XRO Limited

Directors' Report
and
Financial Statements
for the year ended
31 December 2000

THE DOCUMENT COMPANY

XEROX

XRO Limited

Directors' Report and Financial Statements for the year ended 31 December 2000

Directors as at 31 December 2000

M.J. Barrett
J.F. Lawler
N.S. Mackintosh

Secretary

M.J. Barrett

Registered Office

6 Connaught Place
London
W2 2EZ

Registered Auditors

KPMG Audit Plc, London

Registered Number

324504

XRO LIMITED
DIRECTORS' REPORT

1. FINANCIAL STATEMENTS

The Directors present the Accounts of XRO Limited ('the Company') for the year ended 31 December 2000.

The profit for the financial year was nil. The Directors do not recommend the payment of a dividend. Retained profits for the year were nil.

2. PRINCIPAL ACTIVITIES

XRO Limited acts as an intermediate holding company for certain of Xerox Corporation's investments in Europe and parts of Africa and Asia.

3. DIRECTORS

(i) The Directors shown on page 1 were in office on 31 December 2000.
Resignations during the year were: C.P. Gilliam on 17 August 2000, D.N. Maw on 24 November 2000. Appointments during the year were: J.F. Lawler on 24 November 2000.

(ii) Directors' emoluments were nil for the year under review.

4. EMPLOYEES

The Company had no employees during the year under review.

5. CHARITABLE AND POLITICAL CONTRIBUTIONS

During the year, there were no charitable or political contributions made by the Company.

6. XEROX CORPORATION TURNAROUND

2000 proved to be a very difficult year for the Xerox Corporation Group as a result of external and internal factors. The Group experienced significant pricing pressures within the office market place as customers and competitors became far more price conscious. This coupled with a weakening product mix, particularly within the production publishing arena, adversely impacted gross margins, although the Group was able to offset this partially through manufacturing and other productivity improvements. The continued restructuring of its infrastructure together with organisational changes led to a greater level of disruption than anticipated. These factors culminated in poor Group financial performance in 2000.

To address these issues, in October 2000 Xerox Corporation announced a 'Turnaround Program'. This includes a wide-ranging plan to sell assets totalling approximately $2-4bn, to reduce worldwide costs by more than $1bn per annum including significant headcount reductions, to focus on profitable and high growth segments of the document market, to transition the equipment financing business to third parties, and to exit from the small office/home office business segment.

The Xerox Corporation Turnaround is discussed further in note 1 to these financial statements.

7. AUDITORS

The auditors, KPMG Audit Plc, have expressed their willingness to continue in office, and a resolution for their re-appointment will be proposed at the Annual General Meeting.

M J Barrett

By order of the Board
M.J. Barrett, Secretary

3 AUGUST 2001

XRO LIMITED
PROFIT & LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2000

During the year the Company did not trade, received no income and incurred no expenditure, consequently the Company made neither a profit nor a loss.

There were no other recognised gains or losses during the year.

The above also applied in the comparative year.

The notes on pages 7 to 12 form part of these financial statements.

XRO LIMITED
BALANCE SHEET
AT 31 DECEMBER 2000

	Note	2000 £m	1999 £m
Fixed assets			
Investments	*2*	1,571	1,571
Total fixed assets		**1,571**	1,571
Current assets			
Debtors			
Due after more than one year	*3*	884	884
Total current assets		**884**	884
Creditors due within one year		**(2)**	(2)
Net current assets		**882**	882
Total assets less current liabilities		**2,453**	2,453
Creditors due after more than one year	*4*	(7)	(7)
Net assets		**2,446**	2,446

	Note	2000 £m	1999 £m
Capital and reserves			
Called up share capital	*5*	172	172
Share premium	*6*	1,133	1,133
Capital redemption reserve		1	1
Profit and loss account	*7*	1,140	1,140
Shareholders' funds		**2,446**	2,446

