

SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND

ROYAL MAIL STEAM PACKET COMPANY LIMITED

REGISTERED NUMBER 2404

DIRECTORS' REPORT AND ACCOUNTS

31 DECEMBER 2006

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**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements for the year ended 31 December 2006

ACTIVITIES

The principal activities of the company, which trades as "Red Funnel", are the provision of ferry and associated catering services. No change to these activities is anticipated in the foreseeable future.

BUSINESS REVIEW

Financial Overview

The company grew market share in the year and enjoyed a 13% increase in revenue. Profit before tax increased to £2.3m from a loss of £1.5m in 2005.

Financial Performance

The financial performance for the year is analysed as follows:

	<u>2006</u> <u>£'000</u>	<u>2005</u> <u>£'000</u>	<u>Change</u> <u>£'000</u>	<u>%</u>
Turnover	30,713.2	27,062.6	3,650.6	13%
Gross Profit	10,932.7 36%	8,340.2 31%	2,592.5 5%	31% 16%
EBITDA	8,966.0	6,147.9	2,818.1	46%

Strategy

The strategy adopted during the year has been to increase revenues by a combination of market share improvements, better use of yield management techniques and additional focus on customer requirements.

Turnover

The company launched its new "Steam" coffee product during the year and revenue from this area showed an increase of 240% compared to the previous offering.

Gross Profit

The 2005 gross profit was adversely affected by a one-off charge of £1.4m relating to additional depreciation following a review of vessel useful lives and residual values.

The 2006 gross profit has been maintained at the adjusted 2005 level, despite a 50% increase in fuel prices.

Operating Costs

2005 operating costs included a one-off charge of £1.8m relating to additional contributions required by the Merchant Navy Officers Pension Fund.

Excluding this charge, the company's administrative costs have increased by 13%; however, a significant proportion of this increase relates to re-organisation costs following a re-structuring of the company's ticket office and travel centre operations.

Capital Expenditure

The company has invested £1.5m in new assets during the year. This was spent on improving customer facilities both onboard the vessels and at the terminals and on ensuring the reliability of vessels and shore-side infrastructure.

Summary of Key Performance Indicators

The directors monitor the progress of the overall strategy by reference to certain key performance indicators:

	<u>2006</u>	<u>2005</u>	<u>Method of calculation</u>
Market share (Car Equivalent Units ("CEU"))	32.5%	32.1%	Total CEU over total market CEU
Turnover growth	13.5%	5.20%	Year on year sales growth expressed as a percentage
Average headcount	404	371	Average of total monthly headcounts derived from payroll records

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

REPORT OF THE DIRECTORS (Continued)

Summary of Key Performance Indicators (Continued)

In addition to the financial key performance indicators, the company also monitors its performance with reference to a number of non-financial key performance indicators as follows

Vessel reliability
Employee turnover
Employee absences
Fuel consumption
Reportable injuries

Future Developments for the Business

The directors recognise that they are operating in a very competitive market but are confident that the strategy for growth, started successfully in 2006 will yield the required increases in market share and revenue that will enable further investment in the services provided

Principal Risks and Uncertainties

The management of the business and the company's strategy are subject to a number of risks. The directors have set out below the principal risks facing the business. The directors are of the opinion that a thorough risk management process is adopted which involves the formal review of all the risks identified below. Where possible, processes are in place to monitor and mitigate such risks.

Failure of Vessel or Shore-side Infrastructure

The company's revenue earning potential is dependent upon a reliable fleet of vessels and the associated shore-side infrastructure. Failure of these can have a detrimental impact on the income achieved by the company.

In order to mitigate such risks, the company has a policy of annual refits and overhauls for the vessels and has service contracts in place for critical plant. In addition, the company has purchased business continuity insurance.

Fluctuations in Fuel Prices

The ferry service relies on marine gas oil, the price of which is susceptible to fluctuations caused by market supply and demand.

In order to mitigate the impact of such price movements, management has made the decision to enter into a Fuel Swap arrangement at a fixed price.

Competition

The cross Solent ferry market is highly competitive and as a result there is constant downward pressure on margins. The directors have implemented a pricing strategy which, when coupled with the service enhancements they are confident will give the company a competitive advantage.

FINANCIAL RISK MANAGEMENT

The company's operations expose it to credit risk, liquidity & cash flow risk and fuel price risk. Given the relative size of the company, the policies set out by the board of directors of the ultimate parent undertaking are implemented by an operational board who have responsibility for this company amongst others.

