SFI Group plc

Annual Report and Accounts 2003

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Chairman's statement

Introduction

This Annual Report and Accounts, which formally cover the year to 31 May 2003, provide me with the opportunity to update shareholders on a range of important matters and set out my proposals for the future delivery of a recovery of value for all stakeholders. The length and complexity of this document along with the proposals for the restructuring of SFI Group plc reflect the full extent of the problems faced by the Group over the last 18 months and the activities and effort required to resolve the myriad of accounting, financial, funding, compliance and regulatory issues encountered.

In summary, my statement seeks to explain and clarify the following:

- The background to the Company's problems (as reflected in the announcements made to shareholders in the past 18 months)
- The results for the year to 31 May 2003
- The restatement of results for the years to 31 May 2002
- A trading update and outlook
- A summary outline of the recovery plan
- The proposals for the restructuring of SFI Group plc

Background

This has been a prolonged period of crisis, which has seen the Company's shares de-listed, shareholder value eroded and a long process of moving towards refinancing arrangements with the Company's bankers. Our focus is now on delivering a successful financial restructuring and implementing a recovery plan which aims to restore value to all stakeholders, although it is appropriate to summarise the events of the recent past so as to place these results in context.

On 21 October 2002, following cash flow pressure and the withdrawal of the Company's proposed final dividend for the year to May 2002, the Company announced that a full financial review was being undertaken by Tim Andrews, who had joined the Company as Finance Director in July of that year.

On 12 November 2002, the Company announced the suspension of its shares pending the conclusion of this review and clarification of its financial position following discovery of serious accounting discrepancies. The announcement stated that the Directors believed that the value of current assets had been over-stated and liabilities under-stated by an amount which in aggregate was likely to exceed £20m. The resignation of the Company's former Chairman was announced on that same date. On 20 December 2002, SFI announced that Simmons & Simmons, assisted by PricewaterhouseCoopers, had been instructed to undertake a full investigation into the matters raised on 12 November 2002.

On 15 April 2003, the Company updated shareholders as to progress, announced sales below expectations in a challenging trading environment, as well as a continued inability to clarify its financial position and, as a consequence, the de-listing of the Company's shares with effect from 12 May 2003.

Following Simmons & Simmons' report to the Board, a circular was sent to shareholders on 6 October 2003 confirming that the investigation supported the conclusions of the Company's announcement on 12 November 2002, including the statement that SFI's net current assets had been substantially over-stated since at least the financial year ended 31 May 2000. It concluded that accounting discrepancies were primarily the result of an operations-driven culture focused on results with accounting errors arising from the Company's rapid growth, which in turn put the finance department under constant time and resource pressure. The report also highlighted serious failures in the Company's management of its cash flow and that capital expenditure committed during the early part of 2002 could not be supported by its bank facilities and operating cash flows. The circular also highlighted that the investigation into accounting discrepancies to that date had concentrated largely on net current assets but that there also remained a need to investigate and restate fixed asset accounts.

Chairman's statement

On 12 December 2003, the Financial Services Authority ("FSA") announced the results of its enquiries into the accounting discrepancies. The FSA concluded that there had been a breach of the Listing Rules, albeit that there was no evidence to suggest that it was deliberate. The FSA acknowledged that the Company had taken a co-operative approach to the investigation and, taking into account this and the Company's financial position, issued a censure but imposed no financial penalty.

The results for the year to 31 May 2003

The results for the year show a pre-tax loss of £110.0m (2002 re-stated loss £6.2m) on turnover of £153.2m (2002 £144.1m). This loss is after exceptional items of £92.1m, comprising net provisions for losses on the disposal of assets and impairment charges arising from a write-down in the value of the Group's fixed assets, professional fees and bank charges.

Profits before interest, tax, depreciation, amortisation and exceptional items were £9.2m (2002 re-stated profit £17.9m). Before interest and exceptional items, the Group reported an operating loss of £6.7m (2002 re-stated profit £4.3m). After pre-exceptional net interest costs of £11.2m (2002 £8.8m), the Group produced a pre-exceptional loss on ordinary activities before taxation of £17.9m (2002 loss £4.5m). As at 31 May 2003 the Group's balance sheet shows net liabilities of £66.0m (2002 net assets £32.3m).

A full commentary on these results is contained within the Financial Review.

The restatement of results for the years to 31 May 2002

Work on the restatement of the results for the years to 31 May 2002 has now concluded and forms the basis of comparative figures included within this report and accounts.

Prior year adjustments totalling £61.6m, pre-tax, have been made of which £25.8m relate to the year to May 2002 and £35.8m to 2001 and earlier. Of these adjustments, £58.8m represents fundamental accounting error and £2.8m change in accounting policy. Prior year tax credits relating to these adjustments amount to £8.4m, resulting in a post-tax prior year adjustment of £53.2m.

The Company has now fully reviewed recorded costs and accumulated depreciation, which together comprise the carrying value of its fixed assets. In addition, a full impairment review, carried out in the context of the Company's restated historic accounts and updated forecasts, has been undertaken to assess the appropriate value at which individual assets should be reflected in the Company's accounts. As forecast in the circular issued by the Company on 6 October 2003, a material downward revaluation of the carrying value of fixed assets and goodwill has resulted, with £32.4m adjusted in respect of accounting errors and £1.3m arising from changes in accounting policy. A further £77.5m adjustment, which has been accounted for in the year to May 2003, has been made to reflect impairment and provision for losses on disposal.

The pre-tax net current asset adjustment (including creditors due outside one year) is £27.9m, with £26.4m arising from fundamental accounting errors in prior years and £1.5m arising from changes in accounting policy.

Further detail on these restatements is contained in the Financial Review.

Trading update and outlook

After reading these audited accounts, shareholders will be aware that the profitability of the Company in the year ended 31 May 2002 was significantly lower than that which was previously reported and the results for the year ended 31 May 2003 were below the restated results for 2002. The current year trading position has therefore started from a much lower base. It has also been adversely impacted by the distressed position that the Company has been in and by challenging market conditions. In addition, throughout the financial year to 31 May 2003 and in the current year, trading has generally been weak across the portfolio.

There are a number of acknowledged challenges facing the sector which have combined to create a very competitive trading environment for high street pubs and bars. Over the summer months these challenges included a general decline in consumer confidence, a reduction in early week and off peak trading, along with

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discounting and pricing pressures on margin. These factors were combined with excellent summer weather which, whilst good for some businesses with sufficiently large outside trading areas, depressed sales in most of the Company's portfolio which is largely high street based and led to like for like declines in sales of a similar magnitude to those reported by our high street competitors. Weak sales levels continued throughout the autumn resulting in the need for the Company to reforecast its internal projections in early December 2003.

The Company's pub and bar portfolio is almost entirely leasehold resulting in it having a cost base which, to a significant degree, is fixed due to rent payments. With this level of operational gearing, in addition to a high level of debt and interest payments, any reduction in sales and margin significantly impacts on profit. Like for like sales declines have been experienced across some but not all of the estate during the year to 31 May 2004. More recently there has been a narrowing of like for like sales declines and some positive returns from selective rebrandings and refurbishment.

Prior to my appointment in June 2003, the Company unsuccessfully marketed the Bar Med and Latin businesses for sale and the resulting uncertainty had a negative impact on their trading performance.

Since the discovery of the serious accounting discrepancies, which were announced in November 2002, the Board has had to manage the business through a period of uncertainty with a difficult cash position. As a result there has not been the ability to invest or take all of the management actions required.

The focus of senior management has understandably been diverted away from the day-to-day operation of the business so as to address the issues arising from the complex accounting investigation and restatement exercise and to complete extensive negotiations with the Company's bankers. Until the proposed restructuring has been effected, full implementation of the recovery plan will not be possible.

Christmas trading began to show an improving trend that has continued into the new year with overall sales levels now broadly in line with current expectations.

The banks have been supportive of the recovery plan and allowed capital investment in a number of sites which are beginning to make positive returns on investment.

Results for the year ending 31 May 2004 will reflect the weak trading start to the year, the impact of actual and attempted disposals, like for like sales declines across some but not all of the portfolio, fixed rental payments and depreciation. Results at the pre-tax level will also account for interest charges prior to the restructuring proposals and continuing exceptional costs.

Further detail on trading and results in the year to 31 May 2003 is contained in the Financial Review.

The recovery plan

Reflecting the factors set out in this statement and reported in detail in these accounts, it is clear the Group's underlying profitability has been and is significantly lower than previously reported and materially below the level of profitability with which shareholders will previously have been familiar. The task of the management team, led by myself, will be to rebuild the profitability of the business from this much lower base.

Following my appointment in June 2003, the Board drew up a recovery plan for the period to May 2006, full implementation of which is subject to the successful completion of the restructuring proposals. The principal purpose of the recovery plan is to rebuild the profitability of the Company over the period of the recovery plan and facilitate the ultimate restoration of value for the stakeholders. By its nature, the recovery plan will impact on almost every area of the business and is designed to deliver sustainable improvements over the medium term.

Whilst the Company has a small number of selected sites identified for potential disposal, the recovery plan does not envisage a significant disposal of pubs or brands. The portfolio currently comprises 157 pubs and bars, the majority of which have late licences. Your directors believe that most of the portfolio is well located and that restoration of value to all stakeholders of the business can best be achieved by improving the trade of the whole portfolio, including currently under-performing and under-invested outlets. The banks are

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supportive of the principles of a trading recovery with careful portfolio management as set out in the recovery plan.

The main elements of the recovery plan, which is designed to produce the necessary improvement in profitability and restoration in value to all stakeholders, are set out below.

People

There have been changes to the management team and its functional alignment including the recent appointment of a new director of buying for the Company and a new director of operations for the Litten Tree division. These changes complement the earlier appointment of a new director of marketing and the re-alignment of responsibilities for property and buying, along with changes to management in the finance function. During the recovery plan period, specific initiatives will be implemented in areas such as recruitment, retention, management development and training, incentivisation and employee communication.

Operations

Following the changes made in the composition of the Board after my arrival last year, direct reporting lines to me were established for the directors of operations of each of the three operating divisions, which comprise Slug & Lettuce, Litten Tree and Late Night Venues. A central operations function has been set up and programmes initiated so as to bring an increased focus on operational standards, unit level profitability and profit conversion, working practices and procedures.

Customer focus

With the management changes referred to above, the recovery plan will now support the implementation of an ongoing range of enhancements to the offer in each of our brands. Selective research has already been undertaken to support the realisation of the opportunities that exist in improving the food and drink ranges and customer offer, including pricing strategy and promotional activity. Within this area we also see an opportunity for ongoing brand development and evolution.

Portfolio

Whilst the portfolio is in the main well located, the financial crisis has meant that only limited capital has been available for investment. Over the recovery plan period, selected investments will be made so as both to improve and sustain unit profitability. With the support of the banks, we have to date re-branded 10 sites and refurbished 13 others and these investments are producing encouraging results. Over the recovery plan period, the portfolio will benefit from an ongoing programme of repair, maintenance, remodelling and refurbishment, along with further site re-brands.

A small number of selected pubs and sites are identified for potential disposal and action is also being taken so as to extinguish ongoing liabilities attaching to 9 remaining landbank sites (and 3 vacant properties).

Support functions

To complement the actions being taken in the business areas set out above, changes are envisaged across many activities within the enabling and support functions. These will be focussed on the implementation of enhanced controls, policies and procedures combined with the delivery of cost efficiencies and the generation of improved flows of data and information for decision-making.

Control environment

In the past, the Company has undertaken an aggressive growth strategy through acquisition and developments, without the necessary controls and processes being in place. As detailed in the October circular, the Company has taken a number of significant steps in the period since the identification and announcement of the accounting discrepancies to respond comprehensively to the underlying causes. This has included the appointment of external professional advisers to conduct a full and independent

Chairman's statement

investigation (as referred to above), the discontinuance of inappropriate accounting practices and the implementation of key internal changes to organisational structure, personnel and processes.

In summary, whilst your Directors recognise that the starting point is clearly a challenging one, the range of activities and management actions set out in the recovery plan support the overall objective of delivering a sustainable improvement in profitability of the Company.

The proposals for the restructuring of SFI Group plc

As at today's date the Company has indebtedness almost fully drawn down against facilities of £152.9m plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m. The Company also has some £5.1m in a prepayment account arising largely from the recent disposal of assets which cash may only be released with the consent of the banks.

Neither the Company's current nor projected trading is sufficient to service such a high level of debt or support repayment. Accordingly the Company's equity value has been completely eroded and we have continued to trade by virtue of the banks' support. A restructuring of the Company's finances is necessary to secure its ability to continue to trade and provide a more appropriate base from which to rebuild the business and to implement the recovery plan.

Negotiations with the banks have concluded and, subject to Court and shareholder approval, the banks have agreed to convert approximately £83.4m of debt and other obligations including unpaid fees owed to the banks and rolled up interest into shares which will represent 75% of the Company's share capital and 72.7% of its votes. This represents a reduction of more than half when compared to current amounts owed by the Group to the banks.

Further details relating to the proposed capital restructuring and implications for shareholders are detailed in the circular to shareholders issued with these accounts. This includes a potential claim against the Company's previous auditors and the issue of litigation certificates to shareholders to enable them to share in any net proceeds arising from the potential litigation. Whilst some of the proposals contained within the circular are necessarily detailed and complex, your Board would encourage you to consider these proposals carefully and recommends your approval of them.

Board changes

Tim Andrews, our Finance Director, who joined the Company in July 2002, was responsible for the identification of the serious accounting discrepancies that led to the announcement made by the Company in November 2002. Since then, together with Glenda Saldanha, Group Financial Controller, he has overseen the steps taken to address the causes and consequences of these findings.

