performances from, all of the deals completed in the previous year with exceptional results being achieved by our new broker dealer in Frankfurt.

Our strategic priorities are to continue to build on the recent strong progress in asset management and to return the growth rate in our banking division to its long term trend. Our securities businesses have strong positions in their respective markets and we see continuing demand for the independent advice offered by our corporate finance business.

We constantly look for acquisition opportunities to strengthen our existing market positions and to take the group into new areas of growth.

**Asset Management**

Our asset management division had another good year with further profit growth and pleasing strategic progress. Profit rose by 21% to £38 million and our funds under management by 16% to £8.2 billion.

On the private client side we saw good growth in profit both on and off shore as we continued to reap the benefits of the earlier reorganisation of our business units. We strengthened our new business development capability and we bolstered our team of private client fund managers. Over the coming year we will be bringing together our private client businesses on and off shore under one brand, Close Wealth Management Group. This will create a solid platform for further growth.

Considerable progress was made in our funds business this year. We announced in April 2006 that we had acquired 70% of Fortune. This acquisition broadens our exposure to alternative asset and multi-manager classes, an important strategic objective, as well as taking us into an area which we believe will be of increasing interest and importance to both private and institutional clients. In the coming year we will be regrouping certain of our funds' activities together under the Close Investments banner. We expect this to result in more productive and cost-effective distribution.

Our private equity business had a record year and we expect continued strong performance in this area.

We remain excited by the prospects for this division.

**Corporate Finance**

Corporate finance had an excellent year with profit up 67% to £17 million. London, Frankfurt and Paris all delivered record performances. The major part of this growth came from mergers and acquisitions work where markets have been buoyant. The other two areas of our business, debt advice and restructuring, have also been busy with our market position and expertise in the latter now recognised as amongst the best in Europe. The division has also won a number of industry awards for successfully completed transactions.

Our opening pipeline is, once again, healthy.

**Securities**

Our securities businesses did well with operating profit up 34% to £48 million.

Winterflood Securities, our UK market-making business which sits at the heart of retail equity and bond trading in London, had a successful year in generally strong markets. Bargain numbers were up significantly on last year although the profit per bargain decreased somewhat. Nevertheless, operating margin held steady at 37% on increased income.

Close Brothers Seydler, our Frankfurt based broker dealer, had an outstanding first full year in the group, with pre-tax profit of £9 million. This was an excellent return on our cost of £21 million. Our business has thrived as German investor interest has recovered strongly on the back of rising equity markets and as the new issues market has returned to life.

Our new financial year has got off to a reasonable start, better in London than Frankfurt, but trading levels are lower than last year.

**Banking**

Banking profit was up 6% to £74 million on a loan book of £1.9 billion which was slightly down on last year. Bad debts remained well contained and provisions as a percentage of the average loan book were 1.0%, an historically low level. Banking continues to provide a high divisional operating margin, which remained steady at 37%.

The planned and profitable run off of a motor finance book acquired last year was the principal cause of this small reduction in our loan book. Good growth in a number of areas, particularly property finance and invoice finance, helped to mitigate the effect of insurance premium deflation and the contraction of our print finance business.

We are not anticipating any immediate improvement in our premium finance business where cyclical premium deflation continues, albeit at a reduced rate. In the meantime, we can see attractive growth prospects in several of our other specialist financing businesses and we have a number of interesting new initiatives under way.

CHAIRMAN'S AND CHIEF EXECUTIVE'S STATEMENT

**BOARD CHANGES**

As previously announced Sir David Scholey will be retiring from the board at the conclusion of our forthcoming Annual General Meeting. After a thorough selection process assisted by external consultants, Sir David will be succeeded as chairman by Mr. Roderick Kent, who served as managing director of Close Brothers for 28 years until 2002 and as a non-executive director since then.

Mr. Strone Macpherson, the senior independent director, will be appointed deputy chairman following our forthcoming Annual General Meeting.

Mr. Bruce Carnegie-Brown was appointed a non-executive director of the company on 22nd June, 2006. We are pleased to welcome him to the board.

Following these changes the board will comprise five executive directors and six independent non-executive directors, in addition to Mr. Kent as chairman.

**OUTLOOK**

We achieved a record profit in 2006 in a year in which the economic climate was relatively benign and stock markets performed well.

Looking forward, the general UK political and economic outlook is becoming somewhat opaque, with risks perhaps more on the downside (interest rates, inflation and consumer debt) than the upside.

All our businesses have started the new year in good shape and, regardless of the short term economic climate, our confidence in our long term growth prospects remains strong.