Credit risk

The company has implemented policies that require appropriate credit checks on potential customers before sales are made.

Liquidity & Cash flow risk

The company has a policy of maintaining debt at a fixed rate to ensure certainty of future debt servicing cash flows. The company has access to group working capital and liquidity facilities and the directors review cash flow forecasts regularly.

Fuel price risk

The company has implemented a policy of hedging its fuel price to stabilise cash outflows.

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

REPORT OF THE DIRECTORS (Continued)

RESULTS OF THE COMPANY

The profit for the year on ordinary activities before taxation was £2.3 million (2005: loss £1.5 million)
The profit for the financial year after taxation was £2.3 million (2005: loss £1.5 million)

The deficit for the year, after dividends, of £2.9 million (2005 re-stated: £6.5 million) is to be deducted from reserves

DIVIDENDS

Dividends totalling £5.2 million (2005: £5.0 million) were paid to ordinary shareholders during the year and a full and final ordinary dividend of £nil is proposed (2005: £nil)

DIRECTORS

The directors of the company during the year were as follows

Mr R A C Scott
Mr T J Docherty
Mr C C Hetherington

A statement of directors' interests in the shares of the company is set in Note 8 to the accounts on page 10

POLITICAL AND CHARITABLE DONATIONS

The company made no political contributions during the year. Donations to UK charities amounted to £2,850 (2005: £8,251)

EMPLOYEES

Protecting the health and safety of employees and customers is a prime responsibility of management and training in navigation, seamanship and other training courses are sponsored by the group as circumstances require

It is the group's policy that disabled people should have the same consideration as others for shore-based job vacancies for which they apply as suitable candidates. Depending on their skills and abilities, the disabled have the same career prospects and opportunities for promotion as other employees

The group has pension and life assurance schemes which cover the majority of employees

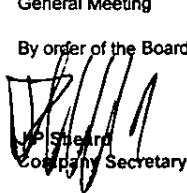
The group issues a variety of newsletters and performance indicators which are circulated to all staff and provide information to employees about current activities and progress

AUDITORS

PricewaterhouseCoopers LLP resigned as auditors on 6 October 2006 and Grant Thornton UK LLP was appointed in their place

A resolution to re-appoint Grant Thornton UK LLP will be proposed at the Group Annual General Meeting

By order of the Board


J P Stearn
Company Secretary

20 April 2007

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**STATEMENT OF DIRECTORS' RESPONSIBILITIES
IN RESPECT OF THE PREPARATION OF ACCOUNTS**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare financial statements in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing those financial statements the directors are required to

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- 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 to 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.

In so far as the directors are aware

- there is no relevant audit information of which the company's auditors are unaware,
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the website and accordingly the auditors accept no responsibility for the information published.

Information published on the website is accessible in many countries and legislation in the UK concerning the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

By order of the Board



J. Sheard
Company Secretary



20 April 2007

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2006**

	2006 £'000	2005 £'000
NOTES		
1 & 2 TURNOVER	30 713 2	27 062 6
Cost of sales	<u>(19 780 5)</u>	<u>(18 722 4)</u>
GROSS PROFIT	10,932 7	8,340 2
Administrative expenses	<u>(5 155 0)</u>	<u>(6 358 0)</u>
OPERATING PROFIT	5,777 7	1,982 2
3 Interest receivable and similar income	13 2	76 1
4 Interest payable and similar charges	(3,522 6)	(3,570 2)
7 PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	<u>2,268 3</u>	<u>(1,511 9)</u>
5 Taxation on profit/(loss) on ordinary activities	(2 4)	(2 0)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION	<u>2,265 9</u>	<u>(1,513 9)</u>

All activities are derived from continuing operations

There is no material difference between the results as reported above and the results restated on an unmodified historical cost basis

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR
ENDED 31 DECEMBER 2006**

		<u>2006</u> <u>£'000</u>	<u>2005</u> <u>£'000</u>
NOTES			
23	Profit/(Loss) for the financial year	2,265 9	(1,513 9)
21	Actuarial loss on pension scheme	(384 0)	(397 0)
	Total recognised gains and losses relating to the year	<u>1,901 9</u>	<u>(1,910 9)</u>
	Prior year adjustment - FRS17	-	(1,951 9)
	Total gains and losses recognised since last annual report	<u><u>1,901 9</u></u>	<u><u>(3,862 8)</u></u>

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**BALANCE SHEET
AS AT 31 DECEMBER 2006**