Following completion of that exercise, Tim has given notice of his intention to resign from the Board enabling a successor to continue the recovery process into the next stage. He will continue to work with the Company for a period of time after he leaves the Board following the appointment of his replacement, focusing his efforts principally on the potential litigation against the Company's former auditors. The Board recognises the very significant contribution Tim has made to the Company and its continued survival during a very difficult period.

I am pleased to announce that it is anticipated that two new appointments to the Board will be made in due course.

Edward Lavelle, our current Commercial Director and Company Secretary, will join the Board on completion of the financial restructuring. Edward, who qualified as a chartered accountant, has corporate finance experience and has held Board positions in various companies, also made a significant contribution to the Company in the period since November 2002 when he was appointed Commercial Director. He was appointed Company Secretary in November 2003.

In addition, a suitably qualified replacement Finance Director has been identified and is currently in discussions with his employer regarding departure timescale and a date upon which he can join the Board.

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Until contract discussions have been concluded with the Company and his current employer, the Board will not be in a position to announce his name or joining date. If and when these discussions are complete an announcement will be made to shareholders.

Conclusion

The last 18 months have been a period of uncertainty for the Company during which a complex range of issues have had to be addressed before we have been able to report fully to shareholders. Your patience throughout this period is acknowledged. Whilst I have been with the Company for only the last 9 months, these have been genuinely challenging for myself, the Board and our Executive and senior management teams.

The results contained within these accounts will understandably make for very disappointing reading for shareholders who have seen the value of their shares eroded in what should fundamentally be a solid business meeting consumers' leisure and lifestyle needs. It is the potential in the business that has afforded us the opportunity to complete the necessary exercises to review and restate the accounts, develop a recovery plan and put forward a recommended restructuring proposal.

The starting point is a challenging one, but the business has some well established brands and a well located portfolio. To operate these assets we have a clear strategy and focus in our recovery plan, a committed management team and loyal employees and an opportunity with your support to create a recovery in value for all stakeholders.

Stuart Lawson
Executive Chairman

7 April 2004

Directors and Board

Non-Executive Directors

John Brackenbury CBE

John Brackenbury, aged 68, who joined the Board in November 1998 was Deputy Chairman of Pubmaster and is a leading industry figure with over 40 years' experience in the drinks and leisure sector, initially with IDV & Watney Mann. He is Chairman of Business in Sport and Leisure; Chairman of the Hospitality Training Foundation; Chairman of Avanti Communications plc and a non-executive director of The Isle of Capri Casinos and Holsten UK. He was appointed a CBE in the Queen's Birthday Honours List in June 2000 for services to tourism, education and employment.

Hugh Siegle

Appointed to the Board in June 2001, Hugh Siegle, aged 57, has extensive leisure industry experience having been at Whitbread for 27 years, latterly as Property Director. He now has non-executive roles as a leisure consultant at DTZ Debenham Tie Lung, and the Boards of Portsmouth Harbour Renaissance Limited, the Portsmouth Naval Base Property Trust, and Business in Sport and Leisure where he also chairs the Property Group. As a Chartered Surveyor he has sat on property committees of the Royal Institution of Chartered Surveyors (RICS) and the Brewers and Licensed Retailers' Association.

Executive Directors

Stuart Lawson, Executive Chairman

Stuart Lawson, aged 41, was appointed Executive Chairman of SFI in June 2003. He is a Chartered Management Accountant with extensive corporate experience of multiple site operations. He has experience of managing turnaround and refinancing situations and most recently was involved in the refinancing and recovery of value of Alldays plc. Previously, he was at Diageo plc where he was Finance Director and Commercial Director of Burger King Limited.

Tim Andrews, Finance Director

Tim Andrews, aged 41, joined SFI in July 2002. He is a chartered accountant with both corporate finance and leisure sector finance director experience. Between 1991 and 1998, he worked for Rea Brothers Limited and was Finance Director of the Slug and Lettuce Group between 1998 and 2000. Up until his appointment at SFI he was Finance Director of Po Na Na Group.

Directors and Board

Board changes

During the year and since the year end there has been a significant change in the composition of the Board.

Four Directors have resigned since May 2002:

NJ Irens	30 June 2002
AS Hill	12 November 2002
AM Latham	3 October 2003
RA Lo (also Company Secretary)	7 November 2003

The current Executive Directors and the Company Secretary have each been appointed since May 2002:

TK Andrews	8 July 2002
S Lawson	23 June 2003
EC Lavelle (Company Secretary)	7 November 2003

Financial review

Summary

The presentation of the accounts for the year has been unavoidably delayed as a result of the significant amount of work that has been necessary to understand the extent of the accounting discrepancies and the correcting adjustments required in respect of not only this year but also prior years. The restatement of prior year accounts has demonstrated a significantly lower level of underlying historic profitability than previously reported.

The cumulative effects of a more challenging trading environment, the adverse impact of the Group's distressed position and significant exceptional costs in respect of professional and other fees, asset write downs and provisions have together resulted in a pre-tax loss for the year of £110.0m (2002 re-stated loss £6.2m) on turnover of £153.2m (2002 £144.1m) and a post-tax loss of £99.7m (2002 loss £10.6m). This is further analysed as:

- operating loss before exceptional items of £6.7m (2002 re-stated profit £4.3m)
- net interest costs before exceptional items of £11.2m (2002 £8.8m)
- loss on ordinary activities before tax and exceptional items of £17.9m (2002 loss £4.5m)
- a tax credit of £10.2m after exceptional items (2002 charge of £4.4m)
- pre-tax net exceptional items amounting to £92.1m, comprising
    - professional fees, bank charges and associated costs of £10.0m
    - provision for losses on disposal of fixed assets completed after the year end of £10.5m
    - provision for onerous lease costs of £3.1m
    - write off of costs of aborted developments of £1.7m (2002 £1.9m)
    - impairment charges against the carrying value of its fixed assets of £67.0m
    - profit on disposal of assets of £0.2m (2002 £0.2m)

The Group's reported performance in the year reflects the cumulative adverse impact of five key elements:

- The underlying profitability of the business is significantly lower than that previously reported as set out in the restatement of the historic results.
- A more challenging trading environment with the high street bar market experiencing increased competition has had a consequential impact on sales and margins.
- There has been an adverse impact on the business' performance owing to the Group being in a distressed position over an extended period of time.
- Significant exceptional costs have necessarily been incurred in the year which have enabled the Group to investigate and deal with the consequences of the accounting discrepancies, to more fully understand and address the causes of the distressed position referred to above and to maintain the ongoing support of the banks.
- Charges have arisen from the impairment review of fixed assets.

The combined impact of prior year adjustments, operating losses in the year and exceptional items has resulted in the Group's balance sheet at the end of the year showing net liabilities of £66.0m (2002 net assets £32.3m).

Turnover

Turnover for the year was £153.2m compared with £144.1m in the prior year, reflecting the positive impact of portfolio movements offset by an 8% negative like for like sales performance.

Financial review

Sales at the start of the year were strong due in the main to the FIFA World Cup in June 2002, however this was not sustained through the remainder of the year with full year sales reflecting a like for like decline of 8%. The uncertainties surrounding the Group and more intense competition impacted significantly during the second half of the year with like for like revenues falling by 10%.

The Group trades with three principal divisions; Litten Tree, Slug & Lettuce and Late Night Venues (which includes Bar Med, Fiesta Havana and Break for the Border operations).

During the year, there were significant variations in performance between these divisions.

In the Slug & Lettuce division, like for like sales were 1% up on the previous year. The sales for the division benefited from having a well located portfolio, the positive contribution from conversions and a quality offer which was sustainable with less discounting of prices than elsewhere in the estate.

The Litten Tree division delivered like for like sales which were 9% down on the previous year. Our Litten Tree venues are mainly located within the competitive high street entertainment areas and as a result were operated on a more discounted pricing strategy. The performance was also impacted by a lack of investment during the year due to cash constraints.

Within the Late Night Venues division, Bar Med's like for like sales were disappointingly down by 23%. Having been unsuccessfully marketed for sale, the inevitable uncertainty of that process adversely affected the performance of those units. In the final month of the financial year, following the assets being withdrawn from sale, Bar Med like for like sales performance had recovered marginally to be down 16%. Comparative revenues generated by Fiesta Havana, which was also subject to a disposal process during the year, were down 7%, whilst Break for the Border, of which only one operating unit now remains within the Group, was down 25%.

Operating Loss

The Group generated operating losses (before exceptional items) of £6.7m as against restated operating profits in the previous year of £4.3m.

A significant part of the decline in operating profits can be attributed to the impact of competition and the effect of price discounting across two out of three divisions. This is evidenced by a reduction in gross margins to 73.6% from 75.5% in the previous year. In particular, prices were discounted aggressively in the first months of 2003 when the market was at its most competitive and the Group was under particular cash flow pressure.

Administrative expenses (before exceptional items) increased from 72.5% of sales to 77.9% of sales in the year. In absolute terms the increase of £14.8m was primarily attributable to the full year effect of the net increase in the portfolio with incremental operating costs, together with a gearing up of the infrastructure during the early part of 2002 to manage anticipated growth. From November 2002, as the Company's actual financial position became more apparent, headcount and operating costs were successfully reduced, partially mitigating some of the profit impact of the sales and margin decline.

The Company's estate is almost entirely leasehold and included within administrative expenses in the year is approximately £29.0m of site property costs (rent, rates and insurance). This fixed cost base results in a relatively high level of operational gearing with the consequentially adverse impact on profitability from declining sales and margins.

Also included within administrative expenses is £15.9m of depreciation and amortisation costs (2002 restated £13.6m) reflecting an increase in the asset base. Overall the Company produced an underlying EBITDA of £9.2m (before exceptional items) to part cover interest payments of £11.2m (2002 £17.9m to cover interest payments of £8.8m).

The increase in net interest payable (before exceptional items) reflected the higher level of average borrowings in the year.

Financial review

As a consequence of the Company's losses and adjustments to brought forward tax liabilities, including deferred tax provisions arising from timing differences, the Group has a profit and loss taxation credit of £10.2m in the year.

The loss on ordinary activities after tax (but before exceptional items and dividends) for the year was £15.9m (2002 £8.9m).

Exceptional Costs

The Group incurred exceptional costs of £92.1m in the year (2002 £1.7m), before an exceptional tax credit of £8.3m.

Professional fees charged in the year to 31 May 2003 amounted to £6.5m with a further £3.5m payable in fees and associated costs to the Company's bankers. Under the restructuring proposals, £2.5m of the fees due to the banks will be rolled up into the bank debt as part of the proposed conversion into equity. These fees were necessarily incurred as a result of the need to investigate the causes of the accounting discrepancies, to assist the Executive Directors in the ongoing discussions with the banks and in securing the banks' continued support for the Group throughout this challenging process. These costs have continued through the year to May 2004 in managing the process which has culminated in the restructuring proposals.

A provision for losses on the disposal of fixed assets after the year-end amounting to £10.5m is included within exceptional costs.

A provision of £3.1m has also been included within exceptional costs in respect of landbank sites where the Company has existing obligations under leases which had previously been entered into but where the venue has not been developed. The provision has been calculated on the basis that the Company will be able to achieve a surrender of these obligations in due course and that in the meantime it will continue to meet its obligations under each of these onerous leases.

In line with the Group's earlier expansion strategy, fees and other costs were incurred in respect of the previous identification of and research into potential landbank or development sites but where leases were not subsequently agreed. Costs in respect of such potential developments amounting to £1.7m (2002 £1.9m) were written off in the year.

In accordance with FRS 11, the Group has undertaken a review of the value of its fixed assets. Following this impairment review, which was conducted on a unit by unit basis and which took account of restated historic and future anticipated earnings, £58.2m has been written off the carrying value of tangible fixed assets and £8.9m has been written off the carrying value of goodwill in the year. Whilst an impairment review was conducted in the previous year, no charge was booked in the accounts. There is a high degree of subjectivity in calculating the amount of the impairment charge that should be allocated to prior years, including the amendment of incorrect management information used in 2002 and the need to exclude hindsight from the calculation of impairment values, and as such the full impact of the impairment charge calculated in the year has been included within the 2003 accounts.

Of the total tax credit in the year of £10.2m, £8.3m related to exceptional items.

Prior Year Adjustments

The Group's results for the year represent a very unsatisfactory performance and were materially below the profits reported in previous years. However, reference must be made to the restated comparative for 2002 and the prior year adjustments to properly compare this performance with those results for prior years.

Prior year adjustments to pre-tax profits totalling £61.6m have been made of which £25.8m relate to the year to May 2002 and £35.8m to 2001 and earlier. Of these adjustments, £58.8m represents fundamental accounting error and £2.8m change in accounting policy.

The restated comparatives for 2002 show an operating profit of £2.4m before profit on disposal of tangible fixed assets of £0.2m and net interest costs of £8.8m, resulting in a loss on ordinary activities before taxation

Financial review

of £6.2m. This restated pre-tax loss represents a £25.8m prior year restatement adjustment from the originally reported profits for that year. After a prior year tax restatement adjustment, the post-tax prior year adjustment is £23.5m.

The prior year adjustment in relation to 2001 and earlier presents a similar picture with a £35.8m pre-tax adjustment necessary in relation to those years, reducing to £29.7m after tax restatements. The 2002 accounts were based on a brought forward profit and loss reserve of £18.4m. Following the restatement, the actual profit and loss reserve at that point was a deficit of £11.3m, reflecting a business that for some time has been generating insufficient operating profits to support its interest and dividend payments.