Sir David Scholey
Chairman

C.D. Keogh
Chief Executive

CONSOLIDATED INCOME STATEMENT
for the year ended 31st July, 2006

| | **2006** **£'000** | 2005 £'000 |
|---|---|---|
| Interest and similar income | **281,926** | 282,841 |
| Interest expense and similar charges | **137,624** | 140,320 |
| Net interest income | **144,302** | 142,521 |
| Fees and commissions income | **302,919** | 228,055 |
| Fees and commissions expense | **(48,913)** | (36,396) |
| Gains less losses arising from dealing in securities | **122,339** | 96,285 |
| Other operating income | **15,627** | 17,019 |
| Other income | **391,972** | 304,963 |
| Operating income | **536,274** | 447,484 |
| Administrative expenses | **346,256** | 285,799 |
| Depreciation and amortisation | **14,083** | 12,145 |
| Impairment losses on loans and advances | **18,621** | 20,044 |
| Total operating costs | **378,960** | 317,988 |
| Operating profit on ordinary activities before impairment losses on goodwill and taxation | **157,314** | 129,496 |
| Impairment losses on goodwill | **-** | 17,735 |
| **Operating profit on ordinary activities before taxation** | **157,314** | 111,761 |
| Taxation | **45,280** | 37,152 |
| Profit on ordinary activities after taxation | **112,034** | 74,609 |
| Profit attributable to minority interests | **3,436** | 2,212 |
| Profit attributable to the shareholders of the company | **108,598** | 72,397 |
| **Basic earnings per share on profit attributable to shareholders** | **74.1p** | 49.8p |
| **Earnings per share before impairment losses on goodwill** | **74.1p** | 62.0p |
| **Diluted earnings per share** | **73.8p** | 49.6p |
| **Dividends per share** | **32.5p** | 28.5p |

All income and profits are in respect of continuing operations.

CONSOLIDATED BALANCE SHEET
at 31st July, 2006

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| **Assets** | | |
| Cash and balances at central banks | **1,272** | 1,244 |
| Settlement accounts | **628,305** | 604,692 |
| Loans and advances to customers | **1,862,023** | 1,939,203 |
| Loans and advances to banks | **510,691** | 786,330 |
| Money market securities | **1,156,768** | 797,498 |
| Debt securities – long positions | **67,066** | 61,345 |
| Equity shares – long positions | **49,623** | 40,377 |
| Loans to money brokers against stock advanced | **156,420** | 158,553 |
| Investment securities | **43,682** | 27,384 |
| Intangible assets – goodwill | **109,807** | 95,711 |
| Intangible assets – other | **2,623** | 1,672 |
| Property, plant and equipment | **42,549** | 38,277 |
| Share of gross assets of joint ventures | **21,743** | 21,624 |
| Share of gross liabilities of joint ventures | **(20,818)** | (20,914) |
| Share of net assets of joint ventures | **925** | 710 |
| Other receivables | **87,549** | 108,949 |
| Deferred taxation assets | **25,362** | 28,976 |
| Prepayments and accrued income | **63,135** | 64,398 |
| Derivative financial instruments | **5,093** | - |
| **Total assets** | **4,812,893** | 4,755,319 |
| **Liabilities** | | |
| Settlement accounts | **573,671** | 561,173 |
| Deposits by customers | **1,843,074** | 1,818,187 |
| Deposits by banks | **168,378** | 108,101 |
| Debt securities – short positions | **54,554** | 49,628 |
| Equity shares – short positions | **21,684** | 20,424 |
| Loans from money brokers against stock advanced | **157,356** | 142,371 |
| Non-recourse borrowings | **150,000** | 200,000 |
| Loans and overdrafts from banks | **363,205** | 494,363 |
| Promissory notes and other debt securities in issue | **358,014** | 367,130 |
| Other liabilities | **219,673** | 182,817 |
| Current taxation liabilities | **16,766** | 19,297 |
| Accruals and deferred income | **136,791** | 138,444 |
| Subordinated loan capital | **75,000** | 75,000 |
| Derivative financial instruments | **12,370** | - |
| **Total liabilities** | **4,150,536** | 4,176,935 |
| **Equity** | | |
| Called up share capital | **36,603** | 36,168 |
| Share premium account | **259,783** | 252,210 |
| Profit and loss account | **346,714** | 279,044 |
| Other reserves | **11,887** | 5,092 |
| Minority interests | **7,370** | 5,870 |
| **Total equity** | **662,357** | 578,384 |
| **Total liabilities and equity** | **4,812,893** | 4,755,319 |