NOTES	2006 £'000	2005 £'000
FIXED ASSETS		
10 Tangible assets	36,436 9	38,123 9
11 Investments	148 0	148 0
	<u>36,584 9</u>	<u>38,271 9</u>
CURRENT ASSETS		
12 Stocks	143 8	177 6
13 Debtors due after more than one year	23 400 5	25 930 0
13 Debtors due within one year	3,142 4	2 231 5
14 Investments	5 0	5 0
Cash at bank and in hand	119 8	558 7
	<u>28,811 1</u>	<u>28,900 8</u>
CREDITORS		
15 Amounts falling due within one year	(6,952 1)	(6 452 5)
NET CURRENT ASSETS	<u>19,859 0</u>	<u>22,448 3</u>
TOTAL ASSETS LESS CURRENT LIABILITIES	<u>56,443 9</u>	<u>60,720 2</u>
CREDITORS		
15 Amounts falling due after more than one year	(40,912 5)	(42 063 7)
16 PROVISIONS FOR LIABILITIES AND CHARGES	(17 5)	(17 5)
NET ASSETS EXCLUDING PENSION LIABILITY	<u>15,513 9</u>	<u>18,639 0</u>
21 PENSION COMMITMENTS	(1,837 0)	(1 664 0)
NET ASSETS INCLUDING PENSION LIABILITY	<u>13,676 9</u>	<u>16,975 0</u>
CAPITAL AND RESERVES		
17 Called up share capital	5 245 1	5,245 1
18 Revaluation reserve	1,060 6	1 060 6
18 Profit and loss account	7 371 2	10,669 3
23 SHAREHOLDERS' FUNDS - EQUITY	<u>13,676 9</u>	<u>16,975 0</u>

The accompanying accounting policies and notes form an integral part of these financial statements and were approved by the board of directors on 20 April 2007 and were signed on its behalf by



R A C Scott
Finance Director



T J Docherty
Managing Director

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006**

1 ACCOUNTING POLICIES

The following accounting policies have been applied consistently

(i) Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules modified to include the revaluation of certain land and buildings. The company has applied the transitional rules contained in FRS 15 *Tangible fixed assets* to retain previous valuations as the basis on which these assets are held.

The company is exempt by virtue of s228 of the Companies Act 1985 from the requirement to prepare group financial statements. These financial statements present information about the company as an individual undertaking and not about its group.

Under Financial Reporting Standard 1 the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of Red Funnel Group (Holdings) Limited, the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties). The consolidated financial statements of Red Funnel Group (Holdings) Limited, within which the company is included, can be obtained from the address given in Note 22.

(ii) Turnover

Turnover is stated exclusive of value added tax and comprises income from ferry and catering services in the UK. Income is recognised in the profit and loss account in the year in which the related services are provided.

(iii) Depreciation

Depreciation is provided on all tangible fixed assets on a consistent basis at rates calculated to write off the net book value of each asset, less estimated residual value, evenly over its estimated remaining useful life as follows:

Ships	
Ferries	30 Years
Catamarans	20 Years
Others	
Linkspans, pontoons and dolphins	15 Years
Other plant	10 Years
Fixtures and fittings	5 - 7 Years
Motor vehicles	7 Years
Freehold buildings	50 Years
Long leaseholds	50 Years
Short leaseholds	Over the term of the lease

(iv) Repairs and Renewals

Service costs in respect of the annual maintenance of vessels are charged to the profit and loss account as incurred.

Costs in respect of major engine overhauls and associated work are capitalised as incurred and depreciated over the service life of such work.

(v) Investments

Fixed asset investments are stated at cost unless, in the opinion of the directors, there has been a permanent diminution in value, in which case an appropriate adjustment is made. Current asset investments are stated at the lower of cost and estimated net realisable value.

(vi) Stocks

Stocks are valued at the lower of cost and net realisable value.

Routine manne spares are charged directly to the profit and loss account when incurred.

Manne spares acquired in connection with the annual maintenance of vessels are initially held in stock and released to the profit and loss account when the annual maintenance takes place.

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

1 ACCOUNTING POLICIES (Continued)

(vii) Taxation

Current tax is provided at amounts expected to be paid or recovered using tax rates and laws that have been enacted or substantially enacted by the balance sheet date

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 that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains or losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is measured at average tax rates that are expected to apply in periods in which timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

(viii) Leased Assets

Where assets are financed by leasing arrangements that give rights approximating to ownership, the assets are treated as if they had been purchased outright with the corresponding lease commitments shown as obligations to the lessor. Lease payments are split between capital and interest elements with depreciation on the relevant assets and interest being charged to the profit and loss account.

