

Annual Report

31 December 2003

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Chairman's Statement

We are reporting a profit of £8,761,000 (2002 restated: £1,591,000). This result equates to a diluted earning per share of 10.9 pence (2002 restated: 3.9 pence). Our diluted net tangible assets per share at the year end were 71.8 pence as against a restated 63.5 pence at the previous year end. This equates to a return on equity of 16.3% for the year.

It has been a quiet but constructive year. Underwriting conditions remained good and the claims experience was relatively benign. We set out to increase the capital of the company but were unable to find any on terms acceptable to existing shareholders. John Shettle and Ed Hochberg resigned their directorships because they are no longer employed by Securitas and PMA respectively.

John Hamblin's non-marine and Richard Williams' aviation teams delivered their business plans almost to the letter, in both cases with excellent results.

The direct property team, headed by Simon King, is now fully in place, complete with a sophisticated computer loss-modelling capability. The account is developing in a very satisfactory way with good loss ratios.

It is worth noting too that our spread vehicle underwriting (on syndicates other than Cathedral Syndicate 2010) has produced a profit for 2001 of 8.5% on capacity compared with a Lloyd's market loss of 18.5%. This is remarkable and I would like to compliment Peter Scales and his team on the Syndicate selections.

We are now regulated by the new Lloyd's franchise board and by the Financial Services Authority, and we have been scrutinised in early 2004 by both bodies. We have good risk management systems at all levels of activity and although being regulated is an expensive business the management is on top of it.

The business is in good shape. Peter Scales in his report gives some idea of the challenges still faced, but again shareholders should be delighted with the team's efforts.

E E Patrick

Chairman

28 April 2004

Chief Executive Officer's Report

Overview

2001 has produced profits on a Lloyd's basis on both Syndicate 2010 and the third party portfolio. Cathedral has posted its largest profit to date with a very promising future earnings stream. The business has achieved genuine franchise status spread over three business areas on which we will continue to build. 2003 was a good year for this business, but our work is far from done yet.

Market

History repeated itself in 2003 as another attractively priced year passed without front page-grabbing incident. The year was the third worst year in a decade for US catastrophes and the marine market suffered a high frequency of expensive claims, but nothing unmanageable given the prevailing trading conditions. The market place was still buoyant in the wake of the collision of a previously unimaginable loss from the US terrorist attacks in 2001 and the legacy of many years of under-priced liability contracts being exposed by the US and latterly European legal systems.

Bermuda continued to flex its muscles to fill incomes, spurred on by IPOs, acquiring US domestic distribution and widening the areas in which it sought to be involved. However, much of the growth came from the larger placements, particularly in the long tail market. Lloyd's had a good year, as perceptions of Lloyd's as security continued to rise while one major industry player after another struggled to deal with old year losses.

By mid 2003, fears started to grow about the 2004 renewal season. However competitive pressure was partly relieved as a considerable proportion of the domestic US reinsurance market withdrew from the market place 'to focus on primary business'. In Europe and 'old Bermuda' there was a degree of deckchair rearrangement in response to legacy woes and the search for new focus.

By the time the renewals came round, despite the growth of the new Bermudians, London orders again increased for the second time in as many years and underwriting discipline remained intact in most specialist classes with business renewing at attractive terms, be that increased, the same, or slightly down on the previous year.

More capital came into the industry for 2004, but tended to be deployed in the longer tail areas, as these were still showing substantial headline rate increases on the back of loss patterns that had become detached from any historic trend. Some elements of new Bermuda had a voracious appetite for US liability business that simply could not have been placed two years ago, apparently keen to be first in the queue to write tomorrow's legacy losses. In London too, the UK liability classes have suddenly become a very popular and more crowded market place.

On previous form it would be an achievement if the industry could keep its cool for another year but one has to be sceptical. Economic fundamentals, the continuing damage coming from legacy losses, counter-party failure and the recent very close examination of the precipice undertaken by some major industry players who we hope might learn from the experience, are counter balancing factors. However, absent major losses, we suggest the prognosis for the next renewal season is much the same as the one we made last year. There will be significant pressure on renewals at year-end.

Last year-end showed a distillation of the market place into the 'haves' and 'have-nots'. This is certain to continue this year-end as competitive pressures manifest themselves. One of Cathedral's central themes has always been to build a focused business where we fit into the 'have' category in each business line we undertake. We restrict ourselves to such areas and endeavour to do them well. We do not intend to change that now.

Chief Executive Officer's Report

continued

Lloyd's

The established big battalions in the industry continue to argue that size and myriad product lines are key to success, while being hamstrung by their legacy and complex underwriting procedures that stretch the word service to its limits. Many of the new Bermudians are hungry for income and have yet to acquire legacy issues, but to date have little presence where specialist underwriting knowledge is required, are straining the limits of their infrastructures and don't give clients a warm feeling about continuity.

Then there is London and Lloyd's. The perception of Lloyd's is steadily appreciating. London orders on mature business have increased for the second time in as many years. The market has benefited from accurately forecasting its liabilities to losses stemming from September 11th in comparison to its main detractors, many of whom seemed to have had problems with their sums.

Lloyd's has undergone a regulatory and risk management refit with the new Franchise Board in place. One hopes it will tackle substandard operations that undermine collective market credibility, while working to enhance its security rating with the agencies. A downside of a market place is the unhelpful politics, ranging from blatant promotion of self interest, to preposterous public statements that the capital structure of the market is to blame for very poor individual results to distract from the fact they have been caused by greed, over gearing, poor underwriting and an unwillingness by management to look closely in the mirror.

Within the companies comprising Lloyd's there is a share of all the faults listed in the market's competitors, but in the round it is currently a good place to do business. As a market place, it will always have its own brand of uncertainties and more than its fair share of regulatory demands. There will always be 'white noise' concerning Lloyd's, as this has been effectively promoted by our competitors for decades.

Our own business could operate anywhere that we could offer the appropriate security for our clients and obtain the necessary licenses, but on any current basis, Lloyd's is the most effective place for a specialist standalone business such as ours.

Syndicate 2010

Cathedral Syndicate 2010 is the mainspring of our operation and started trading for the 2001 year of account at Lloyd's. After 36 months it has closed its first year of account with a small profit. Put into context of a business start up that specialised in property and aviation reinsurance in a year such as 2001, this a great achievement by the team and in some ways has been the making of the franchise that we have today.

As is often the case, the years immediately following a sequence of industry losses look (at this stage) very encouraging and we expect to report healthy profits as this business comes off risk and flows to our balance sheet. During this period we have been active in cementing our franchise in our two specialist classes and have substantially increased the income base in the attractive prevailing trading conditions.

In last year's accounts we stated that we were in the process of adding a 'third leg' to our business in the form of a direct and facultative property unit. I am pleased to report that our team, headed by Simon King has arrived and has established itself in the market place and within Cathedral. Although very early days, the business we have written so far is running in line with the business plan and at some of the best loss ratios that the team has historically seen.

For 2004, we increased the capacity of the Syndicate to £200 million to allow scope for expansion in the property reinsurance division, the aviation division and most materially in the new property account, so that the income of the syndicate will be spread roughly equally across the three units, giving the syndicate greater long term stability.

It is not presently foreseen that we will diversify too much further afield as we have always aimed to provide a sustainable but highly focused business that has lead capability and industry reputation in the lines of business in which we trade. Having said that, we have targeted boosting our underwriting capability on both property units to keep the franchise growing and also enjoy the advantages of a price maker when our market segments come under more sustained pressure.

In terms of absolute size we are unlikely to be increasing Syndicate 2010 for 2005 even if we are successful in adding to our underwriting team and increasing our income as a consequence. The US dollar's depreciation in the last few months (a significant proportion of our business is conducted in this currency) has left sufficient headroom to expand on a sterling basis. If in the longer term the dollar returns to a level where it has traded for the previous few years, we will address our sterling syndicate size when necessary.

I would commend to you reading John Hamblin's report in the Syndicate 2010 Annual Report for a more detailed description of the activities of the Syndicate. Suffice to say the business is growing impressively and progressively in market presence, infrastructure and reputation. Profitability is a very welcome bonus too!

Third Party Portfolio

As you will recall, we have a structure where the Cathedral Group's underwriting has historically been split approximately equally between Syndicate 2010 and a portfolio of complementary syndicates. This structure is in place as it helps diversify exposures to the balance sheet and enhances our capital efficiency.

Last year we suggested that the third party portfolio had done its job and I am pleased to report that eleven of the twelve syndicates supported for 2001 have closed with a profit, the remaining one closed with a creditable expenses loss. Given that the market is likely to produce an overall loss on a Lloyd's basis of 18.5% with the majority of syndicates in loss, our portfolio result of a 8.5% profit is highly creditable. The open years of our portfolio look promising too.

The portfolio is not a strategic imperative of our company but is a highly valuable contributor to our balance sheet. We will continue to use the spread portfolio as a counterbalance to enhance our underwriting returns until such time that we see attractive prospective returns disappear. In the longer term the third party portfolio is likely to reduce both proportionately to our share on Syndicate 2010 and in absolute terms.

A list of our participations for the 2004 underwriting year of account appears below:

Class	Syndicate	Underwriter	Managing Agent	Share £	Percentage of Portfolio %
Marine	609	Dandridge	Atrium Underwriters Ltd	2,035,198	1.1
Non-Marine	318	Pritchard	Beaufort Underwriting Agency Ltd	12,522,524	6.9
	570	Marsh	Atrium Underwriters Ltd	1,639,166	0.9
	623	Beazley	Beazley Furlonge Ltd	35,000,000	19.2
	2010	Hamblin	Cathedral Underwriting Ltd	97,016,434	53.2
Motor	980	Neal	Limit Underwriting Ltd	25,635,416	14.1
Composite	510	Various	R J Kiln & Co Ltd	8,431,762	4.6
				182,280,500	100.0

Chief Executive Officer's Report

continued

Financial Review

The accounting policies adopted by the Group together with any changes in accounting policies, from one year to the next, are set out in Note I of these accounts.

Cathedral accounts for its underwriting participations on an annual accounting basis rather than on the traditional Lloyd's funded accounts basis. However, we are pleased to report that the 2001 underwriting year of account, for Syndicate 2010, on a funded basis closed at a profit of circa 0.7% of capacity, before members' agency fees. Our external underwriting portfolio for the 2001 underwriting year of account also closed at a profit, on a funded basis, of circa 8.5% of capacity supported.

Profit and Loss Account

2003 built on the satisfactory financial performance of the Group last year and the continued growth and diversification in the underwriting operation of our managed syndicate 2010 significantly contributed to the results achieved by the Group. The Group profits after tax grew 450% to £8.76 million. This is derived as follows:

	Underwriting			Corporate £'000	Total £'000
	Managed £'000	External £'000	Total £'000		
Gross Written Premium	60,231	79,703	139,934	–	139,934
Net Earned Premium	32,710	47,257	79,967	–	79,967
Technical Result*	8,634	2,423	11,057	–	11,057
Net Investment Return	252	1,290	1,542	2,656	4,198
Fees, Commissions and other income	–	–	–	2,619	2,619
Other expenses**	–	–	–	(4,578)	(4,578)
Amortisations	(50)	(280)	(330)	(328)	(658)
Profit before tax	8,836	3,433	12,269	369	12,638
Tax	(2,650)	(1,030)	(3,680)	(197)	(3,877)
Profit after tax	6,186	2,403	8,589	172	8,761
Earnings per share***	7.7p	3.0p	10.7p	0.2p	10.9p
Return on Equity****	11.5%	4.5%	16.0%	0.3%	16.3%

* Excluding investment return transferred to the Technical Account

** Other expenses include an amount relating to the staff profit-related pay which has been charged in full against the Corporate activities

*** Earnings per share is fully diluted

**** Return on equity is based on profit after tax divided by opening shareholders' funds as adjusted for new equity issues

For the 2003 underwriting year of account the underwriting capacity of Cathedral Syndicate 2010 was increased to £160 million (2002: £96 million), and the Group through its corporate member subsidiary provided 42.5% (2002: 23.5%) of the capacity. For 2004 underwriting year of account the underwriting capacity of Cathedral Syndicate 2010 has been increased to £200 million and Cathedral provides 48.5% of the capacity.

Lloyd's operates in an environment whereby it takes 3 years from the start of a year of account to when it closes. At the year-end there were substantial unearned premiums, and therefore potential unearned profits, from both the managed and external syndicates supported by the Group. These premiums and potential profits will be earned in future accounting periods of the Group. At the year-end we had net unearned premiums of circa £44.8 million (2002: £14.4 million) on the balance sheet.

The combined ratio of Cathedral Syndicate 2010 continues to improve in response to the favourable underwriting conditions and the financial and other controls under which the syndicate operates. The combined ratios are as set out below:

	31 December 2003	31 December 2002	31 December 2001
Claims ratio	40.7%	57.7%	92.9%
Expense ratio	35.9%	28.1%	32.5%
Total ratio	76.6%	85.8%	125.4%

The combined ratio of the Group, after taking account of the managed and external underwriting results, together with the non-underwriting operations of the Group are as set out below:

	31 December 2003	31 December 2002	31 December 2001
Claims ratio	57.8%	68.9%	83.8%
Expense ratio	31.6%	27.0%	31.9%
Total ratio	89.4%	95.9%	115.7%

The Group's expense ratio includes the Group's share of Syndicate 2010 and third party syndicate expenses together with the other corporate expenses, net of non-underwriting income (excluding investment return) and fees incurred by the Group. The final element of these expenses is the staff profit-related pay which is based on the annual profitability of the Group. An analysis of the expense ratio is set out below:

	31 December 2003	31 December 2002	31 December 2001
Expense ratio:			
Syndicate 2010	11.6%	8.3%	7.9%
Third party syndicates	16.7%	14.9%	18.5%
Corporate	0.1%	2.3%	5.5%
	28.4%	25.5%	31.9%
Staff profit-related pay	3.2%	1.5%	–
Total expense ratio	31.6%	27.0%	31.9%

Cathedral continues to keep a tight rein on expenses with the main internal expenditure of the Group, which includes Syndicate 2010 at the 100% level and not just Cathedral's own share of the syndicate. Payroll costs (before staff profit-related pay) and information technology account for 31% of aggregate expenses. We continue to believe that the business benefits from having highly skilled people and "cutting edge" IT and this is reflected in this level of expenditure.

