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XRO Limited

Directors' Report and Financial Statements for the year ended 31 December 2003



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XRO Limited

Directors' Report and Financial Statements for the year ended 31 December 2003

Directors as at 31 December 2003

M.J. Barrett
N.A Blanche
N.S. Mackintosh

Company Secretary

M.J. Barrett

Registered Office

6 Connaught Place
London
W2 2EZ

Registered Auditors

PricewaterhouseCoopers LLP
Harman House
1 George Street
Uxbridge
Middlesex
UB8 1QQ

Registered Number

324504

XRO LIMITED
DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2003

The Directors present their report together with the audited financial statements of XRO Limited (the "Company") for the year ended 31 December 2003.

1. PRINCIPAL ACTIVITIES, BUSINESS REVIEW AND FUTURE DEVELOPMENTS

The Company acts as an intermediate holding company for Xerox Corporation's interests in Europe and parts of Africa and Asia. The level of business and the year-end financial position were consistent with expectations. The Directors expect that the current activities will continue for the foreseeable future.

2. RESULTS AND DIVIDENDS

The profit for the financial year was £360 million (2002: £nil) including dividend income of £180 million (2002: £nil) from subsidiary RRXH Limited and £180 million (2002: £nil) from subsidiary XRI Limited. During the financial year the Directors proposed and paid a dividend of £360 million (2002: £nil) (Note 2 (C)). The retained result for the year was £nil (2002: £nil).

3. DIRECTORS

The Directors of the Company at 31 December 2003 who served throughout the year are listed on page 2. Mr. J.F.Lawler resigned as a director on 28th January 2003. Mr. N.A.Blanche resigned as a director on 1st January 2004 and Mr T.J. MacCarrick was appointed as a director with effect from the same date.

4. DIRECTORS' INTERESTS IN SHARES OF THE COMPANY

None of the Directors who held office at 31 December 2003 had any beneficial interest in the shares of the Company at that date or in any other corporate body in the Xerox Corporation that is required to be disclosed under the Companies Act 1985.

5. XEROX CORPORATION

Significant Xerox Corporation 2003 event

Recapitalisation & Liquidity

In June 2003, Xerox Corporation completed a \$3.6 billion recapitalisation, which reduced debt by \$1.6 billion, increased common and preferred equity by \$1.3 billion and provided \$0.7 billion of additional borrowing capacity.

The recapitalisation included the offering and sale of preferred stock, common stock, \$700 million of 7.125 percent senior notes due 2010 and \$550 million of 7.625 percent senior notes due 2013, and the closing of Xerox Corporation \$1 billion 2003 credit facility.

Proceeds from the recapitalisation were used to fully repay Xerox Corporation's 2002 credit facility. The 2003 credit facility consists of a \$300 million term loan

XRO LIMITED
DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2003 (continued)

5. XEROX CORPORATION (continued)

and a \$700 million revolving credit facility (which includes a \$200 million sub-facility for letters of credit).

As at 31st December 2003 Xerox Corporation reported cash and cash equivalent of \$2.5 billion.

Xerox Corporation manages its financing arrangements on a global basis; accordingly, XRO's funding requirements are dependent on the above agreement.

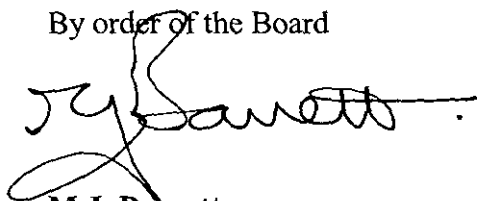
6. AUDITORS

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the annual general meeting.

7. DIRECTORS' RESPONSIBILITIES

The Directors' responsibilities are set out on page 14.

By order of the Board



M.J. Barrett

Company Secretary

XRO LIMITED
PROFIT & LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003

	<i>Note</i>	2003 £m	2002 £m
Operating profit/(loss)		-	-
Income from shares in group undertakings		360	-
Profit on ordinary activities before taxation		360	-
Taxation on profit on ordinary activities	2A	-	-
Profit for the financial year	2B	360	-
Dividends proposed and paid (Including Non-Equity)	2C	(360)	-
Retained results for the financial year		-	-

The notes on pages 8 to 13 form part of these financial statements.

There is no material difference between the reported profits above and their historic cost equivalents.

The company has no recognised gains and losses other than those included in the results above, and therefore no separate statement of total recognised gains and losses has been presented.

The above results relate to continuing operations.