All other leases are operating leases and the annual rentals are charged to the profit and loss account as incurred.

(ix) Pension Contributions

The company operates a defined benefit pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. The amounts charged against profits are set out in Note 21.

The company contributes to an industry-wide funded defined benefit scheme for certain employees. Contributions by the company are determined by the level set by the scheme's actuary. As allowed under FRS 17, the scheme is accounted for as a defined contribution scheme by the company, since its share of the scheme assets and liabilities cannot be separately identified.

The company operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Contributions to the scheme are charged against income as incurred.

(x) Capitalised Interest

The cost of vessels in the course of construction includes interest capitalised where financed by specific borrowings.

2 SEGMENTAL INFORMATION

The company currently has one class of business, being the operation of ferry and associated catering services in the United Kingdom.

	2006	2005
	£'000	£'000
3 INTEREST RECEIVABLE AND SIMILAR INCOME		
Short term deposits and sundry interest	9.2	59.1
Other finance income (Note 21)	4.0	17.0
	13.2	76.1
4 INTEREST PAYABLE AND SIMILAR CHARGES		
Interest on bank overdraft - repayable on demand	-	0.3
Interest on loans from group undertakings	3,327.0	3,403.5
Interest on finance lease payable to group undertaking	108.7	120.8
Interest on retirement benefit liability	88.9	45.6
	3,522.6	3,570.2

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

5 TAX ON PROFIT/(LOSS) ON ORDINARY ACTIVITIES

	<u>2006</u> £'000	<u>2005</u> £'000
Corporation Tax payable on taxable profits/(losses) at 30% (2005 30%)	<u>2 4</u>	<u>2 0</u>

The differences between the total current tax shown and the amount calculated by applying the standard rate of UK Corporation tax to the profit/(loss) before tax are as follows

	<u>2006</u> £'000	<u>2005</u> £'000
Profit/(Loss) on ordinary activities before tax	<u>2,268 3</u>	<u>(1,511 9)</u>
Tax on profit/(loss) on ordinary activities at standard UK corporation tax rate of 30%	680 5	(453 6)
Tonnage tax adjustment	(678 1)	455 6
Current tax charge for the year	<u>2 4</u>	<u>2 0</u>

The company has elected for its results to be assessed under the United Kingdom Tonnage Tax Regulations

6 DIVIDENDS ON EQUITY SHARES

	<u>2006</u> £'000	<u>2005</u> £'000
Equity shares Paid £0 99 (2005 £0 96) per £1 00 ordinary share	<u>5,200 0</u>	<u>5,000 0</u>

7 PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION

	<u>2006</u> £'000	<u>2005</u> £'000
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This is stated after charging

Auditors' remuneration		
Audit	21 6	38 3
Other services - fees paid to the auditor and its associates	8 8	5 5
Other services - fees paid to previous auditors	1 0	3 0
Depreciation		
owned assets	3 025 7	4,019 7
assets held under finance leases	162 6	146 0
Operating lease rentals		
plant and machinery	146 8	174 6
land and buildings	<u>1 096 7</u>	<u>1 070 7</u>

8 DIRECTORS

	<u>2006</u> £'000	<u>2005</u> £'000
Directors' remuneration		
Fees	-	15 0
Directors' emoluments in respect of services provided	330 8	621 6
Pension contributions	30 5	20 0
	<u>361 3</u>	<u>656 6</u>

The remuneration detailed above relates to the directors' services for all the group companies

Retirement benefits have accrued to three directors under a defined benefit scheme (2005 Three)

The aggregate emoluments of the highest paid director was £149,623 (2005 £135,567)

No directors hold shares in the company

Details of shareholdings by directors of this company who are also directors of Red Funnel Group (Holdings) Limited, are contained in the consolidated financial statements of Red Funnel Group (Holdings) Limited within which this company is included

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

9 STAFF COSTS AND NUMBERS	2006 £'000	2005 £'000
i) Wages and salaries	9 117 9	8 231 3
Social security costs	870 7	778 3
Other pension costs (Note 21)	269 4	313 9
	10,258 0	9,323 5

ii) Average number of persons employed (including directors)

Sea-faring staff	204	180
Shore-based staff	98	100
Administration	102	91
	404	371

10 TANGIBLE FIXED ASSETS	Ships £'000	Plant and Equipment £'000	Land & Buildings Freehold £'000	Short Leasehold £'000	Total £'000
COST OR VALUATION					
At 1 January 2006	45 826 0	9 676 2	2 181 1	535 5	58 228 8
Additions	1,080 0	421 3	-	-	1,501 3
Disposals	-	-	-	-	-
At 31 December 2006	46,906 0	10,097 5	2,181 1	535 5	59,730 1