Chief Executive Officer's Report

continued

Investment Strategy and Return

The investment strategy of the Cathedral Group, with respect to its funds at Lloyd's, is designed to preserve the capital of the Group, which is fully deployed to support our underwriting activities. We recognise that at this stage of the insurance cycle our risk exposure should be towards our underwriting and not to the volatility of the investment and financial markets. Our return reflects our current reduced appetite for investment risk though this may change in the future when the insurance cycle softens and we reduce our insurance exposure.

The investment return has been calculated using the long-term rate of investment return with an adjustment for short-term fluctuations in arriving at the operating profit. The long-term rate of return is only applied to the funds at Lloyd's that support the underwriting activities of the Group. These rates of return are based on our expectations of returns over the investment cycle. The actual return for the year was a profit of £2,737,000 (2002: a loss of £805,000) which equates to a return of 5.5% (2002: a negative return of 3.2%). The split of the return is set out below:

	Average funds at Lloyd's £'000	Long-term rate of return %	Actual return %	Actual return £'000
Equities	7,286	6.0	14.4	1,052
Fixed interest	4,267	5.0	4.4	188
Alternative investments	3,701	5.5	10.6	393
Cash	34,492	5.0	3.2	1,104
	49,746	5.2	5.5	2,737

The funds of Cathedral Syndicate 2010 have been held in cash or short dated securities throughout 2003. This is in line with the investment policy adopted with respect to the syndicate funds, which is designed to balance liquidity, security and investment risk so as to enable the syndicate to meet its commitments when they fall due. To that end the US Dollar funds are invested in instruments with an average duration of less than 2 years. The funds of all the other major currencies (Canadian Dollars, Euros and Sterling) are held in cash.

Earnings Per Share

The earnings per share (fully diluted) were 10.9 pence (2002 restated: 3.9 pence). This improvement reflects the continuing improvement and growth of the business.

Dividend Policy

It is intended to maintain the policy of not paying any dividends in the short to medium term. Substantially all of the retained earnings will be used by the Group to support our expanding underwriting business and to take advantage of the current buoyant trading environment.

Balance Sheet

The funds at Lloyd's of the Group have been conservatively invested in the year with a significant reduction in the equity exposure we are prepared to take. In addition to the Group's own funds we have obtained a £21 million (£5 million at the last year end) Letter of

Credit to support the Group's underwriting activities into 2004. An analysis of the Group's own tangible funds at Lloyd's is set out below:

	31 December 2003		31 December 2002	
	£'000	%	£'000	%
Equities	6,062	12.3	5,982	12.7
Fixed interest	4,041	8.2	4,305	9.1
Alternative investments	4,886	9.9	1,677	3.5
Cash	34,394	69.6	35,246	74.7
	49,383	100.0	47,210	100.0

Throughout the 36 month period that a syndicate's year of account is open, the underwriting result is held within the syndicate premiums trust funds and is normally only released to the Group following closure of the year of account. This is also the case with respect to the profit commission that is earned by the managing agency. The results of the 2001 to 2003 underwriting years of account that have been earned/recognised by the Group to date are included within the accrued income figure on the balance sheet. At the year end this figure stood at £16.4 million (2002 restated: £2.7 million).

Late last year Lloyd's announced that they were switching to an annual accounting regime from 1 January 2005 and this could entail annual distribution by syndicates to the Names' premium trust funds. However, we believe that it is extremely unlikely that Lloyd's will allow the Name to distribute this cash from its premium trust fund until the year of account to which it relates has closed, normally at 36 months. However, these funds should be available to support the future underwriting activities of the Group. For the 2004 underwriting year of account we have been able to utilise approximately £4 million (2003 underwriting year of account: circa £1.4 million) of these earned profits by way of solvency credit to support our underwriting activities.

There is little spare cash within the Group, as we wait for the cash from our underwriting profits to flow out from the syndicates we support, and at the year-end we were utilising the overdraft facility which we have from Barclays Bank, which also provides both an overdraft and a catastrophe facility to Syndicate 1010. We continue to monitor and consider the appropriateness of all these facilities to ensure that at all times we have the maximum financial flexibility within the Group while ensuring the financial stability of the business.

The Net Assets of the Group stood at circa £62.5 million (2002 restated: £53.1 million) at the end of the year. This includes approximately £5.2 million (2002: £3.0 million) of intangibles, being goodwill and the cost of syndicate participations. This equates to Net Tangible Assets per share of 71.8 pence (2002 restated: 63.5 pence).

Underwriting Capital

The Financial Services Authority ("FSA") have released a consultative paper CPI 90, which sets out their proposals for the new capital regime for UK insurers. The proposal from the FSA is that the capital requirement of a firm should be more risk based and will require insurers to hold more capital than the current Minimum Capital Requirement. This regime will come into force from 1 January 2005 and though the FSA has yet to release their final proposals for Lloyd's we would not expect these to be materially different from those that will apply to general UK non-life insurers.

The new system will rest on a formulaic Enhanced Capital Requirement ("ECR") for all insurers. There is an expectation that insurers will then model and stress test the capital requirements of their business to enable them to determine the appropriate level of capital they should

Chief Executive Officer's Report

continued

hold to enable them to derive their own Individual Capital Assessment ("ICA"). If the ICA is higher than the ECR number, then the insurer will need to capitalise to the level of the ICA. We have commenced this process (in 2003) with our actuaries and shall be progressing this project throughout the remainder of the year to enable us to meet our obligations as set out by the FSA. The FSA will also carry out their own assessment of an insurer's capital requirement and may impose this (known as Individual Capital Guidance) on any insurer if they believe that they are not holding adequate capital commensurate with the risk of their business. Shareholders will recall that Lloyd's has operated a Risk Based Capital ("RBC") regime for a number of years and the new FSA proposals will build on this further which will hopefully mean that the impact on our business will not be as great as that on other UK general insurers operating outside Lloyd's.

Capital Provision

In contrast to the underwriting side of our business which has been rapidly moving forward along its planned path, gathering the appropriate level of capital to take the business forward at optimal level has been and continues to be a game of moving targets.

You will have seen above that the new underlying underwriting capital regime that is proposed for our business for 2005 introduces new capital requirements for our syndicate, our corporate member of Lloyd's and ultimately the Group. However our funds at Lloyd's requirements are one piece of an interesting jigsaw.

Our thinking since last summer was that for 2005 we would need to increase the size of the syndicate once again and at a minimum support our share (48.5%) of this increase. In order to fund this we asked you at last year's Annual General Meeting to free a block of stock that we could issue to facilitate this process.

Through last summer and autumn we spent time with a substantial number of potential investors. Though many did not progress beyond the first stage as our company did not fit their own portfolio or prejudices about size, diversity, structure, Lloyd's or less obvious issues, other investors reached a stage in their work where they were able to issue draft term sheets describing a basis on which they would invest in the Group.

Although the 'deal' options we were presented with were wide, we decided to proceed with none of them as they would have involved a considerable dilution of existing shareholders' interests together with a significant loss of management control in order to allow new investors' criteria to be achieved.

By the year-end, the continued weakening of the US dollar had made a substantial capital raise unnecessary as it had created the headroom within our syndicate to continue our income growth plans at syndicate level within its existing sterling capacity. As a consequence we examined a number of other options to issue smaller amounts of equity and looked at the possibility of listing the company. However, none of these options were deemed particularly attractive.

Equally another year had passed without major incident to the benefit of the potential 'pipeline' profits within the business. Since the company started we have increased the Group's underwriting in tune with the prevailing trading conditions with substantial increments in the underwriting years 2003 and 2004. Ultimately the degree that the company benefits from the prevailing trading conditions will largely be determined by these two years. Although we are very much on risk for both of them, we know that the business was written to plan and to date there have been no substantial individual or an uncomfortable frequency of losses.

As we sit today, we do not know our exact capital requirements for 2005, although we are hopeful they will not change dramatically from our current situation. We are now examining further options, upon which we will update you during the year, but the flavour is likely to be meeting our requirements by issuing as little new stock as possible.

This situation may involve the use of some debt or leverage to act as a bridge until our profits are released from the Lloyd's system. We are aware of the risks that gearing presents to any business but this exercise would be undertaken against earned profits rather than speculating on dramatically increasing the exposure to our balance sheet after the market has peaked.

Strategy

Since Cathedral started its managing agency business we have had a consistent business plan, to build a valuable franchise and make profits.

We have successfully overcome an initial shock to the industry in 2001, which could have done us substantial damage and have moved on the better for the experience. One of our main aims is to seek liquidity for shareholders when the time is right, but in the meanwhile build a business that will have the ability to attract a premium rating.

We are now in our fourth trading year and excepting cash flow have successfully traded through all the usual new business threats. We now have a valuable franchise, we are well known in the areas we trade and are year on year building our income from a position of strength, a process that we aim to continue.

The strategy going forward is simply more of the same. We will grow in our areas of expertise and add quality underwriters to our teams. We will address our capital issues as our exact capital requirements become apparent but we do not intend to dilute our existing shareholders unless we deem it is to their benefit.

Shareholders have taken the initial business risk that is now all but over. The team will continue to develop the business while hopefully entering a period of accelerating earnings to our balance sheet.

As a project, Cathedral is now truly underway with excellent prospects. For the work done thus far, I would like to extend shareholders' and my thanks to all the Cathedral team.

Peter Scales

Chief Executive Officer

28 April 2004

Directors and Advisors

Chairman	E E Patrick ⁽¹⁾⁽²⁾
Directors – Executive	L A Holder ⁽²⁾ J A Lynch ⁽²⁾ P D Scales ⁽²⁾ A I G C South
Directors – Non-Executive	P M Gillham† A S Minns† ⁽³⁾ W H Salomon† J B Stradtner† J M P Welman† †Member of the Audit, Remuneration and Nomination Committees ⁽¹⁾ Member of the Remuneration and Nomination Committees ⁽²⁾ Member of the Executive Management Committee ⁽³⁾ Senior Independent Director
Company Secretary	J A Lynch
Auditors	Mazars 24 Bevis Marks London EC3A 7NR
Bankers	Barclays Bank PLC PO Box 544 54 Lombard Street London EC3V 9EX
Company Number	3372107
Registered Office	9th Floor Lloyd's One Lime Street London EC3M 7HA
Investment Manager	Close Private Asset Management Limited 10 Crown Place London EC2A 4FT

Directors of the Company

Elvin Patrick

After gaining a Masters degree in Business Administration from Cranfield, Elvin Patrick joined Edward Bates, merchant bankers in 1973 where he specialised in mergers and acquisitions, Stock Exchange practice and Balance Sheet Reorganisations, before joining the Lloyd's market in 1974. In 1981, he joined Stenhouse (becoming Limit/Bankside) as underwriter of marine syndicate 566 (until 1997). From 1989-1999 he was Chairman of Bankside Underwriting Agencies Limited and latterly, 1998/99, Chief Executive Officer of Limit PLC. He has held numerous positions at Lloyd's including Deputy Chairman in 1998, a member of the Lloyd's Regulatory Review Board in 1997 and a member of the Lloyd's Rowland Task Force in 1991. He was Active Underwriter of syndicate 2010 until 30 November 2001.

Lawrence Holder

After gaining a law degree at Manchester University in 1981 and being called to the bar in 1982, Lawrence Holder joined the Corporation of Lloyd's in 1983, subsequently joining Bankside Underwriting Agencies Limited in 1985. He was the Managing Director of Bankside Syndicates Limited from 1990 to 1999 and group Company Secretary from 1986 to 1999. He was then deputy managing director of Limit Underwriting Limited until joining Cathedral. He served on a number of Lloyd's bodies including the FSA's Lloyd's Panel. He is Managing Director of Cathedral Underwriting Limited and Deputy Executive Chairman of Cathedral Capital PLC. He is also a non-executive director of Beaufort Underwriting Agency Limited and Chairman of the Lloyd's Market Association's Risk Management Committee.

John Lynch

After gaining a degree in commerce from University College Cork, Ireland in 1988, John Lynch joined Robson Rhodes and qualified as a chartered accountant in 1992. After spending two years in industry he joined Finsbury Asset Management Limited and became head of accounting and administration for institutional investment clients. Since 1994 he has also been involved in the structuring of capital entities in Lloyd's. He joined Wren Limited as Company Secretary and Head of Finance in January 1999. Following the acquisition of Wren Limited by BRIT Insurance Holdings PLC, he was Company Secretary and group financial controller from September 1999 until October 2000. He is Chief Financial Officer of Cathedral Capital PLC.

Peter Scales

After gaining a degree in Economics and Geography at University College, London, Peter Scales joined Bankside Underwriting Agencies Limited in 1986. In 1991, he joined Wren Underwriting Agencies Limited as an analyst. He was appointed a director of Wren Underwriting Agencies Limited in 1993 and managing director of Wren Lloyd's Advisers Limited in 1994. He was involved in the original placement of one of Lloyd's first listed corporate capital vehicles, subsequently to become Wren Limited, of which he was an executive director. Following the acquisition of Wren Limited by BRIT Insurance Holdings PLC, he was director of capital management. He is Chief Executive Officer of Cathedral Capital PLC.