These adjustments, by type and impact as at 2002 and prior years, are further analysed in the table below:

	By year			*By type of adjustment*		
	2002 £000	*2001 and earlier £000*	*Total £000*	*Change in accounting policy £000*	*Fundamental error £000*	*Total £000*
Intangible assets	—	—	—	—	—	—
Tangible assets	15,629	18,034	33,663	1,256	32,407	33,663
	15,629	18,034	33,663	1,256	32,407	33,663
Stocks	2,195	3,560	5,755	1,488	4,267	5,755
Debtors	3,652	5,257	8,909	—	8,909	8,909
Cash at bank and in hand	1,003	228	1,231	—	1,231	1,231
	6,850	9,045	15,895	1,488	14,407	15,895
Creditors: amounts falling due within one year	3,700	8,489	12,189	—	12,189	12,189
Creditors: amounts falling due after one year	(428)	268	(160)	—	(160)	(160)
Pre taxation	**25,751**	**35,836**	**61,587**	**2,744**	**58,843**	**61,587**
Corporation tax	(1,965)	(2,328)	(4,293)	—	(4,293)	(4,293)
Deferred tax	(322)	(3,784)	(4,106)	—	(4,106)	(4,106)
Post taxation	23,464	29,724	53,188	2,744	50,444	53,188

As a result, the previously reported profit and loss account reserves as at May 2002 have been reduced by £53.2m.

These accounting errors and discrepancies arose primarily as a consequence of an operations-driven culture focused on results and the Company's rapid growth which put the finance department under constant pressure in terms of both time and resources. The Group's rapid growth and the funding of a series of acquisitions largely obscured the existence of these accounting errors.

Note 2 to the accounts provides further detail on these adjustments.

Financial review

Disposals

The Group has undertaken selective disposals of non-core or under-performing assets during the year and subsequent to the year-end. In addition, where it has been in a position to agree acceptable terms, it has entered into arrangements to surrender its interests in sites where leases or agreements to lease have been signed but where those sites have not been developed (“landbank sites”).

During the year, 7 units were disposed of generating proceeds of £3.5m. In addition, 5 landbank sites were disposed of or surrendered for net proceeds of £0.3m, 2 sale and operating leaseback transactions were completed generating net proceeds of £3.6m and other assets were sold realising £0.5m. Overall these disposals produced a net profit of £0.2m.

Subsequent to the year-end the Group has completed a further 19 disposals of trading venues, realising net proceeds of £14.0m and has surrendered its interests in 10 landbank sites at a net cost of £0.2m.

The 26 trading venues disposed during the year and in the period after the year-end included 4 Litten Trees, 3 Slug & Lettuce and 2 Bar Meds. The remaining disposals were from non-core brands including Innlodge, For Your Eyes Only, Break for the Border and other unbranded sites.

The Board will continue to consider further disposals of units on a case-by-case basis but only where such a disposal falls within the overall objectives of the recovery plan. In addition, it will seek to exit its obligations in respect of the remaining 9 landbank sites and 3 vacant sites on acceptable terms.

Balance sheet

The combined impact of prior year adjustments, operating losses and exceptional items has resulted in a significant reduction in the value of shareholders’ funds.

As at May 2003, fixed assets amounting to £99.2m were offset by net current liabilities (excluding loans and overdrafts) of £19.4m, bank debt of £142.5m and provisions for liabilities and charges of £3.3m, resulting in net liabilities of £66.0m.

This excess of bank debt over identifiable assets demonstrates a clear need for a restructuring of the Group’s financing.

Fixed assets

The 6 October 2003 circular to shareholders highlighted that the investigation carried out into the previously announced accounting discrepancies concentrated largely on net current assets but also confirmed the need to investigate and restate fixed asset accounts. As a key part of the restatement exercise underlying this report and accounts, a comprehensive review of fixed asset accounting has been undertaken. This review has resulted in the identification of £32.4m in respect of accounting errors including capitalisation of items that should have been charged to the profit and loss account and under-depreciation of assets.

In addition, a full impairment review, carried out in accordance with FRS 11 and set in the context of the Company’s restated accounts and forecasts has been undertaken. This has resulted in a material downward revision of the carrying value of fixed assets and goodwill with an impairment charge of £67.0m and a provision for losses on post year-end disposals of fixed assets of £10.5m.

The impairment charge impacts on both goodwill, as to £8.8m, and tangible fixed assets, as to £58.2m. The balance sheet still includes £4.2m of goodwill, relating to a number of the Slug & Lettuce units acquired in 2000 and some units subsequently converted to Slug & Lettuce operations where continuing strong performance supports the value of the intangible asset. The Directors believe that the post-impairment carrying values of tangible and intangible fixed assets, at £95.0m and £4.2m respectively, represent a fair reflection of the value of the estate, taking account of its leasehold nature and current and anticipated rents.

Financial review

Current assets and liabilities

Net current assets and liabilities comprise stock (now excluding consumable base stocks as a result of a change in accounting policy), debtors, cash and creditors amounting to net current liabilities at 31 May 2003 of £19.4m before bank loans and overdrafts of £142.5m.

Although in the normal course the business is able to support a net current liabilities position as a consequence of receipts being almost entirely in cash, the level of net current liabilities at the year-end and throughout the majority of the past 18 months has placed a strain on the business and has required both intense working capital management and continuing support from the banks.

Trade creditors in the restated 2002 balance sheet are notably higher than at 31 May 2003. Although this partly reflects a significant tightening of credit terms from suppliers as a consequence of the Company's announcements during the year, it also reflects the serious failures in the Company's management of its cash flow and capital expenditure and, in particular, a level of capital expenditure committed to in early 2002 that could not be supported by its bank facilities and operating cash flows. As a consequence of the accounting weaknesses, the reality of this position was obscured at the time.

On the basis of the restated accounts, the Directors believe that the loan covenants were technically breached in the financial year 2002 and accordingly, bank loans have been reclassified as falling due within one year in the accounts as at May 2002. Given the current status of discussions with the banks, all bank loans and overdrafts for the year are shown as due within one year.

Cash Flow

The past 18 months have involved intensive cash flow management from the Company's finance team, an important element in the Company's survival. With the active support of the Company's bankers, creditors have been paid (including the significant build up of capital creditors in 2002) and the banks have funded the extensive exceptional fees arising from the Company's crisis position.

The cash flow statement shows the extent of bank support with additional loans net of repayments of £7.1m and an increase in overdraft of £9.5m funding a net cash outflow before financing of £16.7m and resulting in an increase in net debt from £122.2m at 31 May 2002 to £138.9m.

The net cash outflow before financing of £16.7m (2002 £16.5m) comprises a £5.8m inflow from operating activities (2002 inflow of £16.0m), net interest and related costs of £11.2m (2002 £8.6m), and net capital expenditure of £11.3m (2002 £19.5m). Capital expenditure in the year included the payment of £3.9m deferred purchase consideration on the 2002 acquisition of Parisa Café Bars. No dividends or taxation were paid in the financial year (2002 £4.4m).

The inflow from operating activities of £5.8m in the year is stated after exceptional cash outflows of £5.0m in respect of professional fees, interest and penalties and £1.7m in respect of costs on aborted developments

On 16 and 17 December 2003, the Company's interest rate hedging agreements, which carried fixed rates at significantly above forward rates available in the market at that time, were terminated and, the cost of this, approximately £4.3m, was added to the Company's total debt.

As at today's date the Company has indebtedness almost fully drawn down against facilities of £152.9m plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m. The Company also has some £5.1m in a prepayment account arising largely from the recent disposal of assets which cash may only be released with the consent of the banks. Neither the Company's current nor projected trading is sufficient to service such a high level of debt or support repayment. Accordingly the Company's equity value has been completely eroded and we have continued to trade by virtue of the banks' support.

Negotiations with the banks have concluded and, subject to Court and shareholder approval, the banks have agreed to convert approximately £83.4m of the amounts owing to them and other obligations to banks into shares. The resultant reduction in debt facilities outstanding to £80m represents a reduction of more than half when compared to current amounts owed by the Group to the banks.

Financial review

Derivatives and other financial instruments

The Group's principal financial instruments, other than derivatives, comprise bank loans and cash. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial instruments such as trade debtors and trade creditors, which arise directly from its operations.

The Group has also entered into derivative transactions (interest rate swaps) in order to manage the interest rate risks arising from the Group's operations and its sources of finance. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk and liquidity risk. The policies for managing each of these risks are summarised below and the magnitude of this risk that has arisen over the period is detailed in note 23.

Interest rate risk

The Group borrows in Sterling at both fixed and floating rates of interest and has then used interest rate swaps to generate the required interest profile and to manage the Group's exposure to interest fluctuations. At the year-end, the Group had £100m of its debts hedged by way of interest rate swap arrangements, the details of which are set out in note 23 to the accounts. Subsequent to the year-end, the Company broke these swap contracts, at a cost of £4.3m. This action was taken in view of the ongoing cost of the contracts and in the context of the overall debt restructuring under negotiation, as detailed below.

Following completion of the restructuring, interest rate risk will be limited to the extent of £35m of one year fixed rate borrowings out of total syndicated facilities of £70m which run to May 2006. The remaining £35m of syndicated facilities and £10m of one-year overdraft will be at floating rates.

Liquidity risk

Liquidity management, both during the year and subsequently, has been intensive and has been required to deal with risks that were not adequately dealt with in prior years.

As referred to in the Chairman's Statement, the Simmons & Simmons' and PricewaterhouseCoopers' report highlighted serious historic failures in the Company's management of its cash flow. It is now clear that the Company's capital expenditure committed to in the early part of 2002 could not be supported by its bank facilities and operating cash flows. Such expenditure exposed the Company to significant risk in the event of deterioration in trading.

As a consequence and as detailed above, the past 18 months have required intensive cash flow management from the Company's finance team and the active support of the Company's bankers.

This approach, through detailed and documented cash management procedures, will continue to develop in order to ensure that liquidity risk is managed effectively.

Taxation

As a consequence of the restatement of prior year accounts and the losses in the year, the Group has a corporation tax recoverable debtor of £1.8m at 31 May 2003, less a deferred tax liability of £0.2m. A deferred tax asset of £2.2m has not been recognised in the accounts. As a result the profit and loss account for the year is after a tax credit of £10.2m (2002 charge £4.4m), £8.3m of which relates to exceptional items.

Going concern

A restructuring of the Company's finances is necessary to enable the business to continue to trade and provide a more appropriate base from which to rebuild the business and to implement the recovery plan. Against this background, the Directors and the Company's advisers have been in extensive discussions with the banks with a view to agreeing a restructuring proposal that will reduce the Company's debt to a level that

Financial review

can be supported by the Company's trading. The banks have considered various alternatives but ultimately the Directors and the banks have reached agreement on restructuring proposals as summarised below.

The restructuring of the Company, once approved by shareholders and the Courts, will reduce the Company's existing facilities of £152.9m (plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m) to £80m with the balance of these obligations due to Banks (amounting in total to approximately £83.4m) being converted into equity. Approximately £5.1m remaining in a prepayment account, which arose largely from the recent disposal of assets, will be released by the banks to the Company on completion to enable the settlement of deal costs and provide working capital. The debt for equity conversion will be coupled with the restructuring whereby a new holding company will become the ultimate holding company of SFI by way of a Scheme of Arrangement. The Company has also applied to the Court to eliminate its deficit on profit and loss reserves under the scheme by cancellation of the amounts standing to the credit of the share premium account and reduction in share capital, as increased by the debt for equity conversion ("reduction of capital"). Full details of the restructuring and Scheme of Arrangement, including a reduction of capital, are set out in a Scheme Circular posted to shareholders at the same time as these accounts. The Court meeting and EGM to approve the Scheme of Arrangement and implement the restructuring will be held on 7 May 2004 and the Scheme of Arrangement is expected to become effective by the end of May. An irrevocable commitment to vote in favour of the resolutions proposed at the Court meeting and EGM has been received from the Company's largest shareholder and your Directors believe that the restructuring will proceed.

In the event that the restructuring proposals are not implemented the Company will not be able to repay its existing facilities in accordance with their terms and would only be able to continue to meet its obligations as they fall due with the ongoing support of the banks. The Board believes that in the context of the discussions and negotiations it has had over the last few months with the banks, in the event that the proposals are not implemented, there can be no guarantee that the Company will continue to enjoy the support of the banks. In such circumstances the Company would be forced to seek the appointment of an administrator or pursue other insolvency options.

Your Directors believe that the restructuring followed by implementation of the recovery plan will enable the Company to continue to operate as a going concern and, in the medium term, to refinance its debt on conventional banking terms at or beyond the term of the new syndicated facilities which, if implemented, will extend to the end of May 2006.

Therefore, the Directors believe it is appropriate to prepare these accounts on a going concern basis. No adjustments have been made to these accounts that would be necessary in the event that the proposed restructuring does not go ahead or that the recovery plan is not successful.

Tim Andrews
Finance Director

7 April 2004

Corporate governance statement

Following the events of the past year and the background to those events in prior years, the Company's commitment to corporate governance has now been redefined. Although the Company has now de-listed and, as a consequence, this statement is not a requirement, the Board remains accountable to the Company's shareholders for good corporate governance and this statement describes how the principles of corporate governance are applied to the Company and its compliance with the Code provisions.