DEPRECIATION

At 1 January 2006	14 140 0	5 393 1	395 7	176 1	20 104 9
Provided during the year	2,442 5	707 1	25 8	12 9	3 188 3
Disposals	-	-	-	-	-
At 31 December 2006	16,582 5	6,100 2	421 5	189 0	23,293 2

NET BOOK VALUE

At 31 December 2006	30,323 5	3,997 3	1,769 6	346 5	36,436 9
At 31 December 2005	31,686 0	4,283 1	1,795 4	359 4	38,123 9

The following amounts relate to assets held under finance leases

Cost	3,177 9	-	-	-	3,177 9
Accumulated Depreciation	440 7	-	-	-	440 7
Net Book Value					
At 31 December 2006	2,737 1	-	-	-	2,737 1
At 31 December 2005	2,950 9	-	-	-	2,950 9

Comparable amounts determined according to the historical cost convention

Cost	46 906 0	10 097 5	1 431 9	420 8	58 856 2
Accumulated depreciation	16,582 5	6 100 2	528 0	282 0	23,492 8
Net Book Value					
At 31 December 2006	30,323 5	3,997 3	903 9	138 8	35,363 4
At 31 December 2005	31,686 0	4,283 1	932 5	151 9	37,053 5

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

10 TANGIBLE FIXED ASSETS (Continued)

Certain of the company's freehold and leasehold land and buildings held at 31 December 1998 were valued at that date by Healey & Baker, International Real Estate Consultants on an open market existing use basis. These valuations were made in accordance with the Appraisal and Valuation Manual issued by the Royal Institute of Chartered Surveyors.

The total valuation amounted to £1.2 million of which £642,000 was apportioned to land, representing an excess of £17,000 over previous valuations. Buildings are included at a valuation based on open market value or depreciated replacement cost as appropriate, 31 December 1987.

No subsequent revaluations have occurred following the company's adoption of the transitional rules of FRS 15 "Tangible Fixed Assets". Included within the cost of ships at 31 December 2006 is an amount of £1.4 million which comprises cumulative capitalised interest (2005: £1.4 million).

11 FIXED ASSET INVESTMENTS

The company owns the whole of the issued ordinary share capital of the following subsidiary undertakings all of which are incorporated in the United Kingdom:

Red Funnel Distribution Limited	- road transport and warehousing
Mashead Services Limited	- dormant
Red Funnel Steamers Limited	- dormant
Red Funnel (Pension Trustees) Limited	- dormant

All trading subsidiary undertakings operate wholly within the United Kingdom. Consolidated financial statements have not been prepared as the company is a wholly owned subsidiary of a company registered in England. In the opinion of the directors the value of the investment in the subsidiary undertakings (including amounts owing by the subsidiary undertakings) is not less than the aggregate amount shown in the parent undertaking's balance sheet.

	<u>2006</u> £'000	<u>2005</u> £'000
Shares in subsidiary undertakings at cost and net book value	<u>148.0</u>	<u>148.0</u>

12 STOCKS

Stocks comprise the following	<u>2006</u> £'000	<u>2005</u> £'000
Fuel oil	92.2	119.6
Marine spares	10.8	6.9
Catering stocks	40.6	51.1
	<u>143.6</u>	<u>177.6</u>

13 DEBTORS

Amounts due after one year

Amounts owed by group undertakings	<u>23,400.5</u>	<u>25,930.0</u>
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	<u>2006</u> £'000	<u>2005</u> £'000
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Amounts due within one year

Trade debtors	903.4	974.0
Amounts owed by group undertakings	228.8	13.7
Amounts owed by subsidiary undertakings	1,216.1	439.4
Prepayments and accrued income	796.1	804.4
	<u>3,142.4</u>	<u>2,231.5</u>

14 CURRENT ASSET INVESTMENTS

Investments at cost

Quoted investments	<u>5.0</u>	<u>5.0</u>
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The directors estimate that the value of the company's quoted investments is at least equivalent to their cost.