Anthony South

Anthony South joined Dashwood Underwriting Agencies Limited in 1971 and helped to build up the agency in its formative years. He was appointed as a director of Wren Underwriting Agencies Limited in 1989 (chairman from 1996-2000), a director of Wren Holdings Limited from 1993 and chairman of Wren Lloyd's Advisers Limited from 1994 until his resignation in November 2000. He was involved in the original placement of one of the first Lloyd's listed corporate capital vehicles subsequently to become Wren Limited of which he was an executive director. An underwriting member since 1976, he resigned as an unlimited Name in 1997 and converted his capital under Cathedral's first conversion offer. He is non-executive Chairman of Cathedral Underwriting Limited and Cathedral Capital Management Limited. He is also a non-executive director of Anton Private Capital Limited and a number of private trading companies.

Directors of the Company

continued

Paul Gillham

After gaining a degree at Cambridge University, Paul Gillham joined Unilever in 1958. He became executive chairman of Keith Prowse Group (1970 to 1980), and of a textile manufacturing and marketing group (1984 to 1992). An underwriting member since 1979, he resigned as an unlimited Name in 1997 and converted his capital under Cathedral's first conversion offer. He served as a non-executive director of Wren Underwriting Agencies Limited from March 1993 to December 1997.

Anthony Minns

After gaining a law degree at Bristol University, Tony Minns qualified as a Barrister. In August 1974 he joined Morgan Grenfell specialising in mergers and acquisitions, tax and executive pay. In 1984 he joined Bank of America International Limited and in 1986 left to co-found his own Company MM&K Limited establishing three teams which covered private client management, senior executive pay and corporate finance. He sold his interest in the Company in 1996. He is now a director of a number of private trading companies and an AIM Listed company. An underwriting member since 1985, he resigned as an unlimited Name in 1997 and converted his capital under Cathedral's first conversion offer.

William Salomon

William Salomon gained law degrees at Cambridge and was subsequently called to the Bar. He is managing partner of Hansa Capital Limited, Deputy Chairman of Ocean Wilsons Holdings Limited and a Director of Hansa Trust plc. He was previously Chairman of Rea Brothers Group plc and subsequently Vice Chairman of Close Asset Management Holdings Limited, and is and has been a director of a number of other investment and trading companies, both private and quoted. He is a German and British citizen.

James B Stradtner

James B. Stradtner is a Managing Director of Century Capital Management and chairman of the Investment Committee of the Private Equity Group. He joined Century in 1996 after 21 years with Alex, Brown & Sons Incorporated where he was a General Partner and a Managing Director and headed the Insurance Investment Banking Group at Alex, Brown & Sons. He earned a B.S. from the University of Maryland and a JD from the University of Maryland School of Law. Mr Stradtner is a Chartered Financial Analyst and a member of the Baltimore Security Analysts Society, National Economists Club, the Association of Insurance and Financial Analysts and the Maryland Bar Association. He is President and a Member of the Board of Directors of the Legal Mutual Liability Insurance Society of Maryland. He is a member of the Board of Directors of Asset Allocation and Management LLC and has been a director of several private and quoted companies.

Jo Welman

After graduating in economics from Exeter University in 1979, Jo Welman joined Baring Brothers where he managed several large segregated UK and US public company pension funds and Unit Trusts. In 1989 he was recruited by Rea Brothers to become the managing director of their investment management activities. He resigned as a director of the Rea Brothers Group plc when the banking group was acquired by Close Brothers in August 1999, when he became Chairman of BRIT Insurance Holdings PLC ("Brit"). He resigned as chairman in September 2002 and will remain a non-executive director of Brit until 27 May 2004. He is non-executive Chairman of the Close FTSE 100 Investment Trust plc and an executive director of The Equity Partnership Investment Company PLC and EPIC Brands PLC.

Report of the Directors

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

Registered Office

The Company's registered office was changed from 51 Eastcheap, London EC3M 1JP to 9th Floor, Lloyd's, One Lime Street, London EC3M 7HA on 16 January 2004.

Principal Activity and Review of the Business

The Company was originally set up as a Names' Conversion vehicle, in 1997, which enabled Names with unlimited liability to convert to limited liability. The 1998 year of account was the first underwriting year that the Group participated in. The Company underwrites at Lloyd's through its corporate member subsidiary.

In late 2000, the Company acquired Cathedral Underwriting Limited, a Lloyd's managing agency, which has the rights to manage Syndicate 2010, which commenced underwriting for the 2001 year of account. At the same time, the Company also acquired Cathedral Capital Services Limited, an employment company, and Cathedral Capital Management Limited, a FSA registered advisory company.

The principal business of Cathedral Underwriting Limited is that of a Lloyd's managing agency which manages Syndicate 2010, a syndicate currently specialising in non-marine and aviation reinsurance and direct and facultative property, with capacity of circa £200 million for the 2004 year of account (£160 million for the 2003 year of account). Syndicate 2010 has just closed its first year, 2001 year of account, with a small profit. The company also manages an inherited marine syndicate, which has been placed in run-off, having ceased underwriting at the end of the 2000-year of account. Cathedral Underwriting Limited is authorised and regulated by the FSA and Lloyd's.

When it was acquired, Cathedral Capital Services Limited had the benefit of a number of employment contracts with underwriters and management staff who now operate and manage the Lloyd's managing agency and other businesses within the Group. Cathedral Capital Services Limited, together with Cathedral Underwriting Limited, are joint employing companies within the Group.

Cathedral Capital Management Limited advises the Group on its underwriting participations and advises third party clients on their insurance activities. It is authorised and regulated by the FSA.

The Group's corporate member underwrote circa £135 million of capacity for the 2003 year of account (2002: £45 million). Of this capacity, £68 million supported Syndicate 2010 (2002: £22.5 million). For the 2004 year of account, the Group increased the underwriting capacity it supports to circa £182 million of which £97 million supports Syndicate 2010, with the remainder supporting a select number of external third party syndicates.

A more detailed review of the activities and results of the Group are included in the Chairman's Statement and Chief Executive Officer's Report.

Results and Dividends

The results attributable to shareholders for the year and the transfer to reserves are shown on page 25.

Details of the accounting policies adopted by the Group, together with the changes to these policies from prior years, for the year are set out in Note 1 to the Financial Statements.

The Directors do not intend to declare a dividend for the year (2002: £nil).

Report of the Directors

continued

Future Developments

Details of future plans for the Group are set out in the Chairman's Statement and Chief Executive Officer's Report on pages 2 to 11.

Share Capital

On 9 April 2003, 1,000,000 A Convertible Ordinary 25p shares were issued for non-cash consideration. A Section 103, of the Companies Act 1985, report has been obtained from the Auditors, which placed a value of 71.7 pence per share on these shares.

Convertible Debt

As part of the capital raise in 2002, a loan instrument was created and £1,604,621.20 nominal value of A Convertible Unsecured Loan Notes were issued. These notes pay a coupon of 6% per annum and are convertible, at a future value, into A Convertible Ordinary 25p shares.

Directors

The Directors who held office at the year-end and who are still in office at the date of this report are shown on page 12.

In addition, Mr Hochberg served as a Director throughout the year until the date of his resignation on 5 June 2003. Mr Tirney replaced Mr Hochberg as a non-executive Director on 30 June 2003 and resigned as a Director on 6 January 2004. Mr Shettle was appointed a non-executive Director on 4 March 2003 and resigned as a Director on 11 December 2003.

Directors' Interests in Transactions

PMA Capital Insurance Company entered into an agreement with Cathedral Capital Services Limited under which fees of £45,000 per annum are payable. PMA Capital Insurance Company is part of the PMA Group. The PMA Group is the beneficial holder of 23,630,770 A Convertible Ordinary 25p shares in the Company, Messrs Hochberg and Tirney had an interest in these shares through their shareholding in the PMA Group. Up to the date of Mr Hochberg's resignation on 5 June 2004, the Group received £19,232 (2002: £77,726) of fee income under this agreement. From the date of Mr Tirney's appointment to the Group Board ("the Board") to the end of the year, £22,685 of fee income was received by the Group under this agreement.

On 11 March 2003 the Company acquired an income share in PMA Re Corporate Capital Limited, a corporate name at Lloyd's which underwrote exclusively on Syndicate 2010 for the 2001 and 2002 underwriting years of account. This share entitles the Company to 30 per cent of the aggregate post tax profits of PMA Re Corporate Capital Limited in return for the Company indemnifying PMA Capital Insurance Company and PMA Re Corporate Capital Limited for any post tax losses in excess of £300,000. A proportion of the Company's funds at Lloyd's comprising approximately £8.9 million were used to support both the underwriting activities of PMA Re Corporate Capital Limited, for the 2001 and 2002 underwriting years, and the underwriting activities of the Group for the 2003 and subsequent underwriting years. Mr Hochberg had an interest in this transaction through his shareholding in the PMA Group and his directorship of PMA Re Corporate Capital Limited.

Mr Salomon has entered into a client agreement with Cathedral Capital Management Limited. Under the terms of this agreement Cathedral Capital Management Limited received a fee of £4,000 (2002: £667) and is entitled to a profit commission of 3 per cent. Ascension Limited has entered into a client agreement with Cathedral Capital Management Limited. Under the terms of this agreement Cathedral Capital Management Limited received a fee of £8,000 (2002: £1,333) and is entitled to a profit commission of 3 per cent. Mr Salomon is also interested in this agreement as he is a director of Ascension Limited and a director and shareholder of its ultimate holding company.

Gralenno Limited has entered into a client agreement with Cathedral Capital Management Limited. Under the terms of this agreement Cathedral Capital Management Limited receives a fee of £8,000 per annum and is entitled to a profit commission of 3 per cent. Mr South is interested in this agreement as he was appointed a director of Gralenno Limited on 1 October 2003. Since Mr South has been appointed a director of Gralenno Limited fees of £2,000 have been paid under this agreement.

	31 December 2003		31 December 2002	
	A Convertible Ordinary shares	C Convertible Ordinary shares	A Convertible Ordinary shares	C Convertible Ordinary shares
E E Patrick	2,253,492	818,168	2,253,492	818,168
P M Gillham	478,088	–	478,088	–
L A Holder	153,845	818,168	153,845	818,168
J A Lynch	185,000	818,168	185,000	818,168
A S Minns	155,280	–	155,280	–
W H Salomon	–	–	–	–
P D Scales	210,000	818,168	210,000	818,168
A I G C South	250,000	–	180,000	–
J B Stradtner	–	–	–	–
J M P Welman	–	–	–	–

Mr Gillham's wife is the beneficial holder of 343,968 A Convertible Ordinary 25p shares of the Company.

Deutsche Bank Nominees (Jersey) Ltd (1993) and Deutsche Bank Nominees (Jersey) Ltd (1994) are each interested in 769,230 A Convertible Ordinary 25p shares of the Company. Mr Salomon has a beneficial interest in one of these Trusts. Mr Salomon is a director of Hansa Trust PLC, which is interested in 6,153,000 A Convertible Ordinary 25p shares of the Company.

Mr Stradtner has a beneficial interest in the General Partner, which is invested in the Century Capital Partners III, L.P. fund. The Century Capital Partners III, L.P. fund is interested in 6,921,099 A Convertible Ordinary 25p shares of the Company.

Messrs Hochberg and Tirney were shareholders of PMA Capital Corporation, which is the holding company of PMA Capital Insurance Company, which is interested in 23,630,770 A Convertible Ordinary 25p shares of the Company.

Mr Shettle had no interest in the share capital of the Company.

No Director has any interest in either the Employee Share Ownership Plan or the Approved Share Option Scheme 2000 of the Company at the year-end or at the date of this report.

Report of the Directors

continued

Directors' Remuneration

Amounts earned by Directors during the year ended 31 December 2003 were as follows:

	31 December 2003				31 December
	Fees & Salaries £'000	Benefits in kind £'000	Pension £'000	Total £'000	2002 Total £'000
E E Patrick	236	1	35	272	175
P M Gillham	20	–	–	20	15
L A Holder	236	1	20	257	168
J A Lynch	236	1	20	257	168
A S Minns	20	–	–	20	20
W H Salomon	20	–	–	20	2
P D Scales	236	1	20	257	168
A I G C South	96	1	26	123	102
J B Stradtner	20	–	–	20	2
J M P Welman	20	–	–	20	20
	1,140	5	121	1,266	840

Mr Hochberg elected to receive his fee by way of expense allowance. Mr Hochberg was entitled to an expense allowance of £20,000 per annum and in 2003 received an allowance of £9,607 (2002: £1,667). Mr Tirney received no remuneration during his tenure as a Director of the Company.

Mr Shettle received no remuneration during his tenure as Director of the Company.

The Group operates a profit sharing scheme from which all executive Directors and employees of the Group can benefit. The size of this profit related pool created under this scheme is determined annually and is equal to 15 per cent of the consolidated Group pre tax and pre amortisation profits. Any distribution from this scheme is entirely at the discretion of the Board. The amounts allocated or paid, from this scheme, to the executive Directors have been included within the Fees and Salaries disclosed above. The amount of the profit sharing scheme is set out in detail in note 23.

All pension contributions are made to the Directors' own personal pension schemes.

Related Parties

PMA Capital Insurance Company held 29.9 per cent of the Company's share capital until 9 April 2003 the date when their shareholding fell to 29.6 per cent through the issue of 1,000,000 A Convertible Ordinary 25p shares.

Both Hansa Trust PLC and Century Capital Management each have a right to appoint a Director to the Board.

Approved Share Option Scheme 2000 ("the approved scheme")

The approved scheme is a discretionary share option scheme, which was approved on 14 February 2001 by the Inland Revenue under Paragraph 1, Schedule 9 of the Income and Corporate Taxes Act 1988. Options may only be granted within certain periods and no option can be granted more than ten years after the date of adoption of the approved scheme.

The Board will determine the price payable for each share under an option at the time of grant of the option. So long as the Company remains unquoted, the Share Valuation Division of the Inland Revenue will agree the price of an option in advance on the grant date (or such other day as may be agreed with the Inland Revenue). The aggregate market value of the shares (determined at the time of grant of the option) which may be acquired in pursuance of options granted to a person other than of the approved scheme may not exceed £30,000.