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31st July, 2006

| | **2006** **£'000** | 2005 £'000 |
|---|---|---|
| **Called up share capital** | | |
| Opening balance | **36,168** | 36,066 |
| Exercise of options | **435** | 102 |
| **Closing balance** | **36,603** | 36,168 |
| **Share premium account** | | |
| Opening balance | **252,210** | 250,430 |
| Exercise of options | **7,573** | 1,780 |
| **Closing balance** | **259,783** | 252,210 |
| **Profit and loss account** | | |
| Opening balance | **279,044** | 242,637 |
| Retained profit for the year | **108,598** | 72,397 |
| Dividends | **(42,524)** | (39,240) |
| IAS 39 adjustments at 1st August, 2005 | **(1,589)** | - |
| Other reserve movements | **3,185** | 3,250 |
| **Closing balance** | **346,714** | 279,044 |
| **Other reserves:** | | |
| **ESOP trust reserve** | | |
| Opening balance | **(3,786)** | (3,962) |
| Shares purchased at cost | **(4,926)** | - |
| Shares released at cost | **410** | 176 |
| **Closing balance** | **(8,302)** | (3,786) |
| **Share-based awards reserve** | | |
| Opening balance | **7,614** | 4,285 |
| Charge to the income statement | **3,307** | 1,940 |
| Movement relating to deferred share awards | **887** | 1,389 |
| **Closing balance** | **11,808** | 7,614 |
| **Exchange movements reserve** | | |
| Opening balance | **1,264** | - |
| Currency translation differences | **(326)** | 1,264 |
| **Closing balance** | **938** | 1,264 |
| **Cash flow hedging reserve** | | |
| Opening balance recorded for derivatives under IAS 39 at 1st August, 2005 | **(1,843)** | |
| Movement on derivatives during the year | **1,976** | |
| **Closing balance** | **133** | |
| **Available-for-sale reserve** | | |
| Opening balance under IAS 39 at 1st August, 2005 | **3,431** | |
| Movement on available-for-sale investments | **3,879** | |
| **Closing balance** | **7,310** | |
| **Total other reserves** | **11,887** | 5,092 |
| **Minority interests** | | |
| Opening balance | **5,870** | 4,538 |
| Movement during the period | **1,500** | 1,332 |
| **Closing balance** | **7,370** | 5,870 |
| **Total equity** | **662,357** | 578,384 |

CONSOLIDATED CASH FLOW STATEMENT
for the year ended 31st July, 2006

| | Note | **2006** **£'000** | 2005 £'000 |
|---|---|---|---|
| Net cash inflow from operating activities | 4(a) | **153,418** | 307,161 |
| Net cash outflow from investing activities: | | | |
| Dividends paid to minority interests | | **(1,669)** | (934) |
| Purchase of assets let under operating leases | | **(13,865)** | (11,213) |
| Purchase of property, plant and equipment | | **(8,121)** | (6,920) |
| Sale of property, plant and equipment | | **4,155** | 1,685 |
| Purchase of intangible assets | | **(2,447)** | (1,175) |
| Purchase of equity shares held for investment | | **(9,911)** | (7,523) |
| Sale of equity shares held for investment | | **11,168** | 19,091 |
| Minority interests acquired for cash | | **(2,853)** | (5,134) |
| Purchase of loan book | | **-** | (130,530) |
| Purchase of subsidiaries | 4(b) | **(11,258)** | (29,506) |
| | | **(34,801)** | (172,159) |
| Net cash inflow before financing | | **118,617** | 135,002 |
| Financing activities: | | | |
| Issue of ordinary share capital including premium | | **8,008** | 1,882 |
| Repayment of subordinated loan capital | | **-** | (21,937) |
| Equity dividends paid | | **(42,524)** | (39,240) |
| Interest paid on subordinated loan capital | | **(5,616)** | (7,743) |
| Net increase in cash | | **78,485** | 67,964 |

In the directors' view, cash is an integral part of the group's operating activities, since it is a bank's stock in trade. Nevertheless, as required by International Accounting Standard No. 7, cash is not treated as cash flow from operating activities but is required to be shown separately in accordance with the format above.

THE NOTES

## 1. Accounting policies

**(a) Adoption of International Financial Reporting Standards**

The consolidated financial statements are prepared, for the first time, in accordance with all relevant International Financial Reporting Standards ("IFRS") adopted for use in the European Union and therefore comply with Article 4 of EU Regulation. The date of transition to IFRS and the date of the opening IFRS balance sheet was 1st August, 2004. As allowed by IFRS 1, the group has not restated its comparative consolidated income statement and balance sheet to comply with IAS 32 and IAS 39.