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

	<u>2006</u> £'000	<u>2005</u> £'000
15 CREDITORS		
Amounts falling due within one year		
Trade creditors	1,684 0	1,931 9
Amounts owed to group undertakings	2,359 3	1,995 2
Finance lease creditor owed to group undertakings	255 4	255 4
Amounts owed to subsidiary undertakings	709 2	829 3
Taxation and social security	454 5	376 7
Other creditors - MNOFF Pension Liability	123 6	115 1
Corporation tax payable	2 4	2 0
Accruals and deferred income	1,363 7	1,148 9
	<u>6,952 1</u>	<u>6,452 5</u>

Included in the amounts owed to group undertakings is £1,027,700 which is interest bearing (2005: £965,000), all other balances are interest free

Amounts shown as owed to subsidiary undertakings are interest free

	<u>2006</u> £'000	<u>2005</u> £'000
Amounts falling due over one year		
Amounts owed to group undertakings	37,705 5	38,477 8
Finance lease creditor owed to group undertakings	1,748 6	2,004 0
Other creditors - MNOFF Pension Liability	1,458 4	1,581 9
	<u>40,912 5</u>	<u>42,063 7</u>

The interest rate and repayment profile of the company's financial liabilities at 31 December 2006 was

	<u>2006</u> £'000	<u>2005</u> £'000
<u>Fixed rate borrowings (8.58%) owed to group undertakings</u>		
In one year or less by instalments	772 3	710 0
In more than one year but not more than two years	839 9	772 3
In more than two years but not more than five years	2,987 9	2,747 1
In more than five years	33,877 6	34,958 4
	<u>38,477 7</u>	<u>39,187 8</u>

	<u>2006</u> £'000	<u>2005</u> £'000
<u>Variable rate borrowings (1% above bank base rate) owed to group undertakings</u>		
In one year or less by instalments	255 4	255 4
In more than one year but not more than two years	255 4	255 4
In more than two years but not more than five years	766 3	766 3
In more than five years	727 0	982 4
	<u>2,004 1</u>	<u>2,259 5</u>

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

15 CREDITORS

	<u>2006</u>	<u>2005</u>
	<u>£'000</u>	<u>£'000</u>
<u>Fixed rate borrowings (4.2%) owed to MNOPF</u>		
In one year or less by instalments	123 6	115 1
In more than one year but not more than two years	132 0	123 6
In more than two years but not more than five years	448 8	421 4
In more than five years	879 5	1 036 9
	<u>1,581 9</u>	<u>1,697 0</u>

16 PROVISION FOR LIABILITIES AND CHARGES

	<u>Pension Cost £'000</u>
Balance as at 1 January 2006 & 31 December 2006	<u>17 5</u>

Deferred taxation provided in the accounts and the potential amounts are as follows

	<u>2006</u>	<u>Amounts Provided</u>	<u>2005</u>	<u>Potential Liability</u>	<u>2005</u>
	<u>£'000</u>		<u>£'000</u>	<u>£'000</u>	<u>£'000</u>
Taxation on revaluation surplus	-	-	318 2	318 2	

The potential deferred taxation on the revaluation surplus would become payable if the properties were disposed of at the revalued amount

The company has elected to be assessed under Tonnage Tax. No provision for accelerated capital allowances is required

	<u>2006</u>	<u>2005</u>
	<u>£'000</u>	<u>£'000</u>
17 CALLED UP SHARE CAPITAL		
Authorised		
7 000 000 ordinary shares of £1.00 each - equity	<u>7,000 0</u>	<u>7,000 0</u>
Issued and fully paid		
5 245 129 ordinary shares of £1.00 each - equity	<u>5,245 1</u>	<u>5,245 1</u>

18 RESERVES

	<u>Revaluation Reserve 2006 £'000</u>	<u>Profit and Loss Account 2006 £'000</u>
At 1 January 2006	1,060 6	10,669 3
Actuarial loss on pension scheme	-	(364 0)
Profit for the year after taxation	-	2 265 9
Dividends paid in the year		(5 200 0)
At 31 December 2006	<u>1,060 6</u>	<u>7,371 2</u>

19 CAPITAL COMMITMENTS

The company had capital commitments of £0.2m in relation to engine overhaul costs as at 31 December 2006 (2005: £nil)

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

20 LEASING COMMITMENTS

Leasing charges are payable under non-cancellable operating leases on land and buildings and plant and machinery. The position as at 31 December is as follows:

	<u>2006</u> £'000	<u>2005</u> £'000
<u>Operating leases on land and buildings</u>		
Annual commitments which expire		
After five years	<u>914 1</u>	<u>897 8</u>
<u>Operating leases on plant and machinery</u>		
Annual commitments which expire		
Within one year	78 3	86 3
Between two and five years	54 9	60 4
	<u>133 2</u>	<u>146 7</u>

21 PENSION COMMITMENTS

The company operates a defined benefit pension scheme with assets held in a separately administered fund. In addition, some employees are members of the Merchant Navy Officers Pension Fund.