Statement by the Directors on compliance with the provisions of the Combined Code

The Company has been in full compliance with the provisions set out in Section 1 of the Combined Code throughout the year with the exception of:

B2.1& B2.2 The remuneration committee did not comprise solely independent Non-Executive Directors as Tony Hill is not considered independent and was on this committee until his resignation on 12 November 2002.

Following the year-end, the Company was non-compliant in the following areas:

C3.1 Following the resignation of Robert Lo on 7 November 2003, the audit committee comprised only 2 Non-Executive Directors.

A2.1 The role of Chairman and Chief Executive has been combined since Stuart Lawson's appointment on 23 June 2003.

The workings of the Board and its Committees

The Board

The Board currently comprises the Executive Chairman, the Finance Director and two independent Non-Executive Directors. The biographies appear on page 8. Two Non-Executive Directors resigned during the year. Subsequent to the year-end one Executive and a further Non-Executive Director resigned.

All of the Non-Executive Directors who have served during the year are considered by the Board to be independent except for Tony Hill due to his role in founding the Company and subsequently as Chief Executive.

Following the appointment of Stuart Lawson to the Board on 23 June 2003 and the resignation of Andrew Latham on 3 October 2003, the role of Chairman and Chief Executive has been combined into Stuart Lawson's role of Executive Chairman.

The senior Non-Executive Director is John Brackenbury.

The Board is responsible to shareholders for the proper management of the Group. A statement of the Directors' responsibilities in respect of the accounts is set out on page 28 and a statement on going concern is given on page 38.

The Board has a formal schedule of matters specifically reserved to it for decision. All Directors have access to the advice and services of the Company Secretary, Edward Lavelle, who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. In addition, the Company Secretary ensures that the Directors receive appropriate training as necessary. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The Board meets every month, reviewing trading performance, ensuring adequate funding, setting and monitoring strategy and reporting to shareholders. The Non-Executive Directors have a particular responsibility to ensure that the strategies proposed by the Executive Directors are fully considered. To enable the Board to discharge its duties, all Directors now receive appropriate and timely information. Briefing papers are distributed by the Company Secretary to all Directors in advance of Board meetings. The Chairman ensures that the Directors take independent professional advice as required.

Corporate governance statement

The following committees deal with the specific aspects of the Group's affairs.

Nomination committee

During the year the nomination committee, chaired by John Brackenbury, comprised the Non-Executive Directors. Following his appointment on 23 June 2003, Stuart Lawson, the Executive Chairman, also joined the committee.

The committee is responsible for proposing candidates for appointment to the Board, having regard to the balance and structure of the Board. In appropriate cases, recruitment consultants are used to assist the process. All Directors are subject to re-election at least every three years.

Remuneration committee

John Brackenbury chairs the remuneration committee and its other members are Nicholas Irens (until his resignation on 30 June 2002), Tony Hill (until his resignation on 12 November 2002), Robert Lo (until his resignation on 7 November 2003) and Hugh Siegle. It is responsible for making recommendations to the Board, within agreed terms of reference, on the Company's framework of executive remuneration and its cost. The committee determines the contract terms, remuneration and other benefits for each of the Executive Directors, including performance related bonus schemes, pension rights and compensation payments. The Board itself determines the remuneration of the Non-Executive Directors.

Further details of the Company's policies on remuneration, service contracts and compensation payments are included in the Directors' Remuneration Report.

Audit committee

The audit committee which was chaired by Robert Lo, until his resignation on 7 November 2003 at which time Hugh Siegle was appointed chairman in his place, comprises all the Non-Executive Directors, and meets not less than twice annually. The committee provides a forum for reporting by the Group's external auditors. Meetings are also attended, by invitation, by the Executive Chairman and the Finance Director.

The audit committee is responsible for reviewing a wide range of matters including the annual financial accounts before their submission to the Board and monitoring the controls that are in force to ensure the integrity of the information reported to the shareholders. The audit committee advises the Board on the appointment of external auditors and on their remuneration both for audit and non-audit work, and discusses the nature, scope and results of the audit with external auditors. The audit committee keeps under review the cost effectiveness and the independence and objectivity of the auditors.

Relations with shareholders

Communications with shareholders continue to be given high priority. The Financial Review set out above includes a review of the business and likely future developments.

The Board uses the Annual General Meeting to communicate with private and institutional investors and welcomes their participation. The Chairman aims to ensure that the chairmen of the audit, remuneration and nomination committees are also available at Annual General Meetings to answer questions.

Internal control

The Directors acknowledge that they are responsible for the Group's system of internal control and for reviewing its effectiveness and that significant attention has been required in this area over the past year. The processes adopted to address control failures are summarised in the Chairman's Statement. The system now in place, which is still subject to further planned improvement, is designed to manage rather than eliminate the risk of failure to achieve the Group's strategic objectives, and can only provide reasonable not absolute assurance against material misstatement or loss.

Corporate governance statement

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing the significant risks faced by the Group. The process was formally instituted in September 2002 and has been in place since the end of 2002 and up to the date of approval of the report and accounts. The Board regularly reviews the process and has reviewed the effectiveness of the system of internal controls in the year to May 2003.

The Group's key risk management processes and system of internal control procedures include the following:

- Management structure
- Identification and evaluation of business risks
- Information and financial reporting systems
- Investment appraisal
- Audit committee

Directors' remuneration report

Remuneration committee

John Brackenbury chairs the remuneration committee. The committee makes recommendations to the Board, within agreed terms of reference, on an overall remuneration package for Executive Directors and other senior executives. Stuart Lawson, the Executive Chairman, provides advice to the committee in relation to the remuneration of other senior executives.

Remuneration policy

The Company's policy on Directors' remuneration for 2003 and subsequent financial years is that the overall remuneration package should be sufficiently competitive to attract, retain and motivate high quality executives capable of achieving the Group's objectives and thereby enhancing shareholder value. The package consists of basic salary, benefits, share options, performance related bonuses and pension contributions, with a significant proportion based on performance and dependent upon the achievement of demanding targets. Consideration is given to pay and employment policies elsewhere in the Group, especially when determining annual salary increases.

Executive remuneration package

The remuneration committee has now implemented its proposals to realign executive Directors' remuneration packages to support the Company's business strategy, whilst ensuring that rewards are market competitive.

The details of individual components of the remuneration package and service contracts are discussed below.

Basic salary and benefits

The salary and benefits are reviewed annually, with the policy for 2003 and subsequent years being that basic salary does not increase by more than the average increase for employees throughout the Group. Benefits principally comprise private healthcare.

Share options

No share options have been granted in the year.

Performance related bonuses

Andrew Latham received a bonus in the year relating to performance, as then reported, for the year to 31 May 2002.

On joining the Company, Stuart Lawson had an entitlement to a bonus of up to 100% of salary on the basis of set criteria agreed by the remuneration committee. In the current year, 50% of that bonus is guaranteed with the balance conditional on performance and the success of the proposed restructuring.

Tim Andrews has an entitlement to a bonus of up to 50% of salary conditional on performance and the success of the proposed restructuring.

Pensions

The Company contributes into the pension schemes of Executive Directors at 10% of salary with the Director paying a minimum of 3%.

Fees

The fees for Non-Executive Directors are determined by the Board within the limits stipulated in the Articles of Association. The Non-Executive Directors are not involved in any discussions or decision about their own remuneration.

Directors' remuneration report

Service contracts

The Company's policy is for all Executive Directors to have contracts of employment of one year's duration and with provision for termination on no more than 12 months' notice.

None of the Non-Executive Directors have service contracts. Letters of appointment provide for an initial period of three years, subject to review. The remuneration of the Non-Executive Directors takes the form solely of fees, which are set by the Board having taken advice on appropriate levels.

There are no predetermined special provisions for Executive or Non-Executive Directors with regard to compensation in the event of loss of office. The remuneration committee considers the circumstances of individual cases of early termination and in exceptional circumstances only would recommend compensation payments in excess of the Company's contractual obligations.

The service contracts and letters of appointment of the Directors include the following terms:

	Date of Contract	*Unexpired term (months)*	*Notice period (months)*
Executive Directors:			
S Lawson	23 June 2003	12	6
TK Andrews	26 April 2002 (note 1)	(note 2)	12

Non-Executive Directors:

Hugh Siegle and John Brackenbury are appointed under letters of appointment by which they do not participate in any of the Company's bonus, share option or incentive schemes and are not subject to a notice period.

Note 1 — Contract effective 8 July 2002

Note 2 — Tim Andrews gave 12 months' notice of his resignation on 27 January 2004

Directors' remuneration report

Directors' remuneration

The remuneration of the Directors is as follows:

	Basic salary and fees £000	*Benefits £000*	*Performance related bonuses £000*	*Compensation for loss of office £000*	*Total 2003 £000*	*Total 2002 £000*
Executive Directors:						
AM Latham (resigned 3/10/03)	190	1	10	—	201	179
TK Andrews (appointed 8/7/02)	126	—	—	—	126	—
Non-executive Directors:						
AS Hill (resigned 12/11/02)	62	—	—	—	62	460
RA Lo (resigned 7/11/03)	25	—	—	—	25	30
H Siegle	25	—	—	—	25	29
NJ Irens (resigned 30/6/02)	2	—	—	—	2	29
FEJG Brackenbury	25	—	—	—	25	31
Former Directors:						
CR Eplett (resigned 12/9/01)	—	—	—	32	32	49
JSP Kowszun (resigned 30/4/02)	—	—	—	—	—	151
	455	1	10	32	498	958

Clive Eplett left SFI Group plc's employment and resigned as a Director in September 2001, however the Company continued to pay him a salary according to his contract until September 2002. These amounts are included in "compensation for loss of office" above.

The remuneration package of Executive Directors includes non-cash benefits comprising the provision of private health insurance.

Following the year-end Andrew Latham received compensation under the terms of a compromise agreement of £217,490.

Pension entitlements

The Company contributes to Executive Directors' private defined contribution pension schemes.

The pension contributions of the Directors are as follows:

	2003 £000	*2002 £000*
AS Hill (resigned 12/11/02)	—	127
AM Latham (resigned 3/10/03)	19	14
TK Andrews (appointed 8/7/02)	12	—
CR Eplett (resigned 12/9/01)	—	3
JSP Kowszun (resigned 30/4/02)	—	11
	31	155

Tony Hill was an Executive Director until April 2002 when he became Non-Executive Chairman, at which date the contributions paid by the Company into his personal pension scheme ceased.

Directors' remuneration report

Interests in options

Share options are granted by the remuneration committee to attract, retain and motivate employees and Directors and to reflect their performance.

The Directors who served during the year held the following interests in options as at the year-end:

	Exercise Price	*At 1 June 2002 No.*	*Awarded during the year No.*	*Exercised during the year No.*	*Expired unexercised during the year No.*	*At 31 May 2003* No.*	*Dates exercisable No.*
AS Hill	109.5p	105,000	—	—	—	105,000	2000-2007
	198p	150,000	—	—	—	150,000	2002-2009
	204p	26,700	—	—	—	26,700	2003-2010
		281,700	—	—	—	281,700	
AM Latham	109.5p	55,556	—	—	—	55,556	2000-2007
	198p	150,000	—	—	—	150,000	2002-2009
	204p	5,300	—	—	—	5,300	2003-2010
		210,856	—	—	—	210,856	

* or at date of resignation if earlier

Messrs Andrews, Lo, Siegle, Brackenbury and Irens have held no options in the shares of the Company.

All options to Directors are only available for exercise if the growth in the basic earnings per share at the third anniversary of the date of grant shows an increase of 2% or more than the increase in Index of Retail Prices over that three-year period.

The market price of the Company's shares on 12 November 2002, the date of their suspension was £0.31 per share. The highest and lowest market prices during the year were £2.13 and £0.23 respectively.

The interests of the Directors to subscribe for or acquire ordinary shares have not changed since the year-end.

By order of the Board

Edward Lavelle
Company Secretary

7 April 2004

Directors' report

The Directors present their report and accounts for the year ended 31 May 2003.

Results and dividends

The Group loss for the year, after taxation, amounted to £99.7m, an increase in losses from £10.6m in the previous year.

No dividend will be paid (2002: dividend of £2,082,000 of which £1,402,000 was withdrawn).

During the year to 31 May 2002, the Company paid an interim dividend of £680,000. Subsequently, it has been found that the Company did not have adequate distributable reserves to pay this dividend as required under the Companies Act. This is evident from Note 25 to these accounts. Consequently, as the statutory procedures in respect of this dividend were not complied with, it was unlawful. The Directors are considering legal remedies. The final dividend paid in respect of the year to 31 May 2001 was also unlawful on the same basis. Again, the Directors are considering legal remedies. No asset is recognised in these accounts in respect of any potentially recoverable amounts.

Principal activity

The principal activity of the Group continues to be the operation of high street bars, public houses and restaurants.

Review of the business and future developments

A review of the business and the future developments of the Group is presented in the Chairman's Statement and in the Financial Review.

Events since the balance sheet date

Subsequent to the year-end the Company has completed a further 19 disposals of trading venues, realising net proceeds of £14.0m and has surrendered its interests in 10 landbank sites at a net cost of £0.2m.

On 16 and 17 December 2003, the Company's interest rate hedging agreements, which carried fixed rates at significantly above forward rates available in the market at that time, were terminated at a cost of approximately £4.3m, which was added to the Company's total debt.

A restructuring of the Company's finances is necessary to enable the business to continue to trade and provide a more appropriate base from which to rebuild the business and to implement the recovery plan. Against this background, the Directors and the Company's advisers have been in extensive discussions with the banks with a view to agreeing a restructuring proposal that will reduce the Company's debt to a level that can be supported by the Company's trading. The banks have considered various alternatives but ultimately the Directors and the banks have reached agreement on restructuring proposals as summarised below.