The company financial statements are prepared in accordance with Section 226 of, and Schedule 4 to, the Companies Act 1985 and with all relevant UK accounting standards. Any differences in these standards from their IFRS counterparts are stated in the remainder of this note.

**(b) Accounting convention**

The consolidated financial statements have been prepared under the historical cost convention, modified by the revaluation of financial assets and liabilities held at fair value through profit or loss, available-for-sale financial assets and all derivative contracts.

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the group's accounting policies. These notes set out areas involving a higher degree of judgement or complexity or areas where assumptions are significant to the financial statements. These areas are the fair value of financial assets and liabilities, impairment losses on loans and advances and goodwill.

**(c) Basis of consolidation**

The consolidated financial statements incorporate the individual financial statements of Close Brothers Group plc, the company, and entities it controls (its subsidiaries). Control exists where the company has the power to govern the financial and operating policies of the entity.

The acquisition method of accounting has been adopted for subsidiaries. Under this method the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition with the interest of minority shareholders stated at the minority's proportion of these amounts. Any excess of the cost of acquisition over these net assets is booked as goodwill. The results of subsidiaries are included in the consolidated income statement up to the date of disposal.

The consolidated financial statements consolidate the individual financial statements of its associates using the equity method.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. As allowed by IFRS 1, the group has not restated business combinations that took place before 1st August, 2004.

**(d) Net interest income**

Interest on loans and advances made by the group, and fee income and expense and other direct costs relating to loan origination, restructuring or commitments are recognised in the income statement using the effective interest rate method. This method applies a rate that discounts estimated future cash payments or receipts to the net carrying amount of the financial instrument. When calculating the effective interest rate, the cash flows take into account all contractual terms of the financial instrument including transaction costs and all other premiums or discounts but not future credit losses.

Interest on impaired financial assets is recognised at the original effective interest rate applied to the carrying amount as reduced by an allowance for impairment.

**(e) Fees and commissions net income**

Where fees, that have not been included within the effective interest rate calculation as described in note 1(d), are earned on the execution of a significant act, such as fees arising from negotiating or arranging a transaction for a third party, they are recognised as revenue when that act has been completed. Fees and corresponding expenses in respect of other services are recognised in the income statement as the right to consideration or payment accrues through performance of services. To the extent that fees and commissions are recognised in advance of billing they are included as accrued income or expense.

**(f) Gains less losses arising from dealing in securities**

This includes the net gains arising from both buying and selling securities and from positions held in securities, including related interest income and dividends.

THE NOTES

**1. Accounting policies** continued

**(g) Loans and advances**

Loans and advances are recognised when cash is advanced to borrowers at cost including any transaction costs. They are then amortised using the effective interest rate method as explained in note 1(d). Loans and advances are stated net of provisions for impairment losses.

Impairment provisions are made if there is objective evidence of impairment as a result of one or more events regarding a significant loan or portfolio of loans ("loans") occurring after its initial recording and which has an impact that can be reliably estimated by management.

For loans that are not considered individually significant, the group adopts a formulaic approach which allocates a loss rate which is dependent on the overdue period. Loss rates are based on the discounted expected future cash flows from loans and are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

The amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at original effective interest rate. As the loan or portfolio amortises over its life, so the impairment loss may amortise. All impairment losses are reviewed at least at each reporting date. If subsequently the amount of the loss decreases as a result of a new event, the outstanding impairment loss is correspondingly reversed.

**(h) Finance leases, operating leases and instalment finance**

A finance lease is a lease or hire purchase contract that transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. Finance leases are recognised as loans at an amount equal to the gross investment in the lease discounted at its implicit interest rate. Finance charges on finance leases are taken to income in proportion to the net funds invested.

Rental costs under other leases and hire purchase contracts are charged to the income statement in equal annual amounts over the period of the leases.

**(i) Equity shares and debt securities**

The long and short positions in equity shares and debt securities are classified as held for trading and represent the aggregate of trading positions in individual securities arising respectively from a net bought and net sold position. They are valued at the dealers' bid and offer prices respectively at the close of business.

Other investments designated at inception under the fair value option are fair valued through profit or loss at mid-market values if listed and at directors' valuation if unlisted, with gains and losses being included directly in the income statement.