**XRO LIMITED
BALANCE SHEET
AT 31 DECEMBER 2003**

	<i>Note</i>	2003 £m	2002 £m
Fixed assets			
Investments	3	1,571	1,571
Total fixed assets		1,571	1,571
Current assets			
Debtors			
Due after more than one year	4	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	5	(7)	(7)
Net assets		2,446	2,446
Capital and reserves			
Called up share capital	6	172	172
Share premium account	7	1,133	1,133
Capital redemption reserve		1	1
Profit and loss account	8	1,140	1,140
Total Shareholder's funds (Including Non-Equity)		2,446	2,446

The Financial statements on pages 5 to 13 were approved by the Board of Directors on 22nd October 2004 and signed on its behalf by



Director

RECONCILIATION OF MOVEMENTS IN SHAREHOLDER'S FUNDS

	2003 £m	2002 £m
Profit for the financial year	360	-
Dividends proposed and paid <i>(Including Non-Equity)</i>	(360)	-
Net addition to shareholder's funds	-	-
Opening shareholder's funds	2,446	2,446
Closing shareholder's funds	2,446	2,446

SHAREHOLDER'S FUNDS ANALYSED AS FOLLOWS

Equity	2,199	2,199
Non equity	47	47
	2,446	2,446

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2003**

1. PRINCIPAL ACCOUNTING POLICIES

The Company's accounting policies are summarised below.

(A) Accounting Principles and basis of preparation

These financial statements are prepared on the going concern basis, under the historical cost convention and in accordance with the Companies Act 1985 and applicable United Kingdom Accounting Standards. Accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

In preparing these financial statements, the Directors have assessed that the Company will continue in operational existence for the foreseeable future and have received a letter of support from Xerox Corporation.

Consolidated accounts have not been prepared as the Company is a wholly owned subsidiary of Xerox Investments Europe B.V., a company incorporated in the EU, and is therefore exempt under Section 228 of the Companies Act 1985 from the obligation to prepare and deliver group accounts.

Xerox Corporation's Annual Report (Form 10-k) has been filed with Securities and Exchange Commission (www.sec.gov).

(B) Investments

Investments in subsidiaries and associates are held at cost, less any provisions required where there has been an impairment in the value of the investments (Note 3).

(C) Disclosures

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.

(D) Translation of foreign currency

Share capital is translated at the appropriate historic rate. Differences between historic rates and the balance sheet rate are taken to reserves.

2. PROFITS FOR THE FINANCIAL YEAR AND DIVIDENDS

(A) Taxation

	2003	2002
	£m	£m
Tax on profit on ordinary activity	0	0

The effective tax rate can be reconciled to the UK statutory corporation tax rate of 30% as follows

UK Standard Corporation Tax Rate	30%	30%
Non taxable dividend income	(30)%	-
Effective Tax Rate	0%	30%

(B) Profit for the financial year

Directors' remuneration for services provided to the Group as a whole and Auditors' remuneration were borne by a fellow group subsidiary, Xerox Limited. This treatment is consistent with the prior year.

There were no employees of the Company during the year (2002: nil).

(C) Dividends

In 2003, dividends were proposed and paid for the sum of £360,341,484.

Non-equity dividends

- (1) £14,228,459 (US\$ 11.08 cents per share) in respect of the 227,552,614 Convertible Cumulative Preference Shares of 1 cent ("the US\$ Cumulative Preference Shares") of the Company.
- (2) £345,247,742 in respect of the 1,172,378,553 Preferred Ordinary Shares of 1 cent ("the US\$ Preferred Ordinary Shares") of the Company.

Equity dividends

- (3) £865,283 Ordinary Shares of 10 pence ("the Sterling Ordinary Shares") of the Company.

There is no final dividend proposed. Retained result for the year was £ nil (2002: £nil).

3. INVESTMENTS

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

	2003 £m	2002 £m
At 1 January	1,571	1,571
Additions	-	-
At 31 December	1,571	1,571

(B) Principal direct subsidiaries at 31 December 2003, which are intermediate holding companies

	Percentage voting interest	Class of capital owned	Percentage holding
XRI Limited	100%	Ordinary	100%
XRI Limited		5% Pref.	100%
RRXH 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 principal subsidiaries can be found in Xerox UK Holding Ltd's (the ultimate UK parent) financial statements. A complete list of subsidiaries will be filed with the Company's next annual return.

4. DEBTORS - DUE AFTER MORE THAN ONE YEAR

	2003 £m	2002 £m
Amounts due from Group company	884	884

There are no immediate plans to settle this intercompany amount and no interest is charged.

5. CREDITORS - DUE AFTER MORE THAN ONE YEAR

Amounts owed to Group company	7	7
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There are no immediate plans to settle this intercompany liability and no interest is charged.