The restructuring of the Company, once approved by shareholders and the Courts, will reduce the Company's existing facilities of £152.9m (plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m) to £80m with the balance of these obligations due to Banks (amounting in total to approximately £83.4m) being converted into equity. Approximately £5.1m remaining in a prepayment account, which arose largely from the recent disposal of assets, will be released by the banks to the Company on completion to enable the settlement of deal costs and provide working capital. The debt for equity conversion will be coupled with the restructuring whereby a new holding company will become the ultimate holding company of SFI by way of a Scheme of Arrangement. The Company has also applied to the Court to eliminate its deficit on profit and loss reserves under the scheme by cancellation of the amounts standing to the credit of the share premium account and reduction in share capital, as increased by the debt for equity conversion ("reduction of capital"). Full details of the restructuring and Scheme of Arrangement, including the reduction of capital, are set out in a Scheme Circular posted to shareholders at the same time as these accounts. The Court meeting and EGM to approve the Scheme of Arrangement and implement the restructuring will be held on 7 May 2004 and the Scheme of Arrangement is expected to become effective by the end of May. An irrevocable commitment to vote in favour of the resolutions proposed at the Court

Directors' report

meeting and EGM has been received from the Company's largest shareholder and your Directors believe that the restructuring will proceed.

In the event that the restructuring proposals are not implemented the Company will not be able to repay its existing facilities in accordance with their terms and would only be able to continue to meet its obligations as they fall due with the ongoing support of the banks. The Board believes that in the context of the discussions and negotiations it has had over the last few months with the banks, in the event that the Proposals are not implemented, there can be no guarantee that the Company will continue to enjoy the support of the banks. In such circumstances the Company would be forced to seek the appointment of an administrator or pursue other insolvency options.

Your Directors believe that the restructuring followed by implementation of the recovery plan will enable the Company to continue to operate as a going concern and, in the medium term, to refinance its debt on conventional banking terms at or beyond the term of the new syndicated facilities which, if implemented, will extend to the end of May 2006.

Therefore, the Directors believe it is appropriate to prepare these accounts on a going concern basis. No adjustments have been made to these accounts that would be necessary in the event that the restructuring and recovery plan do not succeed.

Political and charitable contributions

During the year, the Group made no political or charitable contributions.

Disabled employees

The Group gives full consideration to applications for employment from disabled persons where the requirements of the job can be adequately fulfilled by a handicapped or disabled person.

Where existing employees become disabled, it is the Group's policy wherever practicable to provide continuing employment under normal terms and conditions and to provide training and career development and promotion to disabled employees wherever appropriate.

Employee involvement

The Company continues to encourage the involvement and participation of employees in matters which affect their interests as employees. It is the Group's policy to promote equality of opportunity in both recruitment and career development.

Health and safety

The Group is committed to providing a safe environment for its customers and employees. Formal policies and procedures to ensure this aim is met are regularly reviewed and form a core part of each employee's training.

Environment

The Group aims to limit the impact of its operations on the environment and therefore seeks to develop and maintain good environmental practices. The Group is fully compliant with EU and domestic packaging legislation and other requirements.

Directors' report

Directors and their interests

The Directors of the Company as at the end of the year and their interests in its share capital which is beneficially held other than options to acquire ordinary shares as detailed in the analysis of options included in the Directors' Remuneration Report are as follows:

25p ordinary shares	*At 31 May 2003*	*At 1 June 2002 or subsequent date of appointment*
AM Latham (resigned 3 October 2003)	18,067	18,067
TK Andrews (appointed 8 July 2002)	—	—
RA Lo (resigned 7 November 2003)	172,618	172,618
H Siegle	8,601	8,601
FEJG Brackenbury	20,773	20,773

In addition to the above, AS Hill and NJ Irens served as Directors until 12 November 2002 and 30 June 2002 respectively at which date they resigned.

Following the year-end, S Lawson was appointed to the Board on 23 June 2003.

The interests of the Directors in the ordinary shares have not changed since the year-end.

Major interests in shares

As at the date of this document, Trafalgar Catalyst Fund held 16,011,907 ordinary shares of 25p each (21.3% of the ordinary share capital) in the Company and Canada Life Investment Management (UK) Limited held 2,598,000 ordinary shares of 25p each (3.5% of the ordinary share capital). No other person has notified an interest in the ordinary shares of the Company required to be disclosed to the Company in accordance with sections 198 to 208 of the Companies Act 1985.

Creditor payment policy and practice

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers, provided that all trading terms and conditions have been complied with.

At 31 May 2003, the Company had an average of 41 days (2002: 98 days) purchases outstanding in trade creditors.

Special business at the Extraordinary General Meeting

The recommended proposals for the restructuring of the Company, the introduction of a new holding company and a reduction of capital through a Scheme of Arrangement under Section 425 of the Companies Act, together with the approval of these accounts will be put to shareholders at an extraordinary general meeting on 7 May 2004.

Auditors

Horwath Clark Whitehill resigned as auditors on 2 September 2003 and Ernst & Young LLP were appointed to fill the vacancy arising.

A resolution to reappoint Ernst & Young LLP as auditors was put to the members at the Annual General Meeting on 7 November 2003 and was approved.

Edward Lavelle
Company Secretary

7 April 2004

Statement of directors' responsibilities in respect of the financial statements

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

Independent auditors' report

to the members of SFI Group plc

We have audited the Group's financial statements for the year ended 31 May 2003 which comprise the Group profit and loss account, Group statement of total recognised gains and losses, Group balance sheet, Balance sheet, Group statement of cash flows, Reconciliation of shareholders' funds and the related notes 1 to 28. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report and Accounts, including the financial statements which are required to be prepared in accordance with United Kingdom law and accounting standards as set out in the Statement of Directors' Responsibilities in relation to the financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you 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 regarding directors' remuneration and transactions with the Group is not disclosed.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited financial statements. This other information comprises the Directors' report, Chairman's statement, Financial review, Directors' remuneration report and Corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 Group's circumstances, consistently applied and adequately disclosed.

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

Fundamental uncertainty — going concern

In forming our opinion we have considered the adequacy of the disclosures made in the financial statements concerning the possible outcome for continuing finance being made available to the Company. The bankers have agreed with management a restructuring plan for the Company, to reduce existing obligations of £163.4m to £80m, with the balance of these obligations (amounting to £83.4m) being converted into equity. This transaction cannot be implemented until both shareholder and court approval have been obtained. The

Independent auditors' report
to the members of SFI Group plc

financial statements have been prepared on a going concern basis, the validity of which depends upon both shareholder and court approval of the proposed restructuring. The financial statements do not include any adjustments which would result from a failure to achieve approval of the proposed restructuring. Details of the circumstances relating to this fundamental uncertainty are described in full within note 1. 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 and of the Group as at 31 May 2003 and of the loss of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor

Southampton

7 April 2004

Group profit and loss account
for the year ended 31 May 2003

	Notes	Before Exceptional items 2003 £000	Exceptional items 2003 £000	Total 2003 £000	(restated) 2002 £000
Turnover	4	**153,171**	**—**	**153,171**	**144,143**
Cost of sales		(40,446)	—	(40,446)	(35,322)
Gross profit		112,725	—	112,725	108,821
Administrative expenses		(119,382)	(78,270)	(197,652)	(106,414)
Operating (loss)/profit	5	**(6,657)**	**(78,270)**	**(84,927)**	**2,407**
Profit on disposal of tangible fixed assets	6	—	149	149	186
Provision for loss on disposal — tangible fixed assets	6	—	(10,459)	(10,459)	—
(Loss)/profit on ordinary activities before interest and taxation		**(6,657)**	**(88,580)**	**(95,237)**	**2,593**
Bank interest receivable		7	—	7	—
Interest payable and similar charges	8	(11,201)	(3,549)	(14,750)	(8,806)
Loss on ordinary activities before taxation		**(17,851)**	**(92,129)**	**(109,980)**	**(6,213)**
Tax on loss on ordinary activities	9	1,972	8,265	10,237	(4,350)
Loss on ordinary activities after taxation		(15,879)	(83,864)	(99,743)	(10,563)
Dividends					
Ordinary dividend on equity shares	11	1,402	—	1,402	(2,082)
Retained loss for the year		**(14,477)**	**(83,864)**	**(98,341)**	**(12,645)**
Loss per share	12	£(0.21)	£(1.12)	£(1.33)	£(0.14)

Group statement of total recognised gains and losses
for the year ended 31 May 2003

	2003 £000	(restated) 2002 £000
Loss for the financial year	(99,743)	(10,563)
Total recognised losses relating to the year	(99,743)	(10,563)
Prior year adjustment (as explained in note 2)	(53,188)	
Total losses recognised since last annual report	(152,931)	

Reconciliation of shareholders' funds
for the year ended 31 May 2003

	2003 £000	(restated) 2002 £000
Total recognised gains and losses	(99,743)	(10,563)
Dividends	1,402	(2,082)
Other movements:		
New shares issued	95	272
Total movements during the year	(98,246)	(12,373)
Shareholders' funds at 1 June (originally £85,465,000 (2002 £74,374,000) before deducting prior year adjustment of £53,188,000 (2002 £29,724,000))	32,277	44,650
Shareholders' funds at 31 May	(65,969)	32,277

Group balance sheet
at 31 May 2003

	Notes	2003 £000	(restated) 2002 £000
Fixed assets			
Intangible assets	13	4,167	13,797
Tangible assets	14	95,041	175,309
		99,208	189,106
Current assets			
Stocks	16	2,609	4,043
Debtors	17	3,018	4,959
Cash at bank and in hand		3,609	3,511
		9,236	12,513
Creditors: amounts falling due within one year	18	(171,124)	(154,805)
Net current liabilities		(161,888)	(142,292)
Total assets less current liabilities		(62,680)	46,814
Creditors: amounts falling due after more than one year	19	—	(3,902)
Provisions for liabilities and charges	22	(3,289)	(10,635)
		(65,969)	32,277
Capital and reserves			
Called up share capital	24	18,770	18,748
Share premium account	25	37,578	37,505
Profit and loss account	25	(122,317)	(23,976)
Shareholders' funds — equity interests		(65,969)	32,277

Approved by the Board on 7 April 2004

Stuart Lawson Executive Chairman	Tim Andrews Finance Director

Balance sheet
at 31 May 2003

	Notes	2003 £000	(restated) 2002 £000
Fixed assets			
Tangible assets	14	62,882	124,599
Investments	15	41,470	50,036
		104,352	174,635
Current assets			
Stocks	16	2,609	4,043
Debtors	17	27,949	31,582
Cash at bank and in hand		3,609	3,511
		34,167	39,136
Creditors: amounts falling due within one year	18	(191,093)	(172,293)
Net current liabilities		(156,926)	(133,157)
Total assets less current liabilities		(52,574)	41,478
Creditors: amounts falling due after more than one year	19	—	(3,902)
Provisions for liabilities and charges	22	(3,116)	(8,798)
		(55,690)	28,778
Capital and reserves			
Called up share capital	24	18,770	18,748
Share premium accounts	25	37,578	37,505
Profit and loss account	25	(112,038)	(27,475)
Shareholders' funds — equity interests		(55,690)	28,778

Approved by the Board on 7 April 2004

Stuart Lawson
Executive Chairman

Tim Andrews
Finance Director

Group statement of cash flows
for the year ended 31 May 2003

	Notes	2003 £000	(restated) 2002 £000
Net cash inflow from operating activities	26(a)	5,728	15,986
Returns on investments and servicing of finance			
Interest received		7	—
Interest paid		(9,890)	(8,628)
Bank fees		(1,299)	—
		(11,182)	(8,628)
Taxation			
Corporation tax		2	(2,457)
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(15,357)	(25,431)
Receipts from sales of intangible fixed assets		—	702
Receipts from sales of tangible fixed assets		7,970	13,491
		(7,387)	(11,238)
Acquisitions and disposals			
Purchase of subsidiary undertaking		—	(8,255)
Net cash acquired with subsidiary undertaking		—	40
Deferred consideration relating to 2002 acquisition		(3,902)	—
		(3,902)	(8,215)
Equity dividends paid		—	(1,950)
Net cash outflow before financing		(16,741)	(16,502)
Financing			
Issue of ordinary share capital		95	271
New loans		11,190	18,500
Payment of loans		(4,074)	(2,808)
		7,211	15,963
Decrease in cash	26(b)	(9,530)	(539)

Reconciliation of net cash flow to movement in debt
for the year ended 31 May 2003

	Notes	2003 £000	(restated) 2002 £000
Decrease in cash	26(b)	(9,530)	(539)
Cash inflow from increase in loans		(11,190)	(18,500)
Repayment of loans		4,074	2,808
Change in net debt resulting from cash flows		(16,646)	(16,231)
Movement in net debt	26(b)	(16,646)	(16,231)
Net debt at 1 June	26(b)	(122,201)	(105,970)
Net debt at 31 May	26(b)	(138,847)	(122,201)

Notes to the financial statements

at 31 May 2003

1. Fundamental accounting concept — going concern

A restructuring of the Company's finances is necessary to enable the business to continue to trade and provide a more appropriate base from which to rebuild the business and to implement the recovery plan. Against this background, the Directors and the Company's advisers have been in extensive discussions with the banks with a view to agreeing a restructuring proposal that will reduce the Company's debt to a level that can be supported by the Company's trading. The banks have considered various alternatives but ultimately the Directors and the banks have reached agreement on restructuring proposals as summarised below.