Investments with fixed or determinable payments that are held with the intention and ability to hold to maturity are classified as held-to-maturity. They are initially recognised at fair value including direct and incremental transaction costs and subsequently valued at amortised cost, using the effective interest rate method as explained in note 1(d).

Investments classified as available-for-sale are recognised at fair value with changes being accounted for through equity. If such an asset is sold or there is objective evidence that it is impaired, the cumulative gains and losses recognised in equity are recycled to the income statement. Fair values are obtained from independent open market sources, discounted cash flow models based on market rates or option pricing models.

Equity shares held by the employee benefit trust are deducted in arriving at equity and realised surpluses and deficits are not taken to the income statement.

**(j) Depreciation**

Property, plant and equipment, including freehold investment properties held for long term investment, and intangible assets other than goodwill, are stated at cost less accumulated depreciation or amortisation and less provisions for impairment, if any. The provision for depreciation or amortisation on these assets is calculated to write off their cost over their estimated useful lives by equal annual instalments as follows:

| | |
|---|---|
| Fixtures, fittings and equipment | 10% to 33% |
| Motor vehicles | 25% |
| Freehold and long leasehold property | 2.5% |
| Short leasehold property | over the length of the lease |
| Intangible assets – other | 10% to 25% |

No depreciation is provided in respect of freehold land, which is stated at cost.

**1. Accounting policies** continued

**(k) Foreign currencies**

For the company and those subsidiaries whose balance sheets are denominated in sterling, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the closing rates of exchange at the balance sheet date. Foreign currency transactions are translated into sterling at the average rates of exchange over the year and exchange differences arising in these cases are taken to the income statement.

The balance sheets of subsidiaries denominated in foreign currencies are translated into sterling at the closing rates. The income statements for these subsidiaries are translated at the average rates and exchange differences arising in these cases are taken to the exchange movements reserve.

As allowed by IFRS 1, cumulative foreign exchange differences up to 31st July, 2004 have not been recognised in the exchange movements reserve.

**(l) Deferred taxation**

Deferred taxation is provided in full on temporary timing differences, at the rates of taxation expected to apply when these differences crystallise. Deferred taxation assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which temporary differences can be set.

**(m) Intangible assets - goodwill**

Goodwill arising on the acquisition of business assets before 1st August, 1998 has been written off to reserves. From that date such goodwill arising has been capitalised as an intangible asset and amortised, in equal annual instalments, unless there has been impairment, over its estimated useful life of up to 20 years. From 1st August, 2004, amortisation of goodwill has ceased, negative goodwill is credited to the income statement and the net book value of goodwill is subject to impairment review at least annually.

**(n) Pensions**

Contributions to defined contribution schemes are charged in the income statement when they become payable.

For the group's one defined benefits scheme, which was closed to new entrants in 1996 and involved at 31st July, 2006 only 105 active and deferred members, scheme liabilities are measured on an actuarial basis using the projected credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the income statement over the members' expected average remaining working lives.

**(o) Share-based awards**

The group has for many years operated long term incentive arrangements. These include the 2004 Long Term Incentive Plan, the 1995 Executive Share Option Scheme and the Inland Revenue approved Savings Related Share Option Scheme, together "Incentive Schemes". The group has applied IFRS 2 "Share-based Payment" to all grants of equity instruments under these Incentive Schemes after 7th November, 2002.

The expense for these Incentive Schemes is measured by reference to the fair value of the shares or share options granted on the date of grant. Such fair values are determined using option pricing models which take into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the company's share price over the life of the option/award and other relevant factors. Vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting the number of equity instruments included in the measurement of the transaction such that the amount recognised reflects the number that actually vest. The fair value is expensed in the income statement on a straight line basis over the vesting period.

**(p) Derivative financial instruments ("derivatives") and hedge accounting**

Derivatives are used within the group only to minimise the impact of interest and currency rate changes on financial assets and liabilities and meet the IAS 39 criteria for hedge accounting. They are carried on the balance sheet at fair value which is obtained from quoted market prices in active markets, including recent market transactions, and discounted cash flow models.

On acquisition, a derivative is designated as a hedge and the group formally documents the relationship between the derivative and the hedged item. The group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedge derivative is highly effective in offsetting changes in fair values or cash flows of hedged items. If a hedge was deemed wholly or partially ineffective, the amount of the ineffectiveness, taking into account the timing of the expected cash flows where relevant, would be recorded in the income statement.

For fair value hedges, changes in fair value are recognised in the income statement, together with changes in the fair value of the hedged item.