Options granted under the approved scheme may only be exercised within certain qualifying periods, such periods not to commence prior to three years after the grant of the options. Options cannot be exercised after ten years from the date of grant of the option.

Options granted are as follows:

No of Option Holders	Date of grant of options	Amount of shares under option	Exercise price	Date from which exercisable	Expiry date of options
13	18 April 2001	425,238	63p	18 April 2004	17 April 2011
10	27 November 2002	207,611	65p	27 November 2005	26 November 2012
3	7 July 2003	24,808	68p	7 July 2006	6 July 2013
Total		657,657			

No Directors of the Company were option holders at the year-end or at the date of this report.

Cathedral Capital Employee Share Ownership Plan (“ESOP”)

This plan has been set up for the benefit of all employees in the Group. At 31 December 2003, there were 701,924 A Convertible Ordinary 25p shares held in the plan. During 2003, certain employees acquired 100,000 of the shares from the ESOP, some of the shares were gifted and others were acquired under deferred consideration terms. This gave rise to a profit in the ESOP, further details of which are set out in note 18. Although the Group only has de facto control of the ESOP, the Group is required under Urgent Issues Task Force (UITF) Abstract 13 to account for the assets of the ESOP as if they belong to the Group. Consequently, they appear as an asset in both the Group and Company balance sheets.

Grants under this scheme have been made, and details are as listed below:

No of participants	Date of grant of shares	Price per share	Amount of shares
3	27 November 2002	65p	125,847
1	10 January 2003	65p	50,000
1	4 July 2003	68p	25,000
1	4 July 2003	0p	75,000

The shares that have been acquired by participants on a deferred consideration basis have one-third of the consideration payable on 27 November 2004 and the remaining two-thirds on 27 November 2005.

Share Transfer Market

At the Extraordinary General Meeting of the Company held on 19 October 2000, shareholders approved, by special resolution, the Rules of the Cathedral Capital PLC Share Transfer Market.

Report of the Directors

continued

This share transfer market will be in operation for the two weeks (1 June 2004 to 15 June 2004 inclusive) immediately preceding the Annual General Meeting. Clyde & Co, the company's legal advisors, has agreed to administer the market on behalf of the Company. All purchase and sale applications must be returned to Clyde & Co by the close of business on 15 June 2004 at which time the share transfer market will close. The results of this market will be notified to shareholders at the Annual General Meeting.

Any shareholders who wish to participate in the market can obtain the relevant documentation from the Secretary of the Company at the Company's Registered Office.

Corporate Governance

The Board comprises executive and non-executive Directors and meetings are held quarterly or at such other intervals as may be determined by the Board to discuss corporate business, with further meetings to consider Lloyd's related matters as required by Lloyd's or the FSA. Additional ad hoc meetings are convened as required. As provided in the Articles of Association, the quorum for Board meetings is two.

The highest level of authority in the Group lies with the Board. However, under the Articles of Association, the Board may delegate any of its powers, authorities and discretion to committees. The Board has appointed the following committees, the powers of which are set out in their respective terms of reference:

- (i) Executive Management Committee;
- (ii) Audit Committee;
- (iii) Remuneration Committee; and
- (iv) Nomination Committee.

(i) Executive Management Committee

The Executive Management Committee is appointed by the Board on the nomination of the Executive Chairman. The Committee comprises the executive Directors and selected senior management and underwriters. The Executive Chairman is the Chairman of the Committee and the Group Compliance Director is Secretary of the Committee.

The Committee is the primary vehicle for day-to-day management of the Group. It has delegated authority from the Board to make such decisions and authorise such acts as are decided by the Committee to be necessary to manage and control the Group's affairs, subject to a schedule of the matters which require the prior approval of the Board or such other Board committees as the Board may from time to time determine. It meets at least quarterly.

(ii) Audit Committee

The Audit Committee comprises all the non-executive Directors of Cathedral Capital PLC. The Senior Independent Director is Chairman of the Committee. The quorum for Committee meetings is three, and all meetings are held at the trading offices of the Group unless the Board agree otherwise. The Committee reports to the Board at least once a year.

The main responsibilities of the Committee include a review of accounting policies and the financial statements, an evaluation of the effectiveness of internal controls, monitoring compliance with statutory requirements for financial reporting and the appointment and fees of external auditors. The Committee meets with the Company's external auditors and receives a report from them at least once a year.

The Group has established a Risk Management Committee, which sits as a Committee within the Group's managing agency subsidiary. This Committee comprises a number of executive Directors of this Company and senior managers and underwriters of the managing

agency. This Committee, though primarily determining and monitoring risks and controls within the regulated business of the managing agency, will also evaluate risks and controls throughout the rest of the Group. This Committee will report formally to the Audit Committee at least annually.

(iii) Remuneration Committee

The Board approves membership of the Remuneration Committee, which comprises all non-executive Directors together with Executive Chairman of Cathedral Capital PLC or his alternate, the Chief Executive Officer. The Senior Independent Director is Chairman of the Committee. The quorum for Committee meetings is three, one of whom shall be the Executive Chairman or his alternate the Chief Executive Officer. The Committee meets at least once a year and reports to the Board.

The Committee ensures that salary, benefit and incentive levels throughout the Group are sufficiently competitive to attract and retain staff, particularly those holding key positions of responsibility. The Committee agrees the remuneration of the Group Chairman (and if he is not also the Executive Chairman, the Executive Chairman) Group Chief Executive and other executive Directors of the Board, together with that of senior executives having basic salaries of £100,000 and above.

(iv) Nomination Committee

The Board approves membership of the Nomination Committee, which comprises all non-executive Directors, together with the Executive Chairman of Cathedral Capital PLC or his alternate, the Chief Executive Officer. The Senior Independent Director is Chairman of the Committee. The Committee meets at least once a year.

The Committee is responsible for nominating candidates for the approval of the Board to fill vacancies on the Board of Directors and also for assessing the independence, objectivity and suitability of all non-executive Directors, at least annually, and any candidates who are proposed to act as non-executive Directors.

Annual General Meeting

The Annual General Meeting of the Company will be held on Wednesday 16 June 2004 at the Lloyd's Club, 3 Carlisle Avenue, London EC3N 2ES. A separate notice convening this meeting will be circulated to shareholders.

Employee Involvement

The Company is committed to involve all employees in the performance and development of both the Company and the Group and employees are encouraged to discuss matters of interest and subjects affecting day-to-day operations.

Disabled Employees

It is the Group's policy to give full consideration to suitable applications for employment by disabled persons.

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 promotions to disabled employees wherever applicable.

Creditors Payment Policy

It is the Company's policy to settle all expenses on a timely basis in the ordinary course of business. The Company had 0 days purchases (2002: 17 days purchases) outstanding at 31 December 2003, based on the average daily amount invoiced by suppliers during the year.

Donations

During the year the Group made no charitable donations (2002: £2,500). No political donations were made during the year (2002: £nil).

Auditors

Mazars have expressed their willingness to continue in office and a resolution will be proposed at the forthcoming Annual General Meeting to re-appoint them as auditors of the Company.

Going Concern

After making reasonable enquiries the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they have adopted the going concern basis in preparing the accounts.

Directors' Responsibilities

The Directors' are required by law to prepare accounts, which give a true and fair view of the state of affairs of the Company and the Group at the end of the financial year and of the profit and loss of the Group for the period. The accounts must be prepared in compliance with the requirements of the Companies Act 1985 and with applicable Accounting Standards. In addition, the Directors are required:

- (i) to make suitable accounting policies and apply them consistently;
- (ii) to make judgements and estimates that are reasonable and prudent;
- (iii) to state whether applicable Accounting Standards have been followed; and
- (iv) to prepare accounts on a going concern basis unless it is inappropriate to assume the Group will continue in business.

The Directors confirm that the accounts comply with these requirements.

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

By order of the Board

John Lynch

Company Secretary

28 April 2004

Report of the Independent Auditors

Independent Auditors' Report to the Members of Cathedral Capital PLC

We have audited the financial statements of Cathedral Capital PLC for the year ended 31 December 2003 which comprise the Consolidated Profit and Loss Account, the Consolidated Balance Sheet, the Balance Sheet of the Company, the Consolidated Cash Flow Statement and the related notes. These financial statements have been prepared under the historical cost conversion, as modified by the revaluation of certain fixed assets, and 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 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 opinion we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards.

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 Company is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors's Report, the Chairman's Statement and the Chief Executive Officer's 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 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 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 affairs of the Company and the Group as at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

MAZARS

Chartered Accountants and Registered auditors

24 Bevis Marks, London EC3A 7NR

28 April 2004

**Consolidated Profit and Loss Account
Technical Account – General Business
For the year ended 31 December 2003**

	Notes	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Earned premiums, net of reinsurance:			
Gross premiums written	3	139,934	63,120
Outward reinsurance premiums		(28,396)	(15,885)
Net premiums written		111,538	47,235
Change in the provision for unearned premiums:			
Gross amount		(36,033)	(4,482)
Reinsurers' share		4,462	1,506
Earned premiums, net of reinsurance		79,967	44,259
Allocated investment return transferred from the non-technical account		4,121	2,619
Claims paid:			
Gross amount	3	(29,518)	(19,345)
Reinsurers' share		10,658	7,789
		(18,860)	(11,556)
Change in the provisions for claims:			
Gross amount	3	(38,551)	(24,447)
Reinsurers' share		11,183	5,500
		(27,368)	(18,947)
Claims incurred, net of reinsurance		(46,228)	(30,503)
Net operating expenses	4	(22,682)	(10,285)
Balance transferred to the non-technical account		15,178	6,090

A more detailed analysis of the technical account is given in note 2.

Consolidated Profit and Loss Account Non-Technical Account For the year ended 31 December 2003

	Notes	Year ended 31 December 2003 £'000	Year ended 31 December 2002 (Restated) £'000
Balance on technical account for general business		15,178	6,090
Net investment return	5	4,198	658
Allocated investment return transferred to the technical account for general business	6	(4,121)	(2,619)
Fees and profit commission	8	2,452	616
Other income	7	167	190
Other expenses		(5,236)	(3,232)
Profit on ordinary activities before tax	9	12,638	1,703
Tax charge on profit on ordinary activities	12	(3,877)	(112)
Profit on ordinary activities after tax		8,761	1,591
Dividends		–	–
Retained profit for the financial year		8,761	1,591
Basic earnings per share	14	11.0p	3.9p
Diluted earnings per share	14	10.9p	3.9p
Operating earnings per share (diluted)	14	10.8p	7.6p

All activities derive from continuing operations.

Consolidated Statement of Total Recognised Gains and Losses

	Notes	Year ended 31 December 2003 £'000	Year ended 31 December 2002 (Restated) £'000
Profit for the year		8,761	1,591
Prior year adjustment	26	(578)	(274)
Total gains and losses recognised since last annual report		8,183	1,317

The inclusion of unrealised gains and losses in the profit and loss account to reflect the marking to market of investments in the balance sheet is deemed not to be a departure from the unmodified historical cost basis of accounting. Accordingly a separate note of historical cost profits and losses is not given.

The notes on pages 30 to 57 form part of these accounts.

Consolidated Balance Sheet
As at 31 December 2003

	Notes	31 December 2003 £'000	31 December 2002 (Restated) £'000
Intangible assets:			
Syndicate participations	15	2,943	483
Goodwill	15	2,256	2,587
Negative goodwill	15	(18)	(21)
		5,181	3,049
Investments:			
Financial investments	16	76,235	41,271
Deposits with ceding undertakings		35	38
Own shares	18	92	129
		76,362	41,438
Reinsurers' share of technical provisions:			
Provision for unearned premiums		8,659	4,181
Claims outstanding		45,671	39,228
		54,330	43,409
Debtors:			
Arising out of direct insurance operations		19,673	10,780
Arising out of reinsurance operations		36,238	27,388
Other	19	2,187	5,969
		58,098	44,137
Other assets:			
Tangible assets	20	259	332
Cash at bank and in hand		51,059	44,411
Other		6,298	2,088
		57,616	46,831
Prepayments and accrued income	21	14,101	8,062
Total assets		265,688	186,926

A more detailed analysis of the balance sheet is given in note 38.

The notes on pages 30 to 57 form part of these accounts.

Consolidated Balance Sheet As at 31 December 2003

continued

	Notes	31 December 2003 £'000	31 December 2002 (Restated) £'000
Capital and reserves:			
Called up share capital	25	19,951	19,701
Share premium	26	35,801	35,363
Merger reserve	26	1,447	1,447
Profit and loss reserve	26	5,325	(3,436)
Equity shareholders' funds		62,524	53,075
Technical provisions:			
Claims outstanding – gross		121,542	94,084
Provision for losses foreseen on open years		243	413
Provision for unearned premiums		53,452	18,618
Other technical provisions		327	–
		175,564	113,115
Provisions for other risks and charges:			
Provision for deferred taxation	22	2,310	–
Other provisions	23	2,545	645
		4,855	645
Creditors:			
Arising out of direct insurance operations		948	937
Arising out of reinsurance operations		11,059	10,294
Other creditors	24	8,602	6,987
		20,609	18,218
Accruals and deferred income		2,136	1,873
Total liabilities		265,688	186,926

A more detailed analysis of the balance sheet is given in note 38.

The notes on pages 30 to 57 form part of these accounts.