Approved by the Board of Directors on 3 August 2001 and signed on its behalf by

N.S. Mackintosh
Director

ANALYSIS OF SHAREHOLDERS' FUNDS	2000 £m	1999 £m
Equity interests	2,239	2,239
Non-equity interests	207	207
	2,446	2,446

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

Profit for the financial year	-	-
Equity dividends paid and proposed	-	-
Retained profit for the financial year	-	-
Shares issued at a premium	-	-
Net addition to shareholders' funds	**-**	-
Opening shareholders' funds	2,446	2,446
Closing shareholders' funds	**2,446**	2,446

NOTES TO THE FINANCIAL STATEMENTS

1. PRINCIPAL ACCOUNTING POLICIES

The Company's major accounting policies are summarised below.

(A) Basis of preparation

The Company's ultimate Parent undertaking, Xerox Corporation, has made extensive disclosures in its filing (10K) with the US Securities and Exchange Commission (SEC) in June 2001. These report the sensitivity of the worldwide Xerox Group to available funding. Additionally Xerox Corporation has disclosed a $7 billion revolving credit agreement with a group of banks which matures in October 2002, of which $4 billion is available to Xerox Capital (Europe) plc, a fellow subsidiary. The revolver was fully drawn down at 31 December 2000 and represented approximately 45% of the long term debt at that time. Xerox Corporation's credit rating was significantly reduced in the second half of 2000 which impacted its ability to borrow to support customer financing activities and to maintain certain positions in derivative financial instruments for hedging purposes.

The Directors have considered the funding position of the Company in the light of these disclosures. The Company and its fellow subsidiary undertakings are dependent on Xerox Corporation to arrange various banking facilities that are sufficient for its needs. In October 2000, Xerox Corporation instituted a worldwide Turnaround Program to meet operational challenges and made the following comments in the SEC filing mentioned above. 'Operational challenges, exacerbated by significant technology and acquisition investments, have led to a net loss in 2000, credit rating agency downgrades, limited access to capital markets and market-place concerns regarding our liquidity. In response to these challenges, in October 2000, we announced a Turnaround Program which includes a wide-ranging plan to sell assets, cut costs and strengthen core operations. Additionally, we are exploring alternatives to provide financing for customers in a manner that does not involve the Xerox balance sheet, and over time will provide financing for customers using third parties'.

UK reporting standards generally require directors to look forward 12 months from the date of signing financial statements but do not restrict the period of review when significant events can be foreseen in the more distant future. In preparing the financial statements the directors have taken into account all of the information that could reasonably be expected to be available to them, including information from Xerox Corporation about its Turnaround Program and its strategies for debt redemption and replacement and their implementation. On this basis the directors consider that it is appropriate to prepare the accounts on a going concern basis. This assumes that, to the extent that they affect the company, Xerox Corporation's Turnaround Program is successful and it negotiates funding to replace the revolving credit agreement in October 2002 although it is acknowledged that such outcomes are uncertain. The financial statements do not include any adjustments that would be required if its Parent's actions and negotiations were not successful.

The financial statement balances most sensitive to such adjustments are liabilities due after more than one year and fixed assets, in particular the Company's investments. Further, in accordance with FRS 11, the Directors have reviewed the carrying values of the subsidiaries on the assumption that the Turnaround Program did not cause a material reduction in the forecast activities of the Company and its subsidiaries. They concluded that the carrying value was unimpaired at the balance sheet date.

The financial statements are prepared on a historical cost basis and in accordance with applicable United Kingdom Accounting Standards. As explained in note 5, there is a departure from FRS4 concerning the treatment of the accrued redemption premium, which arose in 1996 and was taken directly to reserves.

Accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

(B) Investments

Investments in subsidiaries are held at cost, less any provision required where there has been an impairment in the value of the investment (note 2).