For cash flow hedges, the fair value gain or loss associated with the effective proportion of the cash flow hedge is recognised initially directly in equity and recycled to the income statement in the period when the hedged item affects income.

**2. Consolidated income statement reconciliation**

The table below compares the consolidated income statement for the year ended 31st July, 2005, now reported under IFRS, with that previously reported under UK Generally Accepted Accounting Practice ("UK GAAP"):

| | Note 6 | UK GAAP £'000 | Adjustments £'000 | IFRS £'000 |
|---|---|---|---|---|
| Interest and similar income | (i) | 280,827 | 2,014 | 282,841 |
| Interest expense and similar charges | | 140,320 | - | 140,320 |
| Net interest income | | 140,507 | 2,014 | 142,521 |
| Fees and commissions income | (i) | 230,019 | (1,964) | 228,055 |
| Fees and commissions expense | (i) | (35,834) | (562) | (36,396) |
| Gains less losses arising from dealing in securities | | 96,285 | - | 96,285 |
| Other operating income | | 17,019 | - | 17,019 |
| Other income | | 307,489 | (2,526) | 304,963 |
| Operating income | | 447,996 | (512) | 447,484 |
| Administrative expenses | (i) and (ii) | 283,763 | 2,036 | 285,799 |
| Depreciation and amortisation | | 12,145 | - | 12,145 |
| Impairment losses on loans and advances | (i) | 20,349 | (305) | 20,044 |
| Total operating costs | | 316,257 | 1,731 | 317,988 |
| Operating profit on ordinary activities before impairment losses on goodwill and taxation | | 131,739 | (2,243) | 129,496 |
| Impairment losses on goodwill | (iii) | 23,120 | (5,385) | 17,735 |
| **Operating profit on ordinary activities before taxation** | | 108,619 | 3,142 | 111,761 |
| Taxation | (iv) | 37,865 | (713) | 37,152 |
| Profit on ordinary activities after taxation | | 70,754 | 3,855 | 74,609 |
| Profit attributable to minority interests | (v) | 2,177 | 35 | 2,212 |
| Profit attributable to the shareholders of the company | | 68,577 | 3,820 | 72,397 |

**3. Consolidated balance sheet reconciliation**
The table below compares the consolidated balance sheet, as at 31st July, 2005, now reported under IFRS, with that previously reported under UK GAAP:

| | Note 6 | UK GAAP £'000 | Adjustments £'000 | IFRS £'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances at central banks | | 1,244 | - | 1,244 |
| Settlement accounts | | 604,692 | - | 604,692 |
| Loans and advances to customers | (i) | 1,953,031 | (13,828) | 1,939,203 |
| Loans and advances to banks | | 786,330 | - | 786,330 |
| Money market securities | | 797,498 | - | 797,498 |
| Debt securities – long positions | | 61,345 | - | 61,345 |
| Equity shares – long positions | | 40,377 | - | 40,377 |
| Loans to money brokers against stock advanced | | 158,553 | - | 158,553 |
| Investment securities | (vi) | 26,730 | 654 | 27,384 |
| Intangible assets – goodwill | (iii) | 88,863 | 6,848 | 95,711 |
| Intangible assets – other | (vii) | - | 1,672 | 1,672 |
| Property, plant and equipment | (vii) | 39,949 | (1,672) | 38,277 |
| Share of gross assets of joint ventures | | 21,624 | - | 21,624 |
| Share of gross liabilities of joint ventures | | (20,914) | - | (20,914) |
| Share of net assets of joint ventures | | 710 | - | 710 |
| Other receivables | (i) and (vi) | 108,639 | 310 | 108,949 |
| Deferred taxation assets | (iv) | 21,591 | 7,385 | 28,976 |
| Prepayments and accrued income | (i) | 49,600 | 14,798 | 64,398 |
| **Total assets** | | 4,739,152 | 16,167 | 4,755,319 |
| **Liabilities** | | | | |
| Settlement accounts | | 561,173 | - | 561,173 |
| Deposits by customers | | 1,818,187 | - | 1,818,187 |
| Deposits by banks | | 108,101 | - | 108,101 |
| Debt securities – short positions | | 49,628 | - | 49,628 |
| Equity shares – short positions | | 20,424 | - | 20,424 |
| Loans from money brokers against stock advanced | | 142,371 | - | 142,371 |
| Non-recourse borrowings | | 200,000 | - | 200,000 |
| Loans and overdrafts from banks | | 494,363 | - | 494,363 |
| Promissory notes and other debt securities in issue | | 367,130 | - | 367,130 |
| Other liabilities | (i), (ix) and (x) | 211,167 | (28,350) | 182,817 |
| Current taxation liabilities | | 19,297 | - | 19,297 |
| Accruals and deferred income | (i) | 126,019 | 12,425 | 138,444 |
| Subordinated loan capital | | 75,000 | - | 75,000 |
| **Total liabilities** | | 4,192,860 | (15,925) | 4,176,935 |
| **Equity** | | | | |
| Called up share capital | | 36,168 | - | 36,168 |
| Share premium account | | 252,210 | - | 252,210 |
| Profit and loss account | | 255,729 | 23,315 | 279,044 |
| ESOP trust reserve | | (3,786) | - | (3,786) |
| Share-based awards reserve | (ii) | - | 7,614 | 7,614 |
| Exchange movements reserve | (viii) | - | 1,264 | 1,264 |
| Minority interests | (v) | 5,971 | (101) | 5,870 |
| **Total equity** | | 546,292 | 32,092 | 578,384 |
| **Total liabilities and equity** | | 4,739,152 | 16,167 | 4,755,319 |