**Company Balance Sheet
As at 31 December 2003**

	Notes	31 December 2003 £'000	31 December 2002 £'000
Fixed asset investments:			
Listed investments	16	15,004	12,100
Investments in subsidiary undertakings	17	2,014	2,014
Own shares	18	92	129
		17,110	14,243
Current assets:			
Debtors	19	7,799	5,420
Prepayments and accrued income	21	5,919	1,199
Cash at bank		33,456	35,352
		47,174	41,971
Creditors: Amounts falling due within one year			
Creditors	24	(2,917)	(1,779)
Accruals and deferred income		(128)	(171)
		(3,045)	(1,950)
Net current assets		44,129	40,021
Net assets		61,239	54,264
Capital and reserves:			
Called-up share capital	25	19,951	19,701
Share premium	26	35,801	35,363
Investment revaluation reserve	26	71	–
Profit and loss reserve	26	5,416	(800)
Equity shareholders' funds		61,239	54,264

The financial statements on pages 24 to 57 were approved by the Board of Directors on 28 April 2004 and signed on its behalf by:

Peter Scales
Chief Executive Officer

John Lynch
Chief Financial Officer

The notes on pages 30 to 57 form part of these accounts.

Consolidated Cash Flow Statement For the year ended 31 December 2003

	Notes	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Net cash inflow from operating activities	31	1,331	1,540
Returns on investment and servicing of finance:			
Interest paid		(106)	–
Taxation:			
Corporation tax paid		(4)	(3)
Capital expenditure:			
Purchase of syndicate capacity	15	(2,790)	(201)
Purchase of tangible fixed assets	20	(106)	(19)
Total capital expenditure		(2,896)	(220)
Financing:			
Issue of shares in respect of conversion loan notes		–	77
Issue of shares in respect of rights issue		–	26,205
Other issues of shares		688	–
Total financing		688	26,282
(Decrease)/increase in cash in the period		(987)	27,599
Cash flows were invested as follows:			
(Decrease)/increase in cash holdings		(1,949)	720
Net portfolio investments	34	962	26,879
(Decrease)/increase in cash in the period		(987)	27,599

The consolidated cash flow statement excludes syndicate cashflows and cash held within Lloyd's premium trust funds by syndicates on behalf of the Group's underwriting subsidiaries.

Notes to the Financial Statements For the year ended 31 December 2003

I Basis of Preparation of Financial Statements and Accounting Policies

I BASIS OF PREPARATION OF FINANCIAL STATEMENTS

a) *Basis of preparation*

The financial statements of the Group and the Company have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules, modified by the revaluation of investments.

The financial statements of the Group have been prepared in accordance with Section 255 of, and Schedule 9A to, the Companies Act 1985, as amended by the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993. The recommendations of the Statement of Recommended Practice on Accounting for Insurance Businesses issued by the Association of British Insurers in November 2003 (the "ABI SORP") have been adopted.

The balance sheet of the Company has been prepared in accordance with Schedule 4 to the Companies Act 1985. No profit and loss account is presented for the Company as permitted by Section 230 of the Companies Act.

b) *Change in accounting policy – managing agency fee income and profit commission*

In previous years managing agency fees were recognised in the year they were received. Following the release of Application Note G to the Financial Reporting Standard 5 ("Reporting the Substance of Transactions") managing agency fees are recognised in line with the activity to which the fees relate.

In previous years managing agency profit commission was recognised on an annual accounting basis at the same rate as the underwriting result was earned by the members participating on the managed syndicate. Following the release of Application Note G to the Financial Reporting Standard 5 ("Reporting the Substance of Transactions") managing agency profit commission is now only recognised on open years where its measurement is reasonably certain.

Prior year results have been restated to reflect these changes in accounting policies. See note 26.

c) *Change in accounting policy – foreign currencies for syndicates being annually accounted*

For syndicates which are being annually accounted, transactions in US dollars, Canadian dollars and Euros are now converted at the average rates of exchange in the period. Previously these transactions were translated at the closing rates of exchange for the period. This change in accounting policy was made to comply fully with the Statement of Standard Accounting Practice 20, "Foreign Currency Translation".

Comparative figures have not been restated as there would be no change to profit or equity shareholders' funds. The result for the current year would be unchanged if the previous accounting policy had been applied.

d) *Basis of consolidation*

The financial statements of the Group include the accounts of the Company and its subsidiaries, together with the Group's share of the assets, liabilities, revenues and expenses of the Lloyd's syndicates supported by the Group's corporate members for the year ended 31 December 2003.

II ACCOUNTING POLICIES – SYNDICATES

a) *Recognition of insurance transactions*

Preparing accounts in accordance with Section 255 of, and Schedule 9A to, the Act has meant the Group recognises its proportion of all the transactions undertaken by the Lloyd's syndicates in which it participates ("the syndicates").

For each such syndicate, the Group's proportion of the underwriting transactions, investment return and operating expenses has been reflected within the Group's Technical Account. Similarly, the Group's proportion of the syndicate's assets and liabilities has been reflected in its balance sheet. Syndicate assets are held subject to the trust deeds for the benefit of the Group's insurance creditors.

The proportion referred to above is calculated by reference to the Group's participation as a percentage of the syndicate's total capacity.

For the 2000 and prior years of account, the Group has delegated sole management and control of its underwriting through each syndicate to its members' agent who deals with the managing agent of the syndicate ("the managing agent"). The managing agents are therefore responsible for determining the insurance transactions to be recognised by the Group. The only exception to this rule is the level of provision for outstanding claims on the open years of account of syndicates. These provisions are determined by the Directors.

For the 2001 and subsequent years of account, advice on the Group's syndicate participations is provided by the Group's advisory company.

b) Basis of accounting for underwriting results of syndicates managed by the Group and certain external managing agents

For syndicates managed by the Group and certain external managing agents, the Group's share of the technical results is presented on an annual accounting basis. The main accounting policies under the annual accounting basis are set out below.

(i) Premiums

Gross written premiums represent premiums on business incepting during the year together with estimates for pipeline premiums and adjustments to premiums written in previous accounting periods. All premiums are gross of commission payable to intermediaries.

Earned premiums represent premiums written adjusted for the change in the provision for unearned premiums.

Outwards reinsurance premiums are accounted for on an earned basis to match the premiums for the related inwards reinsurance business.

The provision for unearned premiums represents that part of gross premiums written and the reinsurers' share that is estimated to be earned after the balance sheet date. Estimates are based on managing agents' estimates of the exposures of the underlying business written.

(ii) Claims

A provision is made for claims incurred during the period, whether reported prior to the balance sheet date or not. A provision is also made for claims handling expenses. A provision for unexpired risks is made when it is anticipated that unearned premiums will be insufficient to meet future claims and claims settlement expenses of business in force at the period end. No account is taken of future investment income. This is included within technical provisions in the balance sheet.

Claims provisions are estimated based on managing agents expectations and internal projections using known data.

(iii) Deferred acquisition costs

Acquisition costs represent commission and other expenses arising from the conclusion of insurance contracts. They are deferred over the period in which the related premiums are earned.

(iv) Sources of data

The financial information used to compile the annual accounting information used in the Consolidated Technical Account and the syndicate Share of the Consolidated Balance Sheet is based on returns prepared by the managing agents of the syndicates and submitted to Lloyd's.

Notes to the Financial Statements For the year ended 31 December 2003

continued

c) *Basis of accounting for underwriting results of syndicates managed by external managing agents where annual accounting information is unavailable*

For syndicates managed by external managing agents where annual accounting information is unavailable, all classes of insurance business written are accounted for on a three year funded basis because it is the basis most similar to that followed by the syndicates. The nature of the information managing agents can make available is insufficient for the Group to make reliable estimates of the necessary technical provisions on an annual basis of accounting. Under the three year funded basis followed by the Group, the excess of premiums written and attributable net investment return over claims and expenses paid in respect of contracts incepting in an accounting period ('the underwriting year') is carried forward as a technical provision until the end of the third year from the inception of the underwriting year. Profits are only recognised when declared by the syndicate for the year of account after thirty-six months.

If an underwriting year is expected to make a loss, the loss is recognised as soon as it is foreseen by increasing the technical provision to make it sufficient to meet present liabilities and anticipated future claims and expenses.

(i) *Sources of data*

The financial information used to compile the Consolidated Technical Account and the syndicate share of the Consolidated Balance Sheet is based on returns prepared for this purpose by the managing agents of the syndicates ('the returns'). These returns have been audited by the syndicate auditors and are based on the audited syndicate returns submitted to Lloyd's and the audited annual reports to syndicate members. This base data has been adjusted as necessary to reflect the differences in preparation between syndicate annual reports and accounts in accordance with Schedule 9A to the Companies Act 1985.

The format of the returns has been established by Lloyd's and Lloyd's has also been responsible for collating the data at a syndicate level and analysing it into the Group's corporate members' results. The returns cover the twelve months to 31 December 2003 with the comparative period including the returns for the twelve months to 31 December 2002.

(ii) *Premiums*

Premiums written comprise the total premiums receivable for the whole period of cover provided by the contracts incepting during the financial year, together with any adjustments relating to the prior year. Premiums are shown gross of commission payable to intermediaries but exclude insurance premium tax.

Gross premiums written by a syndicate may also include the reinsurance of other syndicates on which the Group participates. No adjustments have been made to gross premiums written or outward reinsurance premiums (or to gross and reinsurers' claims) to remove this intersyndicate reinsurance as there is insufficient information available.

(iii) *Claims incurred*

Claims incurred include the costs of claims handling expenses but are net of recoverable amounts arising out of subrogation or salvage. Claims incurred comprise amounts paid or provided in respect of claims occurring during the current year, together with the amount by which settlement or reassessment of claims from prior years differs from the provision at the beginning of the year.

(iv) *Provision for claims*

Provision is made for claims incurred but not paid in respect of events up to 31 December of the appropriate year. The provision includes the amounts required to ensure that no profit is recognised before the end of the third year under the three year funded basis of accounting.

The provision is increased as appropriate by the Directors to the extent that deficits are anticipated on underwriting years at the twelve and twenty-four months stage or on underwriting years not closed at the thirty-six month stage at the balance sheet date. This additional provision is determined by Directors following discussions with the Group's advisory company.

In deciding whether any such additional provision is necessary, syndicate participations for each year have been considered in aggregate as each year's Lloyd's underwriting is managed together.

(v) *Reinsurance to close*

To the extent that the Group participates on successive years of account of the same syndicate and there is a reinsurance to close between those years, the Group has offset its share of the reinsurance to close received against its share of the reinsurance to close paid.

Where the Group has increased or decreased its syndicate participation from one year of account to the next, the difference between the reinsurance to close received and the reinsurance to close paid is shown in the Technical Account as either gross premiums written or reinsurance premiums payable as appropriate.

The reinsurance to close is technically a reinsurance contract and, as such, the payment of a reinsurance to close does not remove from members of that year of account ultimate responsibility for claims payable on risks they have written. If the reinsuring members under the reinsurance to close become insolvent and the other elements of the Lloyd's chain of security also fail, the reinsured members remain theoretically liable for the settlement of any outstanding claims.

d) *Investments*

Investments are treated as sold and purchased at each 31 December in recognition of the annual venture nature of participations on a syndicate. Their cost is therefore their market value at that date.

e) *Investment return*

Investment return comprises interest receivable and dividends received plus realised gains on the disposal of investments, less investment expenses and charges. Realised gains and losses arise from the difference between proceeds and cost. The realised gains reported by syndicates are net of any realised losses.

All investment income net of realised losses arising on syndicate participations is recognised in the Group's Technical Account, as an integral part of the Group's underwriting business.

f) *Net operating expenses*

Operating expenses have been charged to the underwriting year for which they were incurred. These include the Group's share of syndicate operating expenses, the remuneration payable to managing agents and the direct costs of membership of Lloyd's. Personal expenses are included in the Technical Profit and Loss Account in the year in which the underwriting result is accounted for.

g) *Foreign currencies*

Transactions in foreign currencies other than Sterling, US dollars, Canadian dollars and Euros are translated at the rate of exchange ruling at the date the transaction is processed. For syndicates whose results are annually accounted, transactions in US dollars, Canadian dollars and Euros are converted at the average rates of exchange in the period. For all other syndicates, transactions in US dollars, Canadian dollars and Euros are translated at the rate of exchange ruling at 31 December. All assets/liabilities in currencies other than Sterling are translated at the rate of exchange ruling at 31 December. Exchange differences arising on translation are dealt with in the Technical Account.

h) *Taxation*

The Group is taxed on its share of the underwriting results declared by syndicates and for tax purposes these are deemed to accrue evenly over the calendar year in which they are declared.

The Inland Revenue determines the taxable results of individual syndicates on the basis of computations submitted by the managing agent. At the date of approval of these financial statements, none of the syndicate taxable results have been agreed. Any adjustments that

Notes to the Financial Statements For the year ended 31 December 2003

continued

may be necessary to the tax provisions established by the Group as a result of Inland Revenue agreement of individual syndicate taxable results will be reflected in the financial statements of subsequent periods.

Following new legislation, the underwriting result for tax purposes will be adjusted to reflect discounting of reserves. This will apply to underwriting results declared from 2001 onwards and will increase the tax charge accordingly.

III ACCOUNTING POLICIES – CORPORATE

a) *Investment income and expenses*

Dividends and interest on listed investments (net of any related tax credits) are taken into account by reference to the date the security becomes 'ex-dividend'.

Realised investment gains and losses are calculated as the difference between net proceeds on disposal and their purchase price.