Defined benefit scheme

An actuarial valuation of the Red Funnel Staff Pension Scheme using the projected unit basis, was carried out as at 31 December 2006 by Alexander Forbes Financial Services Limited, consulting actuaries. The major assumptions used by the actuary were:

	<u>2006</u> %	<u>2005</u> %	<u>2004</u> %
Rate of increase in salaries (not applicable as scheme is closed to future accrual)	N/A	N/A	N/A
Rate of increase for pensions in payment	3.15%	2.75%	2.75%
Discount rate	5.15%	4.90%	5.40%
Inflation assumption	3.15%	2.75%	2.75%

The assets in the pension scheme and the expected rate of return were:

	Long-term rate of return expected	Value 2006 £'000	Long-term rate of return expected	Value 2005 £'000	Long-term rate of return expected	Value 2004 £'000
	2006 %		2005 %		2004 %	
Equities	7.5%	4,121 0	7.5%	3,428 0	7.5%	4,316 0
Insurance policy	4.5%	-	4.5%	225 0	5.0%	800 0
Gilts	4.5%	2,106 0	4.5%	2,068 0		-
Cash	4.8%	55 0	4.5%	169 0		-
Total market value of assets		6,282 0		5,890 0		5,116 0
Present value of scheme liabilities		(8,119 0)		(7,554 0)		(8,418 0)
Deficit in scheme		(1,837 0)		(1,664 0)		(1,302 0)
Related deferred tax liability		-		-		-
Net pension liability		<u>(1,837 0)</u>		<u>(1,664 0)</u>		<u>(1,302 0)</u>

	<u>2006</u> £'000	<u>2005</u> £'000
Analysis of the amount charged to operating profit		
Current service cost	-	-
Past service cost	-	-
Total operating charge	<u>-</u>	<u>-</u>

	<u>2006</u> £'000	<u>2005</u> £'000
Amounts credited to other financial income		
Expected return on pension scheme assets	368 0	360 0
Interest on pension scheme liabilities	(364 0)	(343 0)
Net return	<u>4 0</u>	<u>17 0</u>

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

21 PENSION COMMITMENTS (Continued)

	<u>2006</u> £'000	<u>2005</u> £'000
Amount recognised in statement of total recognised gains and losses		
Actual return less expected return on pension scheme assets	99 0	520 0
Experience gains and losses arising on scheme liabilities	(266 0)	(218 0)
Changes in assumptions underlying the present value of the scheme liabilities	(197 0)	(699 0)
Actuarial loss recognised in the STRGL	<u>(364 0)</u>	<u>(397 0)</u>

	<u>2006</u> £'000	<u>2005</u> £'000
The movement in deficit during the year		
Shortfall at 1 January	(1,664 0)	(1 302 0)
Movement in the year:		
Current service cost	-	-
Contributions	187 0	18 0
Past service costs	-	-
Other finance income	4 0	17 0
Actuarial loss	(364 0)	(397 0)
Shortfall at 31 December	<u>(1,837 0)</u>	<u>(1,664 0)</u>

	<u>2006</u> £'000	<u>2005</u> £'000	<u>2004</u> £'000	<u>2003</u> £'000	<u>2002</u> £'000
The history of experience gains and losses is as follows					
Difference between the expected and actual return on scheme assets					
Amount	99 0	520 0	178 0	113 0	(575)
Percentage of scheme assets	0.3%	14.6%	3.5%	2.4%	13.3%
Experience gains and losses arising on scheme liabilities					
Amount	(266 0)	(218 0)	(252 0)	(6 0)	(55)
Percentage of the present value of scheme liabilities	3.3%	2.9%	3.9%	0.1%	1.0%
Total amount recognised in the statement of total recognised gains and losses					
Amount	(364 0)	(397 0)	(754 0)	171 0	(879)
Percentage of the present value of scheme liabilities	5.5%	5.3%	11.8%	3.2%	15.8%

The company contributed £187,000 in 2006 (2005 £18,000). The full actuarial valuation, carried out as at 31 January 2005, suggested that the company contribute at the rate of £204,000 per annum from 2006.

The company also contributes to the Merchant Navy Officers Pension Fund, an industry-wide funded defined benefit scheme for certain employees. The contributions to this scheme are determined with reference to the level set by the scheme's actuaries and charged against income as if it were a defined contribution scheme.