## 4. Consolidated cash flow statement reconciliation

| | UK GAAP 2005 £'000 | Adjustments 2005 £'000 | IFRS 2005 £'000 | **IFRS 2006 £'000** |
|---|---|---|---|---|
| **(a) Reconciliation of operating profit on ordinary activities before taxation to net cash inflow from operating activities** | | | | |
| Operating profit on ordinary activities before taxation | 108,619 | 3,142 | 111,761 | **157,314** |
| (Increase)/decrease in: | | | | |
| Interest receivable and prepaid expenses | (13,375) | (8,976) | (22,351) | **1,886** |
| Net settlement accounts | 21,535 | - | 21,535 | **(11,115)** |
| Net equity shares held for trading | 3,904 | - | 3,904 | **(7,986)** |
| Net debt securities held for trading | (10,038) | - | (10,038) | **(795)** |
| Increase in interest payable and accrued expenses | 17,064 | 8,701 | 25,765 | **(1,877)** |
| Depreciation, amortisation and goodwill impairment losses | 35,265 | (5,385) | 29,880 | **14,083** |
| Net cash inflow from trading activities | 162,974 | (2,518) | 160,456 | **151,510** |
| (Increase)/decrease in: | | | | |
| Debt securities held for liquidity | (11,483) | 10,065 | (1,418) | **(10,890)** |
| Loans and advances to customers | (195) | (155) | (350) | **77,180** |
| Loans and advances to banks not repayable on demand | 190,802 | (186,604) | 4,198 | **5,716** |
| Other assets less other liabilities | (22,821) | 2,673 | (20,148) | **83,350** |
| Increase/(decrease) in: | | | | |
| Deposits by banks | 28,913 | - | 28,913 | **60,277** |
| Customer accounts | 137,035 | - | 137,035 | **24,887** |
| Bank loans and overdrafts | (180,834) | - | (180,834) | **(131,158)** |
| Non-recourse borrowings | (50,000) | - | (50,000) | **(50,000)** |
| Promissory notes and other debt securities in issue | 267,130 | - | 267,130 | **(9,116)** |
| Taxation paid | (37,821) | - | (37,821) | **(48,338)** |
| **Net cash inflow from operating activities** | 483,700 | (176,539) | 307,161 | **153,418** |
| **(b) Analysis of net cash outflow in respect of the purchase of subsidiaries** | | | | |
| Cash consideration in respect of current year purchases | (38,900) | - | (38,900) | **(6,797)** |
| Loan stock redemptions and deferred consideration paid in respect of prior year purchases | (791) | - | (791) | **(4,847)** |
| Net movement in cash balances | 10,185 | - | 10,185 | **386** |
| | (29,506) | - | (29,506) | **(11,258)** |
| **(c) Analysis of changes in financing** | | | | |
| Share capital (including premium) and subordinated loan capital: | | | | |
| Opening balance | 383,433 | - | 383,433 | **363,378** |
| Shares issued for cash | 1,882 | - | 1,882 | **8,008** |
| Repayment of subordinated loan capital | (21,937) | - | (21,937) | **-** |
| **Closing balance** | 363,378 | - | 363,378 | **371,386** |

| | UK GAAP 2005 £'000 | Adjustments 2005 £'000 | IFRS 2005 £'000 | **IFRS 2006 £'000** | **Movement in the period £'000** |
|---|---|---|---|---|---|
| **(d) Analysis of cash balances** | | | | | |
| Cash and balances at central banks | 1,244 | - | 1,244 | **1,272** | **28** |
| Loans and advances to banks repayable on demand | 380,638 | 1,185,785 | 1,566,423 | **1,644,880** | **78,457** |
| | 381,882 | 1,185,785 | 1,567,667 | **1,646,152** | **78,485** |

Except for the above adjustments the comparative consolidated cash flow statement is otherwise unchanged.