Unrealised investment gains and losses are calculated as the difference between the valuation at the balance sheet date and the valuation at the last balance sheet date or purchase price, if acquired during the year. Unrealised investment gains and losses include adjustments in respect of unrealised gains and losses recorded in prior years which have been realised during the year and are reported as realised gains and losses in the current profit and loss account.

b) *Agency fees*

Managing agency fees are recognised in line with the activity to which the fees relate.

c) *Expenses*

All expenses are accounted for on an accruals basis. Expenses which are incidental to the acquisition or disposal of an investment are treated as part of the cost or proceeds of the investment.

d) *Leased assets*

Rentals in respect of assets held under operating leases are charged to the profit and loss account as incurred.

e) *Foreign currencies*

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rates as at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the period end are reported at the rates of exchange prevailing at the period end date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the Non-Technical Profit and Loss Account.

f) *Taxation*

Items of income/gain and expenditure/loss are recognised and assessable to corporation tax in the same period, after adjustment in accordance with tax legislation.

g) *Investments*

The value of fixed asset investments are stated in the financial statements on the following basis:

- (i) Listed investments are stated at closing middle market price on recognised stock exchanges; and
- (ii) Unlisted investments and subsidiary undertakings are stated at cost or Director's valuation.

h) Goodwill

Goodwill arising on the acquisition of companies or businesses is capitalised and amortised on a straight line basis over the period which, in the Directors' opinion, is its useful economic life. The Directors' estimate of the useful economic life of both the positive and negative goodwill arising is ten years.

i) Syndicate participation rights

For those syndicates managed by external managing agents where annual accounting information is unavailable and where the Group has purchased the right to participate on syndicates, the cost is capitalised and amortised in equal annual instalments over three years. Amortisation commences at the end of the third year from the start of the Group's first underwriting year on the syndicate.

For those syndicates whose underwriting results are accounted for by the Group on an annual basis of accounting, the cost of participation rights is capitalised and amortised in equal annual instalments over three years, with amortisation commencing at the start of the Group's first underwriting year on the syndicate.

If, at any time, the Directors become aware of a permanent diminution in the value of the Group's right to participate on a syndicate, the asset will be written down accordingly. If a syndicate participation is sold then any related costs are offset against the disposal proceeds and any gain/loss is taken to the Non-Technical Profit and Loss Account in the same accounting period.

j) Deferred taxation

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax is not provided on timing differences arising from the revaluation of fixed assets where there is no commitment to sell the asset, or on unremitted earnings of subsidiaries where there is no commitment to remit these earnings. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

k) Tangible fixed assets

Tangible fixed assets are stated at cost. Depreciation is calculated so as to write off the cost over their estimated useful economic lives on a straight line basis. The estimated useful economic lives are as follows:

- | | |
|---------------------------------------|---------|
| (i) Computer and other equipment | 3 years |
| (ii) Furniture, fixtures and fittings | 5 years |

l) Investment revaluation reserve

Increases and decreases in the valuation of investments held at the year-end are charged to this reserve in the Company to the extent that the reserve remains positive. Any further decreases are charged to the Consolidated Non-Technical Profit and Loss Account.

m) Employee Share Ownership Plan ("ESOP")

The Company operates an ESOP. The Company has de facto control of the shares held by the ESOP and bears their benefits and risk, and records certain assets and liabilities of the ESOP as its own. Finance costs and administrative expenses are charged as they accrue.

Notes to the Financial Statements For the year ended 31 December 2003

continued

2 Analysis of Technical Account – General Business

	Year ended 31 December 2003							Total £'000
	Syndicate 2010 Year of account:			Cathedral's share of Syndicate 2010 Year of account:				
	2001 100% £'000	2002 100% £'000	2003 100% £'000	2001 24.7% £'000	2002 23.5% £'000	2003 42.5% £'000		
Earned premiums, net of reinsurance:								
Gross premiums written	2,039	1,667	139,757	503	392	59,336	60,231	
Outward reinsurance premiums	(933)	(938)	(31,508)	(230)	(220)	(13,377)	(13,827)	
Net premiums written	1,106	729	108,249	273	172	45,959	46,404	
Change in the gross provision for unearned premiums	181	22,589	(47,723)	45	5,309	(20,262)	(14,908)	
Change in the provision for unearned premiums, reinsurers' share	(31)	(5,101)	5,701	(8)	(1,199)	2,421	1,214	
Net earned premiums	1,256	18,217	66,227	310	4,282	28,118	32,710	
Allocated investment return transferred from the non-technical account*	337	336	212	83	79	90	252	
Claims paid:								
Gross amount	(15,598)	(10,052)	(8,205)	(3,847)	(2,362)	(3,484)	(9,693)	
Reinsurers' share	12,472	1,899	3,477	3,076	446	1,476	4,998	
	(3,126)	(8,153)	(4,728)	(771)	(1,916)	(2,008)	(4,695)	
Change in the provisions for claims:								
Gross amount	5,545	10,051	(38,225)	1,367	2,362	(16,229)	(12,500)	
Reinsurers' share	(1,286)	(3,228)	8,281	(317)	(759)	3,516	2,440	
	4,259	6,823	(29,944)	1,050	1,603	(12,713)	(10,060)	
Net claims incurred, net of reinsurance	1,133	(1,330)	(34,672)	279	(313)	(14,721)	(14,755)	
Net operating expenses**	(345)	(6,865)	(22,129)	(91)	(1,036)	(8,194)	(9,321)	
	2,381	10,358	9,638	581	3,012	5,293	8,886	

*Excluding long term rate of investment return

**After adjusting for intergroup transactions

	Year ended 31 December 2003			Total £'000	Year ended 31 December 2002 Total £'000
	Managed Syndicate 2010 £'000	External managed syndicates Annually accounted £'000	Fund accounted £'000		
Earned premiums, net of reinsurance:					
Gross premiums written	60,231	79,429	274	139,934	63,120
Outward reinsurance premiums	(13,827)	(14,326)	(243)	(28,396)	(15,885)
Net premiums written	46,404	65,103	31	111,538	47,235
Change in the gross provision for unearned premiums	(14,908)	(21,125)	–	(36,033)	(4,482)
Change in the provision for unearned premiums, reinsurers' share	1,214	3,248	–	4,462	1,506
Net earned premiums	32,710	47,226	31	79,967	44,259
Allocated investment return transferred from the non-technical account*	252	1,027	263	1,542	1,283
Claims paid:					
Gross amount	(9,693)	(17,332)	(2,493)	(29,518)	(19,345)
Reinsurers' share	4,998	4,891	769	10,658	7,789
	(4,695)	(12,441)	(1,724)	(18,860)	(11,556)
Change in the provisions for claims:					
Gross amount	(12,500)	(27,120)	1,069	(38,551)	(24,447)
Reinsurers' share	2,440	8,394	349	11,183	5,500
	(10,060)	(18,726)	1,418	(27,368)	(18,947)
Net claims incurred, net of reinsurance	(14,755)	(31,167)	(306)	(46,228)	(30,503)
Net operating expenses**	(9,321)	(13,083)	(278)	(22,682)	(10,285)
	8,886	4,003	(290)	12,599	4,754
Long term rate of investment return				2,579	1,336
Balance on technical account, after long term rate of return				15,178	6,090

*Excluding long term rate of investment return

**After adjusting for intergroup transactions

The Group manages Syndicates 1265 and 2010. Of these, the Group only participates on Syndicate 2010. Syndicate 1265 went into run-off at the end of the 2000 year of account and as the Group has never participated on this syndicate its results have been excluded in compiling this note.

The Group's share of the results of Syndicate 2010, reported above, are stated before restatement of the allocated investment return using the long term rate of return, which is shown separately above.

Notes to the Financial Statements
For the year ended 31 December 2003

continued

3 Segmental Information

(i) Underwriting

	Year ended 31 December 2003					
	Gross Premiums Written £'000	Gross Premiums Earned £'000	Gross Claims Incurred £'000	Gross Operating Expenses £'000	Reinsurance Balance £'000	Total £'000
Direct Business:						
Accident & Health	806	773	(419)	(251)	(13)	90
Motor – third party liability	3,781	2,780	(2,203)	(603)	(12)	(38)
Motor – other classes	25,837	18,054	(12,963)	(3,772)	(406)	913
Marine, Aviation & Transport	11,624	8,477	(2,092)	(2,439)	(1,644)	2,302
Fire and other Damage to Property	19,866	11,950	(4,693)	(3,286)	(1,658)	2,313
Third Party Liability	18,341	9,375	(8,641)	(2,769)	1,206	(829)
Credit and Suretyship	5	5	(32)	(8)	3	(32)
Legal Expenses	7	7	(8)	(3)	(3)	(7)
Other	405	410	(163)	(47)	(105)	95
Total Direct	80,672	51,831	(31,214)	(13,178)	(2,632)	4,807
Reinsurance Business:						
Reinsurance Acceptances	51,364	44,172	(23,775)	(9,460)	(4,823)	6,114
Reinsurance to Close	7,898	7,898	(13,080)	(44)	5,362	136
Total Reinsurance	59,262	52,070	(36,855)	(9,504)	539	6,250
Total	139,934	103,901	(68,069)	(22,682)	(2,093)	11,057

	Year ended 31 December 2002					
	Gross Premiums Written £'000	Gross Premiums Earned £'000	Gross Claims Incurred £'000	Gross Operating Expenses £'000	Reinsurance Balance £'000	Total £'000
Direct Business:						
Accident & Health	950	880	(518)	(284)	(28)	50
Motor – third party liability	1,822	1,705	(1,021)	(354)	(191)	139
Motor – other classes	12,556	11,654	(7,902)	(1,938)	(757)	1,057
Marine, Aviation & Transport	4,515	3,749	(3,195)	(891)	(223)	(560)
Fire and other Damage to Property	6,344	5,071	(3,394)	(1,504)	(155)	18
Third Party Liability	3,370	2,899	(716)	(847)	(611)	725
Credit and Suretyship	156	156	136	(45)	(116)	131
Legal Expenses	20	20	(17)	(8)	(6)	(11)
Other	377	399	(321)	(135)	(395)	(452)
Total Direct	30,110	26,533	(16,948)	(6,006)	(2,482)	1,097
Reinsurance Business:						
Reinsurance Acceptances	22,815	21,910	(10,781)	(4,235)	(5,075)	1,819
Reinsurance to Close	10,195	10,195	(16,063)	(44)	6,467	555
Total Reinsurance	33,010	32,105	(26,844)	(4,279)	1,392	2,374
Total	63,120	58,638	(43,792)	(10,285)	(1,090)	3,471

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Gross premiums in respect of direct business written in:		
United Kingdom	92,860	33,020
Other EU Member States	(38)	6
Rest of World	(10)	(2,916)
	92,812	30,110

(ii) *Movement in provisions for losses foreseen on open years for the year ended 31 December 2003*

	Balance at 1 January £'000	Amounts Utilised £'000	Amounts Unused £'000	Additional Provisions £'000	Balance at 31 December £'000
1998 Year of Account	61	(61)	–	–	–
1999 Year of Account	101	(66)	(11)	8	32
2000 Year of Account	251	(40)	–	–	211
Total	413	(167)	(11)	8	243

The Directors do not consider, at the date of this report, that any provisions are necessary for syndicates supported for the 2002 or 2003 years of account.

Notes to the Financial Statements
For the year ended 31 December 2003

continued

4 Net operating expenses

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Acquisition costs	16,122	6,519
Administrative expenses	2,359	2,000
Loss on exchange	1,795	1,058
Names' personal expenses on Lloyd's syndicates	2,406	708
Total	22,682	10,285

5 Net investment return

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Investment return on underwriting investments:		
Syndicate Investments		
Investment income	2,187	1,383
Realised investment losses	(571)	(63)
Investment expenses	(74)	(37)
Net investment return on syndicate investments	1,542	1,283
Funds at Lloyd's		
Investment income	1,715	1,022
Realised investment losses	(681)	(215)
Unrealised gains/(losses)	1,794	(1,518)
Investment expenses	(91)	(94)
Net investment return on Funds at Lloyd's investments	2,737	(805)
Net investment return on underwriting investments	4,279	478
Investment return on cash and other investments:		
Investment income	55	126
Realised losses	(9)	(67)
Unrealised (losses)/gains	(14)	132
Interest payable	(113)	(11)
Net investment return on other investments	(81)	180
Net investment return	4,198	658

6 Investment return transferred to technical account

The transfer to the technical account represents the estimated long term rate of return applied to the funds at Lloyd's supporting the underwriting and the actual investment return of the syndicates on which the Group participated during the year.

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Long term rate of return applied to funds at Lloyd's	2,579	1,336
Actual investment return on syndicate underwriting	1,542	1,283
Total long term rate of return transferred to Consolidated Technical Account	4,121	2,619

Funds at Lloyd's

The average funds at Lloyd's balance was as follows:

Cash	34,492	14,026
Fixed interest	4,267	4,221
Equities	7,286	6,015
Alternative investments	3,701	1,051

Comparison of actual rate of return to long term rate of return:

Long term rate of return	2,579	1,336
Actual rate of return	2,737	(805)
Effect of short term fluctuations over the period	158	(2,141)

The following long term rates of return (annualised) were used:

Cash	5.0%	5.0%
Fixed interest	5.0%	5.0%
Equities	6.0%	6.0%
Alternative investments	5.5%	5.5%

7 Other income

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
Charge to managed syndicates for use of fixed assets	140	125
Profit arising within the ESOP	12	50
Other income	15	15
Total	167	190

The profit within the ESOP arose on the sale of shares during the year at greater than book value. Although the Company only has de facto control of the shares, its profit has been recognised in the Company's accounts in accordance with Urgent Issues Task Force (UITF) Abstract 13.

Notes to the Financial Statements For the year ended 31 December 2003

continued

8 Fees and profit commission

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 (Restated) £'000
Managing agency fees	639	486
Profit commission	1,703	–
Other fees	110	130
	2,452	616

9 Profit on ordinary activities before taxation

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
The profit on ordinary activities before taxation is stated after charging:		
Operating lease charges – rent	68	79
Depreciation of tangible fixed assets	179	173
Amortisation of goodwill	328	327
Amortisation of syndicate capacity	330	440
Auditors' remuneration:		
– Audit services paid to Mazars	34	31
– Audit services paid to other auditors	15	16
– Other services	101	90

In addition, Mazars received a further £8,000 of fees relating to the issue of shares during the year, which have been treated as issue costs rather than charged to the profit and loss account.