The restructuring of the Company, once approved by shareholders and the Courts, will reduce the Company's existing facilities of £152.9m (plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m) to £80m with the balance of these obligations due to Banks (amounting in total to approximately £83.4m) being converted into equity. Approximately £5.1m remaining in a prepayment account, which arose largely from the recent disposal of assets, will be released by the banks to the Company on completion to enable the settlement of deal costs and provide working capital. The debt for equity conversion will be coupled with the restructuring whereby a new holding company will become the ultimate holding company of SFI by way of a Scheme of Arrangement. The Company has also applied to the Court to eliminate its deficit on profit and loss reserves under the scheme by cancellation of the amounts standing to the credit of the share premium account and reduction in share capital, as increased by the debt for equity conversion ("reduction of capital"). Full details of the restructuring and Scheme of Arrangement, including a reduction of capital, are set out in a Scheme Circular posted to shareholders at the same time as these accounts. The Court meeting and EGM to approve the Scheme of Arrangement and implement the restructuring will be held on 7 May 2004 and the Scheme of Arrangement is expected to become effective by the end of May. An irrevocable commitment to vote in favour of the resolutions proposed at the Court meeting and EGM has been received from the Company's largest shareholder and your Directors believe that the restructuring will proceed.

In the event that the restructuring proposals are not implemented the Company will not be able to repay its existing facilities in accordance with their terms and would only be able to continue to meet its obligations as they fall due with the ongoing support of the banks. The Board believes that in the context of the discussions and negotiations it has had over the last few months with the banks, in the event that the Proposals are not implemented, there can be no guarantee that the Company will continue to enjoy the support of the banks. In such circumstances the Company would be forced to seek the appointment of an administrator or pursue other insolvency options.

Your Directors believe that the restructuring followed by implementation of the recovery plan will enable the Company to continue to operate as a going concern and, in the medium term, to refinance its debt on conventional banking terms at or beyond the term of the new syndicated facilities which, if implemented, will extend to the end of May 2006.

Therefore, the Directors believe it is appropriate to prepare these accounts on a going concern basis. No adjustments have been made to these accounts that would be necessary in the event that the restructuring and recovery plan do not succeed.

2. Prior year adjustments

In accordance with the provisions of FRS18, the Directors have performed a full review of accounting policies and estimation techniques adopted by the Group to ensure that the Company has properly adopted all relevant accounting standards.

Notes to the financial statements
at 31 May 2003

2. Prior period adjustments (continued)

As a result of this exercise the following prior year adjustments have been made in accordance with the provisions of FRS3 — "Reporting Financial Performance".

(a) adjustments impacting on prior period profit and loss accounts

The profit and loss account impact of all positive adjustments in the table below reduces previously reported profits. These are analysed by year and as between adjustments reflecting change in accounting policy and those reflecting fundamental errors.

Group

	By year			*By type of adjustment*		
	2002 £000	*2001 and earlier £000*	*Total £000*	*Change in accounting policy £000*	*Fundamental error £000*	*Total £000*
Intangible assets	—	—	—	—	—	—
Tangible assets	15,629	18,034	33,663	1,256	32,407	33,663
	15,629	18,034	33,663	1,256	32,407	33,663
Stocks	2,195	3,560	5,755	1,488	4,267	5,755
Debtors	3,652	5,257	8,909	—	8,909	8,909
Cash at bank and in hand	1,003	228	1,231	—	1,231	1,231
	6,850	9,045	15,895	1,488	14,407	15,895
Creditors: amounts falling due within one year	3,700	8,489	12,189	—	12,189	12,189
Creditors: amounts falling due after one year	(428)	268	(160)	—	(160)	(160)
Pre taxation	**25,751**	**35,836**	**61,587**	**2,744**	**58,843**	**61,587**
Corporation tax	(1,965)	(2,328)	(4,293)	—	(4,293)	(4,293)
Deferred tax	(322)	(3,784)	(4,106)	—	(4,106)	(4,106)
Post taxation	23,464	29,724	53,188	2,744	50,444	53,188

As a result, the previously reported profit and loss account reserves have been reduced by £53,188,000. The 2002 operating profit has been reduced by £24,783,000, 2002 profit before interest and tax reduced by £24,860,000 and the 2002 interest charge has been increased by £891,000.

Notes to the financial statements
at 31 May 2003

2. Prior period adjustments (continued)

(b) adjustments not impacting on prior period profit and loss accounts

The adjustments below relate to fundamental errors not affecting the profit and loss account.

(1) Goodwill previously written off to reserves

	(restated) *2002* *£000*
As previously stated at 31 May 2002	2,776
Prior year adjustments	(355)
Restated at 31 May 2002	2,421

There is no current year profit and loss effect or reserves effect of these prior year adjustments, which relate to the goodwill allocated to properties when they were disposed of in prior years.

(2) Loans previously shown as falling due after one year

	(restated) *2002* *£000*
As previously stated at 31 May 2002	116,351
Prior year adjustments	(116,351)
Restated at 31 May 2002	—

On the basis of the restated accounts, the Directors believe that the loan covenants were technically breached in the financial year 2002 and accordingly, bank loans have been reclassified as current in the accounts as at May 2002. Given the current status of discussions with the banks, all bank loans and overdrafts for the year are shown as due within one year.

(c) Company adjustments

All of the pre-tax Group adjustments in note 2a above have been reflected through the Company profit and loss account.

All of the tax adjustments in note 2a above, save for £942,000 credit, which relates to Slug & Lettuce Limited, and £358,000 credit, which relates to Parisa Café Bars Limited, have been reflected through the Company profit and loss account.

In addition, £4,318,000 of charges arising from intercompany trading and management charges are reflected in the restatement of the Company profit and loss reserve. These do not impact on the Group position.

The Company profit and loss account reserves are summarised in the table below:

	£000	*£000*
As previously reported at 31 May 2002		22,695
Group prior year adjustments (note 2a)	(53,188)	
Tax adjustments	(1,300)	
Intercompany adjustment	4,318	
		(50,170)
Restated at 31 May 2002		(27,475)

Notes to the financial statements
at 31 May 2003

2. Prior period adjustments (continued)

(d) Changes in accounting policies

The following explanations are provided in respect of changes to accounting policies:

Tangible fixed assets

In previous years the Company capitalised the interest on borrowings directly attributable to properties in the course of major refurbishment or initial construction. As a change to the policy all interest is now charged to the profit and loss account as incurred. Such an accounting policy is deemed to present a more appropriate approach to the accounts. The effect of this change in accounting policy is to reduce the tangible fixed assets as previously reported at 31 May 2002 by £1,256,000 and to reduce profit for the year ended 31 May 2002 by £453,000. It has not been practicable to calculate the impact on the current year had this accounting policy not been changed.

Stocks

In previous years the Company included non-resale consumables within closing stocks. As a change to its accounting policy the cost of such items is now charged to the profit and loss accounts as incurred. Such an accounting policy is believed to present a more appropriate approach to the accounts and is in line with industry best practice principles. The effect of this change in accounting policy is to reduce stocks as previously reported at 31 May 2002 by £1,488,000 and to reduce reported profit for the year ended 31 May 2002 by £344,000. This change in policy has also reduced the reported profit for the year ended 31 May 2003 by £329,000.

(e) Fundamental errors

The following explanations are provided in respect of fundamental errors:

Tangible fixed assets

In previous years the Company has capitalised items of a revenue nature including repair and renewal costs, abortive costs on landbank sites and IT and development team costs. Costs inappropriately capitalised in the year to 31 May 2002 amounted to £10,738,000.

The depreciation calculations in previous years have been arithmetically incorrect and in addition a further undercharge has resulted from inappropriate residual values having been allocated to short life assets. The additional depreciation charge resulting in the year to 31 May 2002 was £4,438,000.

Stocks

In previous years, when a new site was opened an initial level of non-resale consumables would be capitalised as base stock to be used in running the outlet. All future expenditure on non-consumables of this nature should have been expensed through the profit and loss account. This policy was not applied in a consistent manner and a number of sites were found to be carrying an inappropriate level of base stock resulting from continued capitalisation of non-sale consumables after the site had opened.

Stock balances had been carried in respect of balances for goods returned for which the Company expected replacement from suppliers. These balances were found to be unsupported and irrecoverable.

Arithmetic errors in the calculation of house stocks resulted in additional write-offs.

Debtors

A detailed review of debtors at each year-end revealed a number of old irrecoverable balances. The age of these balances was such that a provision should have been made using the information available at the time the accounts were finalised for each year. An additional write-off was made in respect of pre-acquisition costs on sites which have never been developed.

Notes to the financial statements
at 31 May 2003

2. Prior period adjustments (continued)

Cash

In previous years the main bank accounts were reconciled by clearing reconciling items into a number of suspense accounts and control accounts. These accounts were never reconciled and were found to largely comprise irrecoverable balances.

Creditors payable within one year

The trade creditor balance was understated in previous years as a result of incorrect reconciliation of the purchase ledger balance and under accruals in respect of invoices which had not been processed prior to the year-end but which related to pre year-end expenditure. In addition incorrect and insufficient provisions had been made in prior years for other liabilities such as rent, rates, utilities, staff holiday pay and VAT.

Creditors payable after one year

The restatement of this balance resulted from accounting errors in respect of the loan outstanding.

Impairment

Following an impairment review, £58,183,000 has been written off the carrying value of tangible fixed assets and £8,873,000 has been written off the carrying value of goodwill in the year. An impairment review was carried out for the 31 May 2002 year-end accounts and no impairment charge was booked, as previously stated. It is however now known that the cashflow estimates used for this review were inaccurate, as the level of prior year adjustments in these accounts show that they were based on incorrectly stated management information.

There is a high degree of subjectivity in calculating the amount of the impairment charge to be allocated between the current and prior years. This subjectivity arises from a number of areas including (1) appropriately amending the incorrect management information at 31 May 2002, (2) the ability to exclude any hindsight to such a calculation and (3) the estimation of the market values and trends at the date of signing the 2002 accounts.

Recognising this high degree of subjectivity, no part of the impairment charge booked in the 31 May 2003 accounts has been allocated to previous years.

Taxation

The tax adjustments arising from the restatement are treated as fundamental errors on the basis that they relate to fundamental errors in the underlying accounts rather than as a consequence of any errors in the computation of tax based on those numbers.

3. Accounting policies

Basis of preparation

The accounts are prepared under this historical cost convention and in accordance with applicable accounting standards.

Basis of consolidation

The Group accounts consolidate the accounts of SFI Group plc and all its subsidiary undertakings drawn up to 31 May each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the date of their acquisition or up to the date of their disposal.

No profit and loss account is presented for SFI Group plc as permitted by section 230 of the Companies Act 1985.

Notes to the financial statements
at 31 May 2003

3. Accounting policies (continued)

Goodwill

Goodwill arising on acquisitions prior to 31 May 1997 was set off directly against reserves. Goodwill previously eliminated against reserves has not been reinstated on implementation of FRS 10.

Positive goodwill arising on acquisitions since 1 June 1998 is capitalised, classified as an asset on the balance sheet and amortised on a straight line basis over its useful economic life up to a presumed maximum of 20 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

If a subsidiary, associate or business is subsequently sold or closed, any goodwill arising on acquisition that was written off directly to reserves or that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

Fixed assets

Tangible fixed assets are included at their original historic cost.

Depreciation of tangible fixed assets (excluding freehold land, which is not depreciated) is calculated on a straight line basis at rates estimated to write down the cost of each asset to its residual value over its expected useful life.

Expected useful lives are as follows:

Freehold buildings	— over 50 years
Leasehold land and buildings	— over the shorter of the lease term and 50 years
Plant and machinery	— over 10 years
Fixtures and fittings	— over 4 years
Motor vehicles	— over 4 years
Computer equipment	— over 4 years

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Any impairment in the value is charged to the profit and loss account. Profits or losses on disposal of fixed assets reflect the difference between net selling price and net book value at the date of disposal.

Investments

Investments in subsidiary undertakings are stated in the Parent Company's accounts at cost, less provision for any impairment in value.

Stocks

Stocks are stated at the lower of cost and net realisable value with due allowance for any obsolete or slow moving items.

Cost includes all costs incurred in bringing each product to its present location and condition, with the exception of delivery costs that are specifically excluded.

Net realisable value is based on estimated selling price less any further costs expected to be incurred to completion and disposal.

Provisions for liabilities and charges

Provision is made for future rental expenses and related costs of leasehold property to the expected date of disposal of the Company's interests in the lease (net of estimated sublease income) where space is vacant or not yet developed.

Notes to the financial statements
at 31 May 2003

3. Accounting policies (continued)

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exceptions:

- provision is made for tax on gains arising on disposal of fixed assets that have been rolled over into replacement assets only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However, no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only where the replacement assets are sold;
- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Derivative instruments

The Group uses interest rate swaps to adjust interest rate exposures.

The Group considers its derivative instruments qualify for hedge accounting when certain criteria are met.

Interest rate swaps

The Group's criteria for interest rate swaps are:

- the instrument must be related to an asset or a liability; and
- it must change the character of the interest rate by converting a variable rate to a fixed rate or vice versa.

Interest differentials are recognised by accruing with net interest payable. Interest rate swaps are not revalued to fair value or shown on the Group balance sheet at the year-end. If they are terminated early, the gain or loss is taken to the profit and loss account in the year of termination.

Leasing commitments

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

Lease incentives

Lease incentives include rent-free periods and other incentives received from lessors upon entering into lease agreements. The Group's policy for accounting for lease incentives is in accordance with UITF 28, whereby the aggregate income from lease incentives is recognised as an adjustment to rental cost, allocated evenly over the lease term or the term to the first open market rent review if earlier.