## 5. Consolidated equity reconciliation

| | Note 6 | 31st July, 2005 £'000 | 1 August, 2004 £'000 |
|---|---|---|---|
| Profit and loss account reserve previously reported under UK GAAP | | 255,729 | 226,730 |
| Income recognition adjustments | (i) | (14,913) | (14,310) |
| Expense recognition adjustments | (i) | 1,200 | 900 |
| Recognition of share-based awards | (ii) | (2,736) | (796) |
| Goodwill adjustments | (iii) | 6,836 | 1,451 |
| Taxation effect of above items | (iv) | 8,573 | 7,658 |
| Minority interest effect of above items | (v) | 101 | 136 |
| Moving exchange adjustments to exchange movements reserve | (viii) | (1,264) | - |
| Recognition of pension deficit | (ix) | (1,783) | (4,736) |
| Dividend recognition adjustments | (x) | 27,301 | 25,604 |
| | | 23,315 | 15,907 |
| **Profit and loss account reserve reported under IFRS** | | 279,044 | 242,637 |

| | |
|---|---|
| Total equity at 31st July, 2004 previously reported under UK GAAP | 509,264 |
| Above profit and loss account reserve adjustments | 15,907 |
| Recognising share-based awards reserve | 4,285 |
| Including minority interests in equity | 4,538 |
| **Total equity at 1st August, 2004 under IFRS** | 533,994 |

## 6. Comparison of the 2005 consolidated income statement, balance sheet and cash flow statement as now reported under IFRS with those previously reported under UK GAAP

(i) The effective interest rate method has now been applied. Accordingly certain interest, fees and commissions are now spread, also impacting impairment losses.

(ii) Share-based awards are now accrued in the balance sheet and expensed in the income statement.

(iii) Goodwill is now subject to impairment testing, rather than to annual amortisation, and negative goodwill is no longer capitalised.

(iv) Many of the adjustments referred to in this note have related tax effects, nearly all of which are deferred.

(v) Minority interests are recognised as equity rather than as a liability and some of the adjustments to the profit and loss account and opening reserves referred to in this note have related minority interest effects.

(vi) Some investments previously classified as "other receivables" have been reclassified as "investment securities" and valued at fair value rather than cost.

(vii) Certain assets previously classified as "tangible assets" are now classified as "intangible assets – other".

(viii) Exchange adjustments are recognised through the exchange movements reserve rather than the profit and loss account.

(ix) The defined benefit pension scheme deficit is now recognised in equity.

(x) Dividends are now recognised in the period in which they are declared rather than in the period in which earnings are generated to cover the dividend.

**7. Earnings per share**

Basic earnings per share on profit attributable to shareholders of the company is based on profit after taxation and minority interests of £108,598,000 (2005: £72,397,000) and on 146,594,000 (2005: 145,348,000) ordinary shares, being the weighted average number of shares in issue and contingently issuable during the year excluding those held by the employee benefit trust.

Diluted earnings per share is based on this same profit, but on 147,100,000 (2005: 145,829,000) ordinary shares, being the weighted average number of shares in issue disclosed above, plus the weighted dilutive potential on ordinary shares of exercisable employee share options in issue during the year.

**8. Dividend**

The final dividend of 22.0p per share is proposed to be paid on 3rd November, 2006 to holders of ordinary shares on the register at the close of business on 6th October, 2006.

**9. Basis of preparation**

The financial information contained in this announcement does not constitute statutory accounts for the year ended 31st July, 2006 within the meaning of section 240 of the Companies Act 1985, but is derived from those accounts, on which the auditors have yet to sign their report.

Whilst the financial information included in this preliminary announcement has been computed in accordance with IFRS, this announcement does not itself comply with IFRS. The company expect to publish full financial statements that comply with IFRS on 3rd October, 2006.

The UK GAAP statutory accounts for the year ended 31st July, 2005 have been reported on by Deloitte & Touche LLP and filed with the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain a statement under section 237(2) or (3) of the Companies Act 1985. The financial information contained in this announcement for the year ended 31st July, 2005 has been derived from those statutory accounts, adjusted for the impact of IFRS, and is therefore unaudited.