10 Employees

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 £'000
The aggregate payroll costs borne by the Group were as follows:		
Salaries	2,874	1,539
Social security costs	364	144
Pension costs	103	111
	3,341	1,794

The average number of people (excluding non-executive Directors) employed by the Group during the year was 33 (31 December 2002: 30). As at 31 December 2003, the number of people (excluding non-executive Directors) employed by the Group was 38 (31 December 2002: 31).

11 Directors' Emoluments

Details, for each Director, of remuneration and pension entitlements are set out on page 18.

12 Tax on profit on ordinary activities

	Year ended 31 December 2003 £'000	Year ended 31 December 2002 (Restated) £'000
<i>(a) Analysis of charge in the period</i>		
Current tax:		
Corporation tax at 30%	85	9
Adjustments in respect of previous periods	–	–
Overseas tax	4	–
Total current tax charge (note 12(b))	89	9
Deferred taxation:		
– underwriting losses	3,935	1,439
– investment losses	263	(423)
– timing differences on accelerated capital allowances	(16)	(14)
– additional tax losses	(282)	(577)
– other timing differences	(112)	(322)
Total deferred tax charge	3,788	103
Tax charge	3,877	112
<i>(b) Factors affecting tax charge for period</i>		
Profit on ordinary activities before tax	12,638	1,703
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	3,791	511
Expenses not deductible for tax purposes	182	132
Timing differences	(4,274)	(1,052)
Investment income received net of tax	(101)	(96)
Income not taxable	(4)	(15)
Movement in tax losses	377	527
Other taxes	–	2
Prior period adjustments	114	–
Total current tax charge	85	9

(c) Factors that may affect future tax charges

The future tax charge for the Group is dependent on the ability of the Group to utilise tax losses as they become available.

Notes to the Financial Statements For the year ended 31 December 2003

continued

13 Profit attributable to members of the parent company

The profit dealt with in the accounts of the parent company was £6,216,110 (31 December 2002: loss of £866,064), which included a profit arising in the ESOP of £12,000 (2002: £50,339) (see note 18).

As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account for the Company has been included in these financial statements.

14 Earnings per share

	Year ended 31 December 2003	Year ended 31 December 2002 (Restated)
The basic earnings per share is calculated as follows:		
Profit for the year (£'000)	8,761	1,591
Basic weighted average number of shares (no.)	79,533,411	40,788,755
Basic earnings per share (p)	11.0	3.9
The diluted earnings per share is calculated as follows:		
Profit for the year (£'000)	8,761	1,591
Basic weighted average number of shares (no.)	79,533,411	40,788,755
Weighted average convertible loan notes (no.)*	–	37,129
Dilutive potential ordinary shares	595,047	–
Diluted weighted average number of shares (no.)	80,128,458	40,825,884
Diluted earnings per share (p)	10.9	3.9
The operating earnings per share – diluted – is calculated as follows:		
Profit for the year (£'000)	8,761	1,591
Short term fluctuations in investment return (£'000)	(158)	2,141
Tax effect of short term fluctuations in investment return (£'000)	47	(642)
Operating profit for the year (£'000)	8,650	3,090
Diluted weighted average number of shares (no.)	80,128,458	40,825,884
Operating earnings per share – diluted (p)	10.8	7.6

*The nil paid convertible loan notes have been included as the convertible loan note holders provided funds through interavailability which contributed to the profit in the period.

Dilutive potential ordinary shares are those share options granted to employees where the exercise price is less than the average net tangible assets per share during the year.

All classes of shares are equally entitled to any profits arising in the Group. Consequently, no separate earnings per share has been calculated for each class of share.

15 Intangible assets

	Syndicate participations £'000	Goodwill £'000	Total £'000
Cost at 1 January 2003	1,230	3,275	4,505
Purchases in the period	2,790	–	2,790
Disposals in the period	(68)	–	(68)
Cost at 31 December 2003	3,952	3,275	7,227
Amortisation at 1 January 2003	747	709	1,456
Provided during the period	330	328	658
Disposals in the period	(68)	–	(68)
Amortisation at 31 December 2003	1,009	1,037	2,046
Net book value at 31 December 2003	2,943	2,238	5,181
Net book value at 1 January 2003	483	2,566	3,049

16 Financial Investments

The Group's financial investments consist of:

	31 December 2003 Market value £'000	31 December 2003 Cost £'000	31 December 2002 Market value £'000	31 December 2002 Cost £'000
Corporate (Group and Company)	15,004	14,934	12,100	13,810
Syndicate participations	61,231	61,762	29,171	28,874
Group financial investments	76,235	76,696	41,271	42,684
<i>i) Corporate (Group and Company):</i>				
Shares and other variable yield securities	6,077	6,191	6,118	7,830
Alternative investments	4,886	4,654	1,677	1,700
Debt and other fixed income securities	4,041	4,089	4,305	4,280
Total investments – Group and Company	15,004	14,934	12,100	13,810
<i>ii) Syndicate participations:</i>				
Shares and other variable yield securities	518	749	1,649	4,059
Debt securities and other fixed interest securities	41,263	41,357	24,998	22,647
Loans guaranteed by mortgage	4	4	23	23
Other loans	–	–	61	83
Deposits with credit institutions	19,109	19,315	2,202	1,824
Other investments	337	337	238	238
Total investments – Syndicate participations	61,231	61,762	29,171	28,874

All corporate investments are listed on recognised stock exchanges.

Alternative investments are investments which are characterised by a significant degree of capital protection.

Notes to the Financial Statements For the year ended 31 December 2003

continued

17 Investments in subsidiary undertakings

	31 December 2003 £'000
Cost	
At 1 January 2003	2,014
Additions during the year	-
At 31 December 2003	2,014

Details of the Company's subsidiaries are as follows:

Name of company	Nature of business	Proportion of ordinary shares held by the Company	Proportion of ordinary shares held by a subsidiary
Cathedral Capital (1998) Limited	Lloyd's corporate member	100%	
Cathedral Capital (1999) Limited	Lloyd's corporate member	100%	
Cathedral Capital Management Limited	Advisory company regulated by the FSA	100%	
Cathedral Capital Services Limited	Employment company	100%	
Cathedral Capital Holdings Limited	Intermediate holding company	100%*	
Cathedral Underwriting Limited	Lloyd's managing agent		100%

*Cathedral Capital PLC owns 100% of the economic interest of Cathedral Capital Holdings Limited.

As from 1 January 2002, Cathedral Capital (1999) Limited ceased to underwrite new business at Lloyd's.

All companies are registered and operate in England.

18 Own shares

During 2001, an Employee Share Ownership Plan ("ESOP") was set up for the benefit of the employees of the Group. At the end of 2003, 701,924 A convertible shares were held in the ESOP (2002: 801,924 A convertible shares). 100,000 shares were disposed during 2003 giving rise to a profit in the ESOP of £12,000 (2002: £50,339). Details of the shares disposed by the ESOP are set out in the Report of the Directors on page 19.

Although the Group only has de facto control of the ESOP, the Group is required under Urgent Issues Task Force (UITF) Abstract 13 to account for the assets of the ESOP as if they belong to the Group. Consequently, the assets and liabilities, income and expenses of the ESOP appear in both the Group and Company accounts.

The income and expenses, assets and liabilities of the ESOP (as included within the Group and Company accounts) are as follows:

	31 December 2003 £'000	31 December 2002 £'000
Profit & Loss Account		
Profit on sale of shares	12	50
Balance Sheet		
Investments*	92	129
Debtors	131	82
Net assets	223	211
ESOP funds	223	211
Reconciliation of ESOP funds		
ESOP funds at 1 January	211	
Profit arising in ESOP during the period	12	
Expenses incurred and added to cost of investments	-	
ESOP funds at 31 December	223	

*Valued at lower of cost and directors' valuation

19 Debtors

	Group 31 December 2003 £'000	Group 31 December 2002 £'000	Company 31 December 2003 £'000	Company 31 December 2002 £'000
Trade debtors	-	56	-	52
Amounts owed by managed syndicates	124	160	-	-
Amounts owed by group undertakings	-	-	7,668	5,286
Debtors within the ESOP	131	82	131	82
Other debtors	28	22	-	-
Other debtors arising on syndicate participations	1,904	5,649	-	-
	2,187	5,969	7,799	5,420

Debtors within the ESOP are as set out in note 18. Of this balance, £93,000 is due in more than one year (2002: £82,000).

All other debtors are due in less than one year.

Notes to the Financial Statements
For the year ended 31 December 2003

continued

20 Tangible fixed assets

	Computers & other equipment £'000	Furniture, fixtures & fittings £'000	Total £'000
Cost:			
At 1 January 2003	639	212	851
Additions	57	49	106
At 31 December 2003	696	261	957
Depreciation:			
At 1 January 2003	463	56	519
Charge for the year	137	42	179
At 31 December 2003	600	98	698
Net book value:			
At 31 December 2003	96	163	259
At 1 January 2003	176	156	332

21 Prepayments and accrued income

	Group 31 December 2003 £'000	Group 31 December 2002 (Restated) £'000	Company 31 December 2003 £'000	Company 31 December 2002 £'000
<i>Corporate:</i>				
Accrued income – investments	618	397	5,618	397
Accrued income – underwriting	16,398	2,738	–	–
Deferred tax asset	–	1,478	281	657
Prepayments	117	216	20	145
<i>Syndicate participations:</i>				
Deferred acquisition costs	9,350	2,880	–	–
Prepayments and accrued income	(12,382)	353	–	–
	14,101	8,062	5,919	1,199

22 Deferred tax

The movement in the deferred tax balance for the Group is represented by:

	31 December 2003 £'000	31 December 2002 (Restated) £'000
Declared underwriting (profits)/losses	(502)	360
Annually accounted (profits)/losses	(3,900)	(680)
Provisions for future underwriting losses	67	124
Deferred tax on investment losses	258	521
Accelerated capital allowances	30	14
Tax losses carried forward	1,426	940
Other timing differences	311	199
Deferred tax (liability)/asset	(2,310)	1,478
Deferred tax asset at start of year	1,478	
Deferred tax charge in profit and loss account for year	(3,788)	
Deferred tax liability at end of year	(2,310)	

Unprovided deferred tax assets amounted to £19,401 at 31 December 2003 (31 December 2002: £107,000).

The Company had a deferred tax asset at 31 December 2003 of £281,053 (31 December 2002: £656,535) in respect of unrealised losses on investments and tax losses carried forward. The Company had an unprovided deferred tax asset of £nil at 31 December 2003 (31 December 2002: Unprovided deferred tax liability of £nil).

23 Provisions for other risks and charges – other provisions

	Provision in respect of profit sharing scheme £'000
Provision at 1 January 2003	645
Charge for the year	2,537
Utilised in the year	(637)
Provision at 31 December 2003	2,545

The Group operates a profit sharing scheme from which all executive Directors and employees of the Group can benefit. The size of this profit related pool created under this scheme is determined annually and is equal to 15 per cent of the consolidated Group pre-tax and pre-amortisation profits. Any distributions from this scheme are entirely at the discretion of the Board. The provision includes an estimate of employer's National Insurance (at 12.8 per cent) which would be payable.

Notes to the Financial Statements For the year ended 31 December 2003

continued

24 Other creditors

	Group 31 December 2003 £'000	Group 31 December 2002 £'000	Company 31 December 2003 £'000	Company 31 December 2002 £'000
<i>Corporate:</i>				
UK Corporation tax	172	87	64	86
Other taxes and social security costs	120	85	–	–
Bank overdraft	1,295	–	1,295	–
Trade creditors	2,087	1,308	–	152
Convertible loan notes	1,558	1,542	1,558	1,541
<i>Syndicate participations:</i>				
Other creditors	3,370	3,965	–	–
	8,602	6,987	2,917	1,779

Group trade creditors include underwriting losses and early profit releases payable to Lloyd's, of which £1,613,248 (2002: £413,970) is due after more than one year.

As part of the capital raise in 2002, a loan instrument was created and £1,604,621.20 nominal value of A Series Convertible Unsecured Loan Notes 2002-2006 were issued. These notes pay a coupon of 6 per cent per annum and are convertible at a future value into A Convertible Ordinary shares of 25p each.

25 Share capital

	31 December 2003 Authorised No. '000	31 December 2002 No. '000	31 December 2003 Allotted issued and fully paid No. '000	31 December 2002 No. '000
Number:				
A Convertible Ordinary shares of 25p each	391,930	391,930	72,441	71,441
B Ordinary shares of 25p each	20	20	–	–
C Convertible Ordinary shares of 25p each	8,050	8,050	7,364	7,364
Deferred shares of 0.0001p each	5,000,000	5,000,000	–	–
	£'000	£'000	£'000	£'000
Nominal value:				
A Convertible Ordinary shares of 25p each	97,982	97,982	18,110	17,860
B Ordinary shares of 25p each	5	5	–	–
C Convertible Ordinary shares of 25p each	2,013	2,013	1,841	1,841
Deferred shares of 0.0001p each	5	5	–	–
	100,005	100,005	19,951	19,701

During the year, 1,000,000 A Convertible Ordinary shares of 25p were issued for non-cash consideration. A Section 103, of the Companies Act 1985, report has been obtained from the Auditors which places a value of 71.7 pence per share on this consideration.

26 Reserves

Movements in reserves for the year ended 31 December 2003

	Share premium reserve £'000	Merger reserve £'000	Profit and loss reserve £'000	Total £'000
Group:				
Balance at 1 January 2003	35,363	1,447	(2,858)	33,952
Prior year adjustment				
– Changes in accounting policy – profit commission and managing agency fees	–	–	(578)	(578)
Balance at 1 January 2003, as restated	35,363	1,447	(3,436)	33,374
Issue of shares	467	–	–	467
Share issue expenses	(29)	–	–	(29)
Profit for the year	–	–	8,761	8,761
At 31 December 2003	35,801	1,447	5,325	42,573

The profit for the year ended 31 December 2003 without the changes in accounting policy would have amounted to £9,746,000. The effect of the change in accounting policy was to decrease the profit after tax by £985,000 (31 December 2002: decrease the profit after tax by £522,000).