6. AUTHORISED & CALLED UP SHARE CAPITAL

(A) The Company's share capital

	2003 £000s	2002 £000s
Authorised Share Capital		
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:		
	\$000s	\$000s
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		
	£000s	£000s
UK 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:		
	\$000s	\$000s
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 preference shares of 20p each

The Sterling convertible preference shares carry no rights to dividends.

The Company is to redeem the Sterling convertible preference shares by 31 July 2007 or may at its option redeem on 30 June 2003 or thereafter at the rate of 1p for every 20p nominal amount of such shares together with a further sum equal to all arrears and accruals of the preferred dividend thereon.

On winding-up, the Sterling convertible preference shares confer the right to receive out of the assets of the Company, postponed and subject to any payment on the US\$ convertible preference shares and *pari passu* further preference shares but in priority to any other class of shares, 1p for every 20p in nominal amount of the Sterling convertible preference shares held, and *pari passu* with any payment on the Ordinary Shares a sum equal to the amounts which would have been paid on the Ordinary Shares which would have arisen if the Sterling convertible redeemable preference shares had carried the right to be converted into fully paid Ordinary Shares at 5p in nominal amount of Ordinary Shares for every £1,000 in nominal amount of Sterling convertible redeemable preference shares. Holders of Sterling convertible preference shares have the right to receive notice of general meetings but this does not confer any rights to attend or vote at such meetings.

(ii) US\$ preferred ordinary shares

Any dividend declared attributable to US\$ preferred ordinary shares are payable from 99.75% of the profits available for distribution, postponed and subject to any payment of dividend on the US\$ convertible preference shares and in priority to any dividends to any other class of share.

On winding-up, the US\$ preferred ordinary shares confer the right to receive after any payments due to the holder of the Sterling convertible preference shares or the US\$ convertible preference shares repayment in full of the capital paid up on such shares, plus a further amount from 99.75% of the amount available for distribution to members after payments mentioned in the paragraph above and any amount payable to the holders of Sterling convertible preference shares or US\$ convertible preference shares. Each US\$ preferred ordinary share confers the right to 400 votes.

(iii) US\$ convertible preference shares

On US\$ convertible cumulative preference shares, a fixed cumulative preference dividend of such US\$ amount per annum as, in the option of an independent financial adviser, has the effect that as at the time at which the US\$ convertible preference shares are first issued there is no material difference between the values of (i) a holding of one Sterling convertible preference shares and one US\$ convertible preference share and (ii) a holding of one Sterling convertible preference share immediately prior to that time, such payment to rank *pari passu* with any payment of dividend on any US\$ convertible preference share issued after that time, ranking *pari passu* as to participation in the profits of the Company with the US\$ convertible preference shares and in priority to any dividend on any other class of shares is payable in two equal instalments on 31 January and 31 July, paid out of the profits available and resolved to be distributed.

On winding-up, the US\$ convertible preference shares confer the right to receive out of the assets of the Company available for distribution to its members in preference to rights of any other shares an amount up to the US\$ equivalent of £1, and a sum equal to all the arrears and accruals of US\$ preferential dividends.

Holders of US\$ convertible preference shares may attend all general meetings but only vote on resolutions for winding up the Company or which affect the rights attached to such shares or at a general meeting called when dividends on the shares remain unpaid at the date of notice of such meeting for at least 6 months. Where entitled to vote, each holder has one vote on a show of hands and, on a poll, 401 votes for every US\$0.05 in nominal amount of US\$ convertible preference shares held.

7. SHARE PREMIUM

Of the share premium of £1,133,222,000 reported at 2003 year-end, £604,361,000 arose in 1998, when XRO Limited issued £35,389,000 of ordinary and U.S. \$ preferred ordinary shares at a premium of £604,361,000 to Xerox Overseas Holdings Limited; at the same time XRO Limited increased its investment in RRXH Limited and XRI Limited. The remainder of the share premium arose prior to the 1997 Rank Organisation buyout.

8. PROFIT AND LOSS ACCOUNT	2003 £m	2002 £m
Balance at 1 January	1,140	1,140
Retained profit for the year	-	-
Balance at 31 December	1,140	1,140

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 2003, as, in the opinion of the Directors, it is unlikely that they will occur.

The Company had no other contingent liabilities at 31 December 2003 (2002: nil).

10. ULTIMATE PARENT COMPANY

The ultimate parent company, ultimate controlling party and 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.

Statement of Directors' Responsibilities

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

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2003 and that applicable Accounting Standards have been followed. The directors are responsible for keeping proper accounting records that 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 are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors Report

Independent Auditors' report to the members of XRO Limited

We have audited the financial statements, which comprise the profit and loss account, the balance sheet, reconciliation of movements in shareholders' funds and the related notes.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This opinion has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

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 is not disclosed.

Basis of audit 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.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 December 2003 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
West London

27 October 2004