Pensions and other post-retirement benefits

The Group makes defined contributions to employee personal pension plans. The pension cost charged to the profit and loss account represents the contributions payable to the pension plans in respect of the accounting year.

Notes to the financial statements
at 31 May 2003

3. Accounting policies (continued)

Capital instruments

Shares are included in shareholders' funds. Other instruments are classified as liabilities if they contract an obligation to transfer economic benefits and if not they are included in shareholders' funds. The finance cost recognised in the profit and loss account in respect of capital instruments other than equity shares is allocated to periods over the term of the instrument at a constant rate on the carrying amount.

4. Turnover

Turnover represents the amounts derived from the provision of goods and services which fall within the Group's ordinary activities, stated net of value added tax. Turnover is derived wholly within the United Kingdom or the Isle of Man.

5. Operating loss

This is stated after charging/(crediting):

	2003 *£000*	*(restated)* *2002* *£000*
Auditors' remuneration (Group and Company)		
— audit services†	500	91
— non audit services†	100	283
Depreciation of owned assets	15,119	12,834
Impairment charge — goodwill	8,873	—
— tangible fixed assets	58,183	—
Provision for loss on disposal of fixed assets	10,459	—
Amortisation of goodwill	757	757
Rental income	(318)	(119)
Operating lease rentals — plant and machinery	22	18
— other	20,897	14,713

†The auditors' remuneration for the year ended 31 May 2002 was paid to the previous auditors, Horwath Clark Whitehill.

Notes to the financial statements
at 31 May 2003

6. Exceptional items

	2003 £000	(restated) 2002 £000
Recognised in arriving at operating loss:		
Impairment of tangible fixed assets	58,183	—
Impairment of intangible fixed assets	8,873	—
Professional fees and associated costs	6,413	—
Provision for onerous lease costs	3,116	—
Costs on aborted developments	1,685	1,864
	78,270	1,864
Recognised below operating loss:		
Provision for loss on disposal of fixed assets	10,459	—
Profit on disposal of tangible fixed assets	(149)	(186)
	88,580	1,678
Bank charges and associated costs	3,549	—
Exceptional items before taxation	92,129	1,678

The tax effect in the profit and loss account of £8.3m (2002 £Nil) includes £Nil (2002 £Nil) relating to the exceptional items recognised below operating profit.

7. Staff costs

	2003 £000	2002 £000
Wages and salaries	37,775	37,339
Social security costs	2,652	2,621
Other pension costs	206	376
	40,633	40,336

The average monthly number of employees during the year was made up as follows:

	2003 No.	2002 No.
Public house management and staff	3,541	3,679
Administration	139	125
	3,680	3,804

Details of Directors' emoluments can be found within the Directors' Remuneration Report.

8. Interest payable and similar charges

	2003 £000	(restated) 2002 £000
Bank loans and overdrafts	14,750	8,806

Notes to the financial statements
at 31 May 2003

9. Tax

(a) Tax on loss on ordinary activities

The tax (credit)/charge is made up as follows:

	2003 £000	(restated) 2002 £000
Current tax:		
UK corporation tax	—	1,530
Tax underprovided in previous years	225	—
Total current tax (note 9(b))	225	1,530
Deferred tax:		
Origination and reversal of timing differences	(10,462)	2,820
Group deferred tax (note 9(d))	(10,462)	2,820
Tax on loss on ordinary activities	(10,237)	4,350

(b) Factors affecting current tax charge

The tax assessed on the loss of ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 30% (2002 — 30%). The differences are reconciled below:

	2003 £000	(restated) 2002 £000
Loss on ordinary activities before tax	(109,980)	(6,213)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 30 % (2002 — 30%)	(32,994)	(1,864)
Expenses not deductible for tax purposes (including goodwill amortisation)	20,374	6,960
Decelerated/(accelerated) capital allowances	7,140	(2,355)
Losses arising in the year not relievable/(prior year losses utilised)	5,124	(933)
Tax underprovided in previous years	225	—
Other timing differences	356	(278)
Total current tax (note 9(a))	225	1,530

(c) Factors that affect current and future tax charges

The effect of the impairment charge on fixed assets is to reduce their carrying value when determining the potential provision for deferred tax. As a consequence, the potential deferred tax liability for accelerated capital allowances has been significantly reduced.

The Company has significant tax losses carried forward that are available for offset against future taxable profits and as a consequence does not expect to pay corporation tax for the foreseeable future. Deferred tax assets have not been recognised in respect of these losses, as they may not be used to offset taxable profits elsewhere in the Group.

Notes to the financial statements
at 31 May 2003

9. Tax (continued)

(d) Deferred tax

Group

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

	2003 £000	(restated) 2002 £000
Included in provisions for liabilities and charges (note 22)	173	10,635
	173	10,635
Accelerated capital allowances	4,256	11,388
Tax losses carried forward	(4,054)	(628)
Other timing differences	(29)	(125)
Provision for deferred tax	173	10,635

	£000
At 1 June 2002 as restated	10,635
Deferred tax credit in Group profit and loss account (note 9(a))	(10,462)
At 31 May 2003	173

The Group has a potential deferred tax asset, which has not been recognised in the accounts, as follows:

	2003 £000	2002 £000
Tax losses	(1,697)	—
Other timing differences	(467)	—
Unprovided deferred tax asset	(2,164)	—

Company

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

	2003 £000	(restated) 2002 £000
Accelerated capital allowances	4,103	9,404
Tax losses carried forward	(4,103)	(606)
Provision for deferred tax	—	8,798

	£000
At 1 June 2002 as restated	8,798
Deferred tax credit in profit and loss account	(8,798)
At 31 May 2003	—

Notes to the financial statements
at 31 May 2003

9. Tax (continued)

The Company has a potential deferred tax asset, which has not been recognised in the accounts, as follows:

	2003 *£000*	*2002* *£000*
Tax losses	(1,557)	—
Other timing differences	(467)	—
Unprovided deferred tax asset	(2,024)	—

10. Loss attributable to members of the parent company

The loss dealt with in the accounts of the parent company is £85,965,000 (2002 £13,109,000) after the prior year adjustment of £50,170,000 (note 2c).

11. Dividends

	2003 *£000*	*2002* *£000*
Equity dividend paid for the year ended 31 May 2002	—	680
Equity dividend proposed for the year ended 31 May 2002	—	1,402
Withdrawn dividend for the year ended 31 May 2002	(1,402)	—
Equity dividend for the year ended 31 May 2003	—	—
Profit and loss (credit)/charge	(1,402)	2,082

During the year to 31 May 2002, the Company paid an interim dividend of £680,000. Subsequently, it has been found that the Company did not have adequate distributable reserves to pay this dividend as required under the Companies Act. This is evident from Note 25 to these accounts. Consequently, as the statutory procedures in respect of this dividend were not complied with, it was unlawful. The Directors are considering legal remedies. The final dividend paid in respect of the year to 31 May 2001 was also unlawful on the same basis. Again, the Directors are considering legal remedies. No asset is recognised in these accounts in respect of any potentially recoverable amounts.

12. Loss per ordinary share

The calculation of basic loss per ordinary share is based on losses of £(99,743,000) (2002 £(10,563,000)) and on 75,055,971 (2002 74,826,687) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

13. Intangible fixed assets

	Goodwill *£000*
Cost:	
At 1 June 2002 and at 31 May 2003	15,134
Amortisation:	
At 1 June 2002	1,337
Provided during the year	757
Impairment charge	8,873
At 31 May 2003	10,967
Net book value at 31 May 2003	4,167
Net book value at 31 May 2002	13,797

Notes to the financial statements
at 31 May 2003

13. Intangible fixed assets (continued)

The goodwill arises on the acquisition of Slug and Lettuce Group Limited and is being amortised evenly over the Directors' estimate of its useful economic life of 20 years.

In accordance with FRS 11 'Impairment of Fixed Assets and Goodwill' the carrying values of the income generating units have been compared to their recoverable amounts, represented by the higher of their value in use to the Group and net realisable value. Any resulting impairment charge has been allocated against goodwill attributed to that unit in the first instance resulting in the impairment charge of £8,873,000 detailed above.

14. Tangible fixed assets

Group

	Land and buildings £000	*Plant and machinery £000*	*Fixtures and fittings £000*	*Total £000*
Cost:				
At 1 June 2002 as restated	145,169	26,191	34,334	205,694
Additions	6,782	1,005	3,527	11,314
Disposals	(7,037)	(1,307)	(1,568)	(9,912)
At 31 May 2003	144,914	25,889	36,293	207,096
Depreciation:				
At 1 June 2002 as restated	8,652	5,972	15,761	30,385
Provided during the year	4,863	2,483	7,773	15,119
Impairment charge	46,473	6,375	5,335	58,183
Provision for loss on disposal of fixed assets	8,969	1,072	418	10,459
Disposals	(254)	(608)	(1,229)	(2,091)
At 31 May 2003	68,703	15,294	28,058	112,055
Net book value at 31 May 2003	76,211	10,595	8,235	95,041
Net book value at 31 May 2002	136,517	20,219	18,573	175,309

Company

	Land and buildings £000	*Plant and machinery £000*	*Fixtures and fittings £000*	*Total £000*
Cost:				
At 1 June 2002 as restated	105,128	16,856	28,375	150,359
Additions	5,840	746	3,027	9,613
Disposals	(6,899)	(1,301)	(1,547)	(9,747)
At 31 May 2003	104,069	16,301	29,855	150,225
Depreciation:				
At 1 June 2002 as restated	6,349	5,341	14,070	25,760
Provided during the year	3,051	1,536	6,210	10,797
Impairment charge	35,796	3,889	4,990	44,675
Provision for loss on disposal of fixed assets	7,297	612	264	8,173
Disposals	(236)	(606)	(1,220)	(2,062)
At 31 May 2003	52,257	10,772	24,314	87,343
Net book value at 31 May 2003	51,812	5,529	5,541	62,882
Net book value at 31 May 2002	98,779	11,515	14,305	124,599

Notes to the financial statements
at 31 May 2003

14. Tangible fixed assets (continued)

In accordance with FRS 11 "Impairment of Fixed Assets and Goodwill" the carrying values of the income generating units, have been compared to their recoverable amounts, represented by the higher of their value in use to the Group and net realisable value.

The value in use has been derived from discounted cash flow projections using a nominal discount rate of 12% on a pre-tax basis.

The net book value of land and buildings comprises:

	Group		*Company*	
	2003	*2002*	*2003*	*2002*
	£000	*£000*	*£000*	
Long leasehold	645	659	645	659
Short leasehold	73,356	126,794	48,957	89,056
Freehold	2,210	9,064	2,210	9,064
	76,211	136,517	51,812	98,779

15. Investments

	Subsidiary undertakings £000
Cost:	
At 1 June 2002 and 31 May 2003	50,036
Amounts provided:	
At 1 June 2002	—
Provided in the year	8,566
At 31 May 2003	8,566
Net book value at 31 May 2003	41,470
Net book value at 31 May 2002	50,036

The provision of £8,566,000 in the year to 31 May 2003 was raised following a review of the carrying value of the Company's investments in subsidiary undertakings as at 31 May 2003.

Details of the principal trading companies in which the Company holds 20% or more of the nominal value of any class of share capital are as follows:

Name of Company	*Holding*	*Proportion of voting rights and shares held*	*Nature of business*
Slug and Lettuce Limited*	Ordinary shares	100%	Operation of high street bars and public houses
Parisa Café Bars Limited*	Ordinary shares	100%	Operation of high street bars and public houses
Satellite Holdings plc	Ordinary shares	100%	Operation of high street bars and public houses
Inneroll Limited	Ordinary shares	100%	Operation of high street bars and public houses

*Interests held indirectly through The Slug and Lettuce Group Limited and Parisa Group (Holdings) Limited respectively.

Notes to the financial statements
at 31 May 2003

16. Stocks

		Group (restated)		Company (restated)
	2003	2002	2003	2002
	£000	£000	£000	£000
Retail stocks	2,609	4,043	2,609	4,043

The difference between purchase price or production cost of stocks and their replacement cost is not material.

17. Debtors

		Group (restated)		Company (restated)
	2003	2002	2003	2002
	£000	£000	£000	£000
Trade debtors	686	2,064	686	2,064
Amounts owed by group undertakings	—	—	25,142	27,058
Other debtors	53	125	53	125
Corporation Tax	1,806	2,032	1,595	1,597
Prepayments and accrued income	473	738	473	738
	3,018	4,959	27,949	31,582

18. Creditors: amounts falling due within one year

		Group (restated)		Company (restated)
	2003	2002	2003	2002
	£000	£000	£000	£000
Current instalments due on loans	127,808	120,692	127,808	120,692
Bank overdraft	14,648	5,020	14,648	5,020
Amounts owed to group undertakings	—	—	19,969	17,488
Trade creditors	8,173	18,503	8,173	18,503
Other taxes and social security costs	5,177	3,663	5,177	3,663
Other creditors	4,874	4,146	4,874	4,146
Dividends	—	1,402	—	1,402
Accruals and deferred income	10,444	1,379	10,444	1,379
	171,124	154,805	191,093	172,293

Bank loans and overdrafts are secured by fixed and floating charges over the Group's assets.