	Share premium reserve £'000	Profit and loss reserve £'000	Investment revaluation reserve £'000	Total £'000
Company:				
Balance at 1 January 2003	35,363	(800)	–	34,563
Issue of shares	467	–	–	467
Share issue expenses	(29)	–	–	(29)
Increase in unrealised gains on investments	–	–	71	71
Profit for the year	–	6,216	–	6,216
At 31 December 2003	35,801	5,416	71	41,288

Of the profit and loss reserve of the Company:

	31 December 2003 £'000	31 December 2002 £'000
Distributable reserves	5,354	(850)
Undistributable reserves	62	50
	5,416	(800)

The undistributable reserves relate to the cumulative profits of the ESOP recognised in the Company's accounts (see note 18).

Notes to the Financial Statements For the year ended 31 December 2003

continued

27 Reconciliation of shareholders' funds

	Group 31 December 2003 £'000	Group 31 December 2002 (Restated) £'000	Company 31 December 2003 £'000	Company 31 December 2002 £'000
Total recognised gains/(losses) for the year	8,761	1,591	6,287	(866)
Issue of shares	688	26,282	688	26,282
Total movements during the year	9,449	27,873	6,975	25,416
Opening shareholders' funds (restated)	53,075	25,202	54,264	28,848
Closing shareholders' funds	62,524	53,075	61,239	54,264

28 Net tangible assets per share

	31 December 2003 £'000	31 December 2002 (Restated) £'000
Undiluted:		
Net assets	62,524	53,075
Less intangible assets	(5,181)	(3,049)
Net tangible assets	57,343	50,026
Basic number of shares at 31 December (no.)	79,804,644	78,804,644
Net tangible assets per share – undiluted (p)	71.9p	63.5p
	£'000	£'000
Diluted:		
Net tangible assets (as above)	57,343	50,026
Add amounts potentially due in respect of share options	420	268
Net tangible assets after conversion of loan notes	57,763	50,294
Basic number of shares at 31 December (no.)	79,804,644	78,804,644
Add potential dilutive shares in respect of share options (no.)	657,657	425,238
Diluted number of shares at 31 December (no.)	80,462,301	79,229,882
Net tangible assets per share – diluted (p)	71.8p	63.5p

29 Capital commitments

There were no capital commitments at 31 December 2003 (2002: £nil).

30 Operating leases

	31 December 2003 £'000	31 December 2002 £'000
Annual commitments under operating leases which expire:		
Land & buildings:		
between two and five years	305	305
	305	305

The Company had no annual commitments under operating leases.

31 Reconciliation of operating profit to net cash inflow from operating activities

	31 December 2003 £'000	31 December 2002 (Restated) £'000
Profit before tax on ordinary activities	12,638	1,703
Depreciation of fixed assets	179	173
Amortisation of goodwill	328	327
Amortisation of syndicate capacity	330	440
(Increase) in debtors & accrued income	(13,696)	(1,434)
Profit arising on ESOP and expenses paid by group	(12)	(52)
Interest payable	113	11
Increase/(decrease) in creditors	2,541	(1,296)
Realised and unrealised investment (gains)/losses	(1,090)	1,668
Net cash inflow from operating activities	1,331	1,540

Notes to the Financial Statements For the year ended 31 December 2003

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32 Movement in opening and closing portfolio investments, net of financing

	31 December 2003 £'000	31 December 2002 £'000
Net cash (outflow)/inflow for the year	(1,949)	720
Cashflow – portfolio investments	962	26,879
Movement arising from cashflows	(987)	27,599
Changes in market value of investments	1,090	(1,668)
Total movement in portfolio investments, net of financing	103	25,931
Portfolio at 1 January	48,956	23,025
Portfolio at 31 December	49,059	48,956

33 Movement in cash and portfolio investments

	1 January 2003 £'000	Cash flow £'000	Changes to Market value £'000	31 December 2003 £'000
Cash at bank and in hand	1,610	(654)	–	956
Bank overdrafts	–	(1,295)	–	(1,295)
Deposits with credit institutions	35,246	(852)	–	34,394
Total cash	36,856	(2,801)	–	34,055
Shares	6,118	(905)	864	6,077
Fixed income investments	4,305	(220)	(44)	4,041
Alternative investments	1,677	2,939	270	4,886
Total portfolio investments	12,100	1,814	1,090	15,004
Total cash and portfolio investments	48,956	(987)	1,090	49,059

Deposits with credit institutions relates to cash balances held as funds at Lloyd's.

34 Net cash inflow on portfolio investments

	Year ended 31 December 2003			Year ended 31 December 2002		
	Purchases £'000	Sales £'000	Net cash flow £'000	Purchases £'000	Sales £'000	Net cash flow £'000
Deposits with credit institutions	–	–	(852)	–	–	22,047
Shares and other variable yield securities	3,935	4,840	(905)	6,333	2,635	3,698
Fixed income investments	1,498	1,718	(220)	1,862	1,428	434
Alternative investments	3,454	515	2,939	1,500	800	700
	8,887	7,073	962	9,695	4,863	26,879

35 Pensions

The Group does not operate a pension fund. Instead, it makes contributions to employees' individual pension funds.

36 Related party transactions

Certain Directors were interested in contracts and transactions entered into by the Cathedral Group and the nature of these interests are shown in the Report of the Directors on pages 16 and 17.

37 Contingent liabilities

Lloyd's of London

As explained in Note 1 the Group participates on insurance business written by Lloyd's Syndicates. As a result of this participation, the Group is exposed to claims arising on insurance business written by those syndicates.

If either of the corporate member subsidiaries fails to meet any of their Lloyd's obligations, after having called on the Group under its guarantees, then:

- (i) Lloyd's will be entitled to require the other subsidiary to cease or reduce its underwriting; and/or
- (ii) having regard to the fact that the Central Fund or the New Central Fund may be applied to discharge the obligations of the defaulting corporate member subsidiary, Lloyd's will be entitled to require the other corporate member subsidiary to contribute to the Central Fund or New Central Fund to the amount of its net profits held from time to time in its Premium Trust Funds, sufficient to reimburse the Central Fund or the New Central Fund in full for any payment made on behalf of the defaulting member.

In December 2001 the Company agreed for some of the funds at Lloyd's of Cathedral Capital (1999) Limited to be made interavailable for the benefit of Cathedral Capital (1998) Limited. As part of that arrangement, the Company agreed to indemnify the Society of Lloyd's against all actions, proceedings, costs, claims and demands made against the Society of Lloyd's in respect of the Society of Lloyd's consenting and entering into this corporate interavailability proposal ("Deed of Indemnity"). The aggregate liability of the Company in respect of such indemnity shall not in any event exceed £258,610 (together with any reasonable costs and expenses incurred by the Society of Lloyd's). As security for the performance of its obligations under the Deed of Indemnity, the Company granted a floating charge over its undertaking and all of its property and assets existing from time to time in favour of the Society of Lloyd's.

In November 2002, the Company agreed to provide £8,860,001 funds at Lloyd's to PMA Re Corporate Capital Limited (a related group company). These funds at Lloyd's were then made interavailable to Cathedral Capital (1998) Limited. As part of that arrangement, the Company agreed to indemnify the Society of Lloyd's against all actions, proceedings, costs, claims and demands made against the Society of Lloyd's in respect of the Society of Lloyd's consenting and entering into this corporate interavailability proposal ("supplemental Deed of Indemnity"). The aggregate liability of the Company in respect of such indemnity shall not in any event exceed £8,860,001 (together with any reasonable costs and expenses incurred by the Society of Lloyd's). As security for the performance of its obligations under the Supplemental Deed of Indemnity, the Company granted a further floating charge over its undertaking and all of its property and assets existing from time to time in favour of the Society of Lloyd's.

Notes to the Financial Statements
For the year ended 31 December 2003

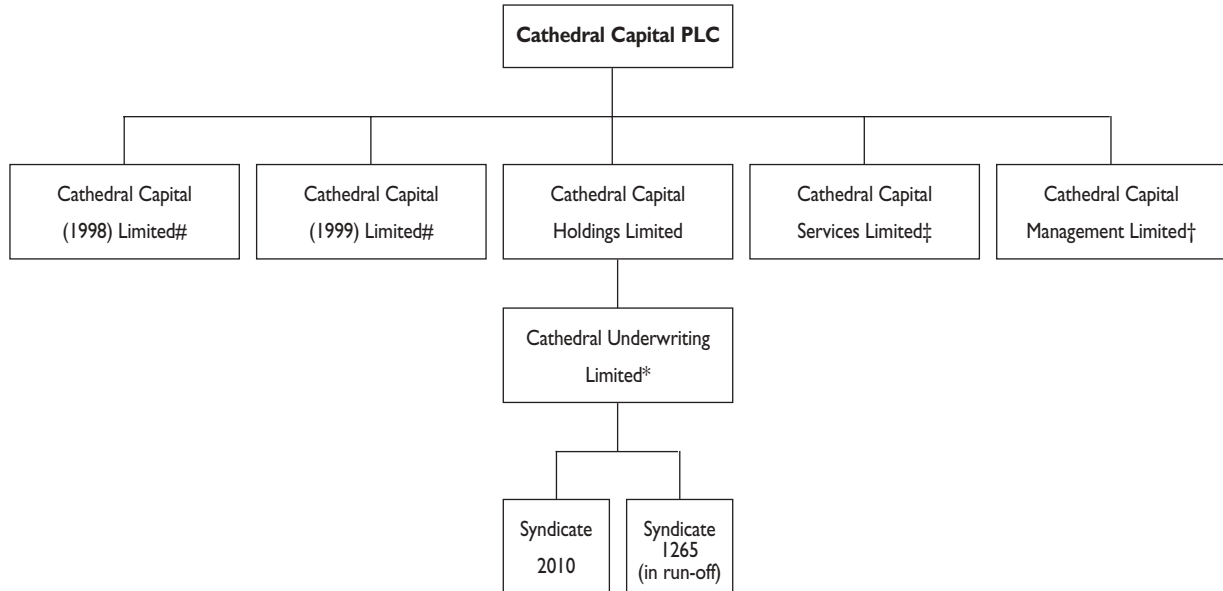
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38 Analysis of Consolidated Balance Sheet

	Managed Syndicate 2010	External managed syndicates Annually accounted	Fund accounted	Corporate	31 December 2003 Total	31 December 2002 Total (Restated)
	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets:						
Syndicate participations	-	-	-	2,943	2,943	483
Goodwill	-	-	-	2,256	2,256	2,587
Negative goodwill	-	-	-	(18)	(18)	(21)
	-	-	-	5,181	5,181	3,049
Investments:						
Financial investments	15,377	40,805	5,049	15,004	76,235	41,271
Deposits with ceding undertakings	-	32	3	-	35	38
Own shares	-	-	-	92	92	129
	15,377	40,837	5,052	15,096	76,362	41,438
Reinsurers' share of technical provisions:						
Provision for unearned premiums	2,233	6,426	-	-	8,659	4,181
Claims outstanding	16,201	24,052	5,418	-	45,671	39,228
	18,434	30,478	5,418	-	54,330	43,409
Debtors:						
Arising out of direct operations	5,154	14,424	95	-	19,673	10,780
Arising out of reinsurance operations	16,687	18,966	585	-	36,238	27,388
Other debtors	770	711	423	283	2,187	5,969
	22,611	34,101	1,103	283	58,098	44,137
Other assets:						
Tangible assets	-	-	-	259	259	332
Cash at bank and in hand	8,947	4,946	1,816	35,350	51,059	44,411
Other	834	5,043	421	-	6,298	2,088
	9,781	9,989	2,237	35,609	57,616	46,831
Prepayments and accrued income:						
Deferred acquisition costs	3,308	6,042	-	-	9,350	2,880
Prepayments and accrued income	(9,196)	(3,670)	484	17,133	4,751	5,182
Total assets	60,315	117,777	14,294	73,302	265,688	186,926

	Managed Syndicate 2010	External managed syndicates Annually accounted	Fund accounted	Corporate	31 December 2003 Total	31 December 2002 Total (Restated)
	£'000	£'000	£'000	£'000	£'000	£'000
Capital and reserves:						
Called up share capital	-	-	-	19,951	19,951	19,701
Share premium	-	-	-	35,801	35,801	35,363
Merger reserve	-	-	-	1,447	1,447	1,447
Profit and loss reserve	-	-	-	5,325	5,325	(3,436)
Equity shareholders' funds	-	-	-	62,524	62,524	53,075
Technical provisions:						
Claims outstanding – gross	36,310	72,136	13,096	-	121,542	94,084
Provision for losses foreseen on open years	-	-	243	-	243	413
Provisions for unearned premiums	18,996	34,456	-	-	53,452	18,618
Other technical provisions	-	-	-	327	327	-
	55,306	106,592	13,339	327	175,564	113,115
Provisions for other risks and charges:						
Provision for deferred taxation	-	-	-	2,310	2,310	-
Other provisions	-	-	-	2,545	2,545	645
	-	-	-	4,855	4,855	645
Creditors:						
Arising out of direct insurance operations	-	824	124	-	948	937
Arising out of reinsurance operations	4,974	5,888	197	-	11,059	10,294
Other creditors	371	2,374	625	5,232	8,602	6,987
	5,345	9,086	946	5,232	20,609	18,218
Accruals and deferred income	(336)	2,099	9	364	2,136	1,873
Total liabilities	60,315	117,777	14,294	73,302	265,688	186,926

Group Structure



Key:

*Lloyd's Managing Agency

†FSA Advisory Company

#Corporate Underwriting Name at Lloyd's

‡Employment Company

Share Transfer Market 2004:

1 June to 15 June

Financial Timetable 2004:

Annual Accounts to shareholders May

Annual General Meeting June

Financial year end December

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