(C) Disclosures

The Company is a wholly owned subsidiary of Xerox Investments Europe BV, the ultimate parent within the European Union, which prepares publicly available consolidated financial statements. Consequently, under Section 228 of the Companies Act 1985, the Company is exempt from the requirement to prepare group accounts. Accordingly these accounts present information about the Company as an individual undertaking and not about its group.

Cash Flow Statement

Under Financial Reporting Standard 1 - Cash Flow Statements, the Company is exempt from the requirement to prepare a Cash Flow Statement.

Related Parties

Under Financial Reporting Standard 8 - Related Party Disclosures, the Company is exempt from the requirement to disclose transactions with other entities within the group headed by Xerox Corporation; other related party disclosures are reported in note 8.

2. INVESTMENTS

(A) The Company's investment in subsidiaries is analysed as follows

	2000 £m	1999 £m
At 1 January	1,571	1,571
Additions	-	-
At 31 December	**1,571**	1,571

(B) Subsidiaries at 31 December 2000.

	Percentage Voting Interest	**Class of Capital owned**	**Percentage holding**
XRI Limited	100%	Ordinary	100%
XRI Limited		5% Pref.	100%
RRXH Limited	100%	Ordinary	100%
Nemo (AKS) Limited	100%	Ordinary	100%

All shareholdings are direct except RRXH Limited, 50% of which is held via XRI Limited. All subsidiaries are incorporated in England.
RRXH Limited, through its subsidiary RRXIL Limited, owns 100% of the ordinary share capital of Xerox Limited, Xerox Holding (Nederland) B.V., Xerox XIB Limited (formerly Xerox Investments (Bermuda) Limited) and Xerox XHB Limited (formerly Xerox Holdings (Bermuda) Limited).
A complete list of subsidiaries will be filed with the Company's next annual return.

3. DEBTORS – DUE AFTER MORE THAN ONE YEAR

	2000 £m	1999 £m
Amounts due from Group company	**884**	884

4. CREDITORS - DUE AFTER MORE THAN ONE YEAR

Amounts owed to Group company	**7**	7

5. AUTHORISED & CALLED UP SHARE CAPITAL

(A) The Company's share capital

Authorised Share Capital	2000 £000's	1999 £000's
UK Sterling		
2,400,000,000 Ordinary shares of 10p each	240,000	240,000
300,000,000 Convertible Redeemable Preference shares of 20p each	60,000	60,000
2,400,000,000 US$ Preferred Ordinary shares of 1 cent each (see below)	14,213	14,213
500,000,000 US$ Convertible Cumulative Preference shares of 1 cent each (see below)	2,945	2,945
	317,158	317,158

US Dollars:	$000's	$000's
2,400,000,000 Preferred Ordinary shares of 1 cent each	24,000	24,000
500,000,000 Convertible Cumulative Preference shares of 1 cent each	5,000	5,000
	29,000	29,000

Issued and fully paid	£000's	£000's
Sterling		
1,172,378,553 Ordinary shares of 10p each	117,238	117,238
227,552,614 Convertible Redeemable Preference shares of 20p each	45,512	45,512
US$ Preferred Ordinary shares (see below)	7,346	7,346
US$ Convertible Cumulative Preference Shares	1,456	1,456
	171,552	171,552

US Dollars:	$000's	$000's
1,172,378,553 Preferred Ordinary shares of 1 cent each	11,724	11,724
227,552,614 Convertible Cumulative Preference shares of 1 cent each	2,276	2,276
	14,000	14,000

(B) Rights of shares under the meaning of Accounting Standard FRS4 - Capital Instruments

(i) Sterling Convertible Redeemable Ordinary Preference Shares of 20p each

The shares carry no fixed dividend entitlement. In respect of any dividend declared attributable to Ordinary Preference shares 0.25% is deemed attributable to the Sterling Ordinary shares.
Redeemable by Company at 1p per share in July 2007.