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

		Group (restated)		Company (restated)
	2003	2002	2003	2002
	£000	£000	£000	£000
Other creditors	—	3,902	—	3,902

Notes to the financial statements
at 31 May 2003

20. Loans

		Group (restated)		Company (restated)
	2003	*2002*	*2003*	*2002*
	£000	*£000*	*£000*	*£000*
Amounts falling due:				
in one year or less or on demand	142,456	125,712	142,456	125,712
in more than one year but not more than two years	—	—	—	—
in more than two years but not more than five years	—	—	—	—
	142,456	125,712	142,456	125,712

21. Obligations under leases

Annual commitments under non-cancellable operating leases are as follows:

Group

		Land and buildings		Other
	2003	*2002 (restated)*	*2003*	*2002 (restated)*
	£000	*£000*	*£000*	*£000*
Operating leases which expire:				
Within one year	213	87	—	—
In two to five years	509	657	18	22
In over five years	18,911	18,104	—	—
	19,633	18,848	18	22
Company				
Operating leases which expire:				
Within one year	137	21	—	—
In two to five years	343	491	18	22
In over five years	12,619	11,833	—	—
	13,099	12,345	18	22

22. Provisions for liabilities and charges

Group

	Onerous leases	Deferred tax	Total
	£'000	*£'000*	*£000*
At 1 June 2002 (restated)	—	10,635	10,635
Arising during the year	3,116	—	3,116
Deferred tax credit in profit and loss account	—	(10,462)	(10,462)
At 31 May 2003	3,116	173	3,289

Notes to the financial statements
at 31 May 2003

22. Provisions for liabilities and charges (continued)

Company	*Onerous leases £'000*	*Deferred tax £'000*	*Total £000*
At 1 June 2002 (restated)	—	8,798	8,798
Arising during the year	3,116	—	3,116
Deferred tax credit in profit and loss account	—	(8,798)	(8,798)
At 31 May 2003	3,116	—	3,116

Leasehold properties

The provision for onerous leases is in respect of vacant leasehold properties, from which the Group does not trade, but is liable to fulfil rent and other property commitments up to the lease expiry date. Amounts have been provided on the basis of current rent obligations and the anticipated timing and cost of extinguishing these liabilities assuming they are payable within a range of 1 to 2 years.

23. Derivatives and other financial instruments

An explanation of the Group's objectives, policies and strategies for the role of derivatives and other financial instruments in creating and changing the risks of the Group in its activities can be found within the Financial Review. The disclosures below exclude short-term debtors and creditors.

Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the Group as at 31 May is as follows:

	Total £000	*Fixed rate financial liabilities £000*	*Floating rate financial liabilities £000*
2003			
Sterling	145,572	103,116	42,456
2002			
Sterling	129,614	103,902	25,712

	Weighted average interest rate %	*Weighted average period for which rate is fixed years*
2003		
Sterling	6.0	6.1
2002		
Sterling	6.0	6.9

The amounts shown in the tables above take into account the interest rate swaps used to manage the interest rate profile of financial liabilities.

The floating rate financial liabilities comprise sterling denominated bank loans and overdrafts that bear interest at rates based on the six month LIBOR.

Notes to the financial statements
at 31 May 2003

23. Derivatives and other financial instruments (continued)

Interest rate risk profile of financial assets

The interest rate profile of the financial assets of the Group as at 31 May is as follows:

	Total	*Floating rate financial assets £000*	*Financial assets on which no interest is earned £000*
2003			
Sterling	3,609	569	3,040
2002			
Sterling	3,511	—	3,511

The financial assets on which no interest is earned comprise the Group's cash floats and cash in transit. The floating rate financial assets comprise a bank account holding disposal proceeds of tangible fixed asset sales (the "prepayments account"). The balance on the prepayments account at the year-end was £569,000 (2002 £Nil). Access by the Group to these funds is restricted such that the it must obtain approval from the banks before these funds are released to it.

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at 31 May is as follows:

	2003 £000	*2002 £000*
In one year or less, or on demand	144,724	125,712
In more than one year but not more than two	848	3,902
In more than two years, but not more than five	—	—
In more than five years	—	—
	145,572	129,614

Borrowing facilities

The Group has various borrowing facilities available to it. The undrawn committed facilities available at 31 May in respect of which all conditions precedent had been met at that date are as follows:

	2003 £000	*2002 £000*
Expiring in one year or less	3,910	2,500
Expiring in more than one year but not more than two years	—	3,910
	—	6,410

Notes to the financial statements
at 31 May 2003

23. Derivatives and other financial instruments (continued)

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of the Group's financial assets and financial liabilities as at 31 May:

	Book value 2003 £000	*Fair value 2003 £000*	*Book value 2002 £000*	*Fair value 2002 £000*
Primary financial instruments				
Short-term borrowings	(142,456)	(142,456)	(125,712)	(125,712)
Deferred Consideration	—	—	(3,902)	(3,902)
Onerous leases	(3,116)	(3,116)	—	—
Cash	3,609	3,609	3,511	3,511
Derivative financial instruments held to manage the interest rate profile				
Interest rate swaps	—	(10,778)	—	(2,506)

Market values have been used to determine the fair value of interest rate swaps. The Directors believe that for all other items, their fair values equate to their book values.

Hedges

The Group's policy has been to hedge the interest rate risk exposures. The Group borrows in Sterling at both fixed and floating rates of interest and has then used interest rate swaps to generate the desired interest profile and to manage the Group's exposure to interest fluctuations. At the year-end, the Group had £100m of its debts hedged by way of interest rate swap arrangements. Subsequent to the year-end, the Company broke these swap contracts, at a cost of £4.3m. This action was taken in view of the ongoing cost of the contracts and in the context of the overall debt restructure under negotiation.

The break cost of £4.3m compares with the fair value at 31 May 2003 of £10.8m set out above.

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses and deferred gains and losses on financial instruments used for hedging are as follows:

	Gains £000	*Losses £000*	*Total £000*
Unrecognised gains and losses on hedges at 31 May 2003	—	(10,778)	(10,778)
Unrecognised gains and losses on hedges at 31 May 2002	—	(2,506)	(2,506)
Gains and losses expected to be recognised in the year to 31 May 2004	—	(4,288)	(4,288)
Gains and losses expected to be recognised in the year to 31 May 2003	—	(2,007)	(2,007)

Of the unrecognised gains and losses on hedges at 31 May 2002, £2,007,000 of losses were recognised in the year and no gains were recognised in the year.

Notes to the financial statements
at 31 May 2003

24. Share capital

Authorised

	2003 £000	2002 £000
Ordinary shares of 25p each	25,000	25,000
	25,000	25,000

Allotted, called up and fully paid

	2003 No.	2002 No.	2003 £000	2002 £000
Ordinary shares of 25p each	75,078,438	74,991,438	18,770	18,748
			18,770	18,748

During the year the allotted share capital was increased by £21,750 by the creation of 87,000 ordinary shares of 25p each. The cash consideration for these shares was £95,265.

Options granted under the Company's share option scheme at 31 May 2003 were as follows:

Exercise period	*Exercise Price*	*At 1 June 2002*	*Granted in the year*	*Exercised in the year*	*Lapsed in the year*	*At 31 May 2003*
1999-2005	25p	344,000	—	—	—	344,000
1999-2006	236p	37,100	—	—	—	37,100
2000-2007	109.5p	540,000	—	(87,000)	(153,000)	300,000
2000-2007	118.25p	276,000	—	—	(50,000)	226,000
2000-2007	187.74p	5,300	—	—	—	5,300
2001-2008	180p	55,556	—	—	—	55,556
2002-2009	198p	1,682,500	—	—	(810,000)	872,500
2003-2010	204p	1,130,300	—	—	(344,900)	785,400
2003-2010	175.5p	398,500	—	—	(134,500)	264,000
2004-2011	191p	1,970,520	—	—	(658,500)	1,312,020
		6,439,776	—	(87,000)	(2,150,900)	4,201,876

25. Reserves

Group

	Share premium £000	*Profit and loss account £000*
At 1 June 2001 (restated)	—	(11,331)
Retained loss for the year	—	(12,645)
At 1 June 2002 (restated)	37,505	(23,976)
Arising on share issues	73	—
Retained loss for the year	—	(98,341)
At 31 May 2003	37,578	(122,317)

The cumulative amount of goodwill written off at 31 May 2003, net of goodwill relating to undertakings disposed of, is £2,421,000 (2002: £2,421,000).

Notes to the financial statements
at 31 May 2003

25. Reserves (continued)

Goodwill previously written off to reserves

	(restated) 2002 £000
As previously stated at 31 May 2002	2,776
Prior year adjustments	(355)
Restated at 31 May 2002	2,421

There is no current year profit and loss or reserves effect of these prior year adjustments, which relate to the goodwill allocated to properties when they were disposed of in prior years.

Company

	Share premium £000	*Profit and loss account £000*
At 1 June 2001 (restated)	—	(12,284)
Retained loss for the year	—	(15,191)
At 1 June 2002 (restated)	37,505	(27,475)
Arising on share issues	73	—
Retained loss for the year	—	(84,563)
At 31 May 2003	37,578	(112,038)

26. Notes to the statement of cash flows

(a) Reconciliation of operating (loss)/profit to net cash inflow from operating activities

	2003 £000	*2002 £000*
Operating (loss)/profit	(84,927)	2,407
Depreciation and impairment of tangible fixed assets	73,302	12,833
Amortisation and impairment of goodwill	9,630	759
Decrease/(increase) in debtors	1,715	(5,072)
Decrease/(increase) in stocks	1,434	(895)
Increase in creditors	1,458	5,954
Increase in provisions	3,116	—
Net cash inflow from operating activities	5,728	15,986

Notes to the financial statements
at 31 May 2003

26. Notes to the statement of cash flows (continued)

(b) Analysis of net debt

	(restated) At 1 June 2002 £000	*Cash flow £000*	*Exchange differences £000*	*Other non-cash movements £000*	*At 31 May 2003 £000*
Cash at bank and in hand	3,511	98	—	—	3,609
Bank overdrafts	(5,020)	(9,628)	—	—	(14,648)
Cash	(1,509)	(9,530)	—	—	(11,039)
Loans due within one year	(120,692)	(7,116)	—	—	(127,808)
	(122,201)	(16,646)	—	—	(138,847)

(c) Major non-cash transactions

Included within creditors is a balance of £2,250,000 in respect of bank fees not paid.

(d) Exceptional items

Cash flows relating to operational exceptional items

Net cash outflow from operating activities in year includes cash outflows of £4,474,000 in respect of professional expenses incurred as a consequence of the Company's distressed position, £1,685,000 in respect of costs on aborted developments and £569,000 in respect of interest and penalties.

Cash flows relating to non-operating exceptional items

Capital expenditure and financial investment cash flows include inflows of £7,970,000 from the sale of tangible fixed assets (2002 £13,491,000) and outflows of £1,299,000 in respect of bank fees.

27. Post balance sheet events

A restructuring of the Company's finances is necessary to enable the business to continue to trade and provide a more appropriate base from which to rebuild the business and to implement the recovery plan. Against this background, the Directors and the Company's advisers have been in extensive discussions with the banks with a view to agreeing a restructuring proposal that will reduce the Company's debt to a level that can be supported by the Company's trading. The banks have considered various alternatives but ultimately the Directors and the banks have reached agreement on restructuring proposals as summarised below.

The restructuring of the Company, once approved by shareholders and the Courts, will reduce the Company's existing facilities of £152.9m (plus rolled up interest of approximately £8.0m and unpaid fees due to the banks of £2.5m) to £80m with the balance of these obligations due to Banks (amounting in total to approximately £83.4m) being converted into equity. Approximately £5.1m remaining in a prepayment account, which arose largely from the recent disposal of assets, will be released by the banks to the Company on completion to enable the settlement of deal costs and provide working capital. The debt for equity conversion will be coupled with the restructuring whereby a new holding company will become the ultimate holding company of SFI by way of a Scheme of Arrangement. The Company has also applied to the Court to eliminate its deficit on profit and loss reserves under the scheme by cancellation of the amounts standing to the credit of the share premium account and reduction in share capital, as increased by the debt for equity conversion ("reduction of capital"). Full details of the restructuring and Scheme of Arrangement, including a reduction of capital, are set out in a Scheme Circular posted to shareholders at the same time as these accounts. The Court meeting and EGM to approve the Scheme of Arrangement and implement the restructuring will be held on 7 May 2004 and the Scheme of Arrangement is expected to become effective by the end of May. An irrevocable commitment to vote in favour of the resolutions proposed at the Court meeting and EGM has been received from the Company's largest shareholder and your Directors believe that the restructuring will proceed.

Notes to the financial statements
at 31 May 2003

27. Post balance sheet events (continued)

In the event that the restructuring proposals are not implemented the Company will not be able to repay its existing facilities in accordance with their terms and would only be able to continue to meet its obligations as they fall due with the ongoing support of the banks. The Board believes that in the context of the discussions and negotiations it has had over the last few months with the banks, in the event that the Proposals are not implemented, there can be no guarantee that the Company will continue to enjoy the support of the banks. In such circumstances the Company would be forced to seek the appointment of an administrator or pursue other insolvency options.

Your Directors believe that the restructuring followed by implementation of the recovery plan will enable the Company to continue to operate as a going concern and, in the medium term, to refinance its debt on conventional banking terms at or beyond the term of the new syndicated facilities which, if implemented, will extend to the end of May 2006.

Therefore, the Directors believe it is appropriate to prepare these accounts on a going concern basis. No adjustments have been made to these accounts that would be necessary in the event that the restructuring and recovery plan do not succeed.

28. Capital commitments

Amounts contracted for but not provided in the accounts amounted to £Nil for the Group and £Nil for the Company (2002 £Nil and £Nil respectively as restated).

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