The company has not adopted the accounting requirements of FRS 17 "Retirement Benefits" in respect of this scheme since it is unable to identify its share of the underlying assets and liabilities.

The cost of contributions to the scheme totalled £69,000 (2005 £76,000). An actuarial valuation of the Merchant Navy Officers Pension Fund was undertaken as at 31 March 2003 which showed that the Old Section of the Scheme had a surplus of £167 million and the New Section of the Scheme had a deficit of £194 million. The trustees have calculated that the company's share of the New Section deficit is £1.8 million which is being paid for at the rate of £202,000 per annum over ten years.

The company also contributes to defined contribution schemes. The contributions to these schemes are charged against income as incurred and totalled £199,900 in the year (2005 £209,900).

22 PARENT UNDERTAKING

The company is a subsidiary undertaking of Red Funnel Group (Holdings) Limited, incorporated in the England, which is the ultimate parent undertaking. The immediate parent undertaking is Red Funnel Ferries Limited.

The largest group in which the results of the company are consolidated is that headed by Red Funnel Group (Holdings) Limited, incorporated in England. The consolidated financial statements of this company are available to the public and may be obtained from Red Funnel Group (Holdings) Limited, 12 Bugle Street, Southampton, SO14 2JY. The smallest group in which the results of this company are consolidated is that headed by Red Funnel Ferries Limited, incorporated in England. The consolidated financial statements of this company are available to the public and may be obtained from Red Funnel Ferries Limited, 12 Bugle Street, Southampton, SO14 2JY.

The company has taken advantage of the exemption in FRS 8 not to disclose transactions between the company and other companies within the group, which exceed the 90% ownership threshold.

**SOUTHAMPTON ISLE OF WIGHT AND SOUTH OF ENGLAND
ROYAL MAIL STEAM PACKET COMPANY LIMITED**

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)**

23 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS	2006 £'000	2005 £'000
Profit/(loss) on ordinary activities after taxation	2 265 9	(1,513 9)
Ordinary dividends	(5,200 0)	(5 000 0)
	<u>(2,934 1)</u>	<u>(6,513 9)</u>
Actuarial loss on pension scheme (Note 21)	(364 0)	(397 0)
Net reduction in shareholders' funds	<u>(3,298 1)</u>	<u>(6,910 9)</u>
Opening shareholders' funds as previously reported	16,975 0	25 837 8
Prior year adjustment - FRS 17	-	(1 951 9)
Opening shareholders' funds as re-stated	<u>16,975 0</u>	<u>23,885 9</u>
Closing shareholders' funds	<u>13,676 9</u>	<u>16,975 0</u>

24 CONTINGENT LIABILITIES

There is a fixed charge over the company's rights under an Issuer/Borrower Facility Agreement to certain providers of finance to Red Funnel Finance Public Limited Company

There is a fixed and floating charge over the assets of the company under an agreement dated 28 May 2004 to certain providers of finance to the parent undertaking Red Funnel Group (Holdings) Limited

The company has a contingent liability of £363 000 under the terms of a counter indemnity agreement with Bank of Scotland, who have guaranteed a bond with the Passenger Shipping Association on behalf of the company

The company has experienced a number of claims for industrial deafness relating back to a previous towage operation. The directors have estimated that, should all previous towage crew members make a claim, there is a potential liability of £150,000

As stated in Note 21 the company contributes to the Merchant Navy Officers Pension Fund. At the time of signing these financial statements, the actuarial valuation of the Merchant Navy Officers Pension Fund as at 31 March 2006 had not been prepared. The directors believe that this valuation will show a worsening of the financial position of the Fund and that the company will be called upon to increase its current contributions of £202 000 per annum, although they are not able to quantify the increase.

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHAMPTON ISLE OF
WIGHT AND SOUTH OF ENGLAND ROYAL MAIL STEAM PACKET COMPANY LIMITED**

We have audited the financial statements of Southampton Isle of Wight and South of England Royal Mail Steam Packet Company Limited for the year ended 31 December 2006, which comprise the profit and loss account, the statement of recognised gains and losses, the balance sheet and the related notes. These financial statements have been prepared under 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 auditor's 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' responsibilities for preparing the Annual Report and the financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report. 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 International Standards on Auditing (UK and Ireland) 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 in accordance with United Kingdom Generally Accepted Accounting Practice of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Grant Thornton UK LLP
Chartered Accountants and Registered Auditors
Southampton



20 April 2007