(ii) US$ Preference shares

The convertible Preference share dividend is paid in two equal instalments on 31st January and 31st July. However as there is no profit in 2000 a dividend is not payable.
The Preferred Ordinary shares carry no fixed dividend entitlement. Any dividend declared attributable to Ordinary shares are deemed 99.75% attributable to the US$ Preferred Ordinary shares.

Departure from FRS4

As part of a capital restructuring in 1996 the redemption value of the Sterling Redeemable Ordinary Preference shares of 20p each in July 2007 was reduced from £1 to 1p at an Extraordinary General Meeting. Following this change, the accrued redemption premium at 1st January 1996 of £11 million was credited as an appropriation to the profit and loss account. This is a departure from FRS4, which requires the difference in the current carrying value and new redemption value to be taken as financing credits over the period to redemption.

The Directors consider that the treatment required by FRS4 would not give a true and fair view as it would involve the inclusion of a credit of £17 million to profit and loss each year until 2007, as the shareholding is held entirely by another group company. The Directors also consider that the non-equity shares should be attributed a share of net assets equivalent to the amount to be repaid on redemption.

6. SHARE PREMIUM

Of the share premium of £1,133,222k reported at 2000 year-end, £604,361k arose in 1998, when XRO Limited issued £35,389k of ordinary and U.S. $ preferred ordinary shares at a premium of £604,361k to Xerox Overseas Holdings Limited; at the same time XRO Limited increased its investment in RRXH Limited and XRI Limited.

7. PROFIT AND LOSS ACCOUNT

	2000 £m	1999 £m
Balance at 1 January	1,140	1,140
Retained profit for the year	-	-
Balance at 31 December	**1,140**	1,140

8. RELATED PARTY DISCLOSURE

An overseas subsidiary of the Group, NV Xerox Management Services SA, has provided a loan to a Director of the Company. At the end of the year there was an outstanding loan to J.F. Lawler of £20k. No interest was charged on this loan. No amounts have been provided for or written off against the loan.

9. CONTINGENT LIABILITIES

As a result of the scheme of arrangement following which The Rank Group Plc acquired 100% of the issued share capital of The Rank Organisation Plc in 1996, it is possible that further liabilities other than those provided for in these accounts may arise. No provision has been made for these liabilities at 31 December 2000 as, in the opinion of the Directors, it is unlikely that they will occur.

The Company had no other contingent liabilities at 31 December 2000 (1999 - nil).

10. ULTIMATE PARENT COMPANY

The largest group in which the results of XRO Limited are consolidated is that of Xerox Corporation, which is incorporated in the United States of America. Copies of the Xerox Corporation Annual Report and Accounts may be obtained from The Investor Relations Department, Xerox Corporation, 800 Long Ridge Road, PO Box 1600, Stamford, Connecticut 06904, U.S.A.; World Wide Web http://www.xerox.com.

The smallest group in which the results of XRO Limited are consolidated is that of Xerox Investments Europe BV, which is registered in The Netherlands. Copies of the Xerox Investments Europe BV Annual Report and Accounts are available from Xerox Investments Europe BV, Gondel 1, 1186 MJ Amstelveen, The Netherlands.

Directors' Responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements 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 Company, and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Report of the Auditors

To the members of XRO Limited
We have audited the financial statements on pages 4 to 12.

Respective responsibilities of Directors and Auditors
The Directors are responsible for preparing the Directors' report and, as described on page 13, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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. 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 company is not disclosed.

Basis of opinion
We conducted our audit in accordance with 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 Company's circumstances, consistently applied and adequately disclosed.

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

Going concern
In forming our opinion we have considered the adequacy of the disclosures made in Note 1 of the financial statements concerning the challenges facing the ultimate parent company, Xerox Corporation, in implementing its Turnaround Program and negotiations for funding to replace the revolving credit agreement. In view of the significance of these uncertainties we consider that they should be drawn to your attention but our opinion is not qualified in this respect.

Opinion
In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2000 and of its result for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc 3 August 2001

KPMG Audit plc
Chartered Accountants
Registered Auditors
London