

25 Financial instruments

Financial risk management objectives and policies

The Group's principal financial instruments, other than derivatives, comprise bank loans, bond issues, loan notes, finance leases and cash. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group also has various other financial instruments such as trade receivables and trade payables, which arise directly from its operations.

The Group also enters into derivative transactions, primarily interest rate swaps and forward currency contracts. The purpose is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance.

It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Classification of financial instruments

The following table analyses by classification and category all of the Group's financial instruments (excluding short term debtors and creditors) that are carried in the financial statements. The values represent both the carrying amounts and the fair value.

	Available for sale £m	At fair value through the income statement £m	Loans and receivables £m	Derivatives used for hedging £m	Liabilities at amortised cost £m	Total £m
At 31 December 2007						
Financial assets						
Investments in units	–	25.4	–	–	–	25.4
Unlisted equity securities	0.3	–	–	–	–	0.3
Investment loan	–	–	29.1	–	–	29.1
Cash flow hedges	–	–	–	5.6	–	5.6
Interest rate swaps	–	–	–	0.1	–	0.1
Cash in hand	–	–	0.8	–	–	0.8
Currency swaps	–	–	–	1.0	–	1.0
	0.3	25.4	29.9	6.7	–	62.3
Financial liabilities						
Bank overdraft	–	–	46.1	–	–	46.1
Obligations under finance leases	–	–	–	–	0.2	0.2
Unsecured loan notes	–	–	–	–	1.7	1.7
Bonds	–	–	461.1	–	–	461.1
Asset-based securitised financing	–	–	9.7	–	–	9.7
Currency swaps	–	–	–	19.1	–	19.1
	–	–	516.9	19.1	1.9	537.9

	Available for sale £m	At fair value through the income statement £m	Loans and receivables £m	Derivatives used for hedging £m	Liabilities at amortised cost £m	Total £m
At 31 December 2006						
Financial assets						
Investments in units	–	19.8	–	–	–	19.8
Unlisted equity securities	0.3	–	–	–	–	0.3
Investment loan	–	–	12.5	–	–	12.5
Cash in hand	–	–	9.7	–	–	9.7
	0.3	19.8	22.2	–	–	42.3
Financial liabilities						
Bank overdraft	–	–	0.5	–	–	0.5
Obligations under finance leases	–	–	–	–	0.5	0.5
Unsecured loan notes	–	–	–	–	22.2	22.2
Bonds	–	–	372.0	–	–	372.0
Asset-based securitised financing	–	–	27.5	–	–	27.5
Currency swaps	–	–	–	6.4	–	6.4
	–	–	400.0	6.4	22.7	429.1

The fair value of financial instruments has been calculated by discounting the expected future cash flows at prevailing interest rates, except for unlisted equity securities and investment loans. Unlisted equity securities and investment loans are held at amortised cost.

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Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long term debt obligations with floating interest rates.

The Group's policy is to manage its interest cost using a mix of fixed and variable rate debts. To manage this, the Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed upon notional principal amount. These swaps are designated to hedge underlying debt obligations.

The interest rate profile of the financial assets and liabilities of the Group as at 31 December is as follows:

At 31 December 2007	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
Fixed rate							
Loan notes	1.7	-	-	-	-	-	1.7
Obligations under finance leases	0.2	-	-	-	-	-	0.2
Floating rate							
Cash in hand	(0.8)	-	-	-	-	-	(0.8)
Overdrafts	46.1	-	-	-	-	-	46.1
Investment loan	-	-	-	-	-	(29.1)	(29.1)
Assets available for sale	-	(0.3)	-	-	-	-	(0.3)
At fair value through income statement	-	(25.4)	-	-	-	-	(25.4)
Bonds	-	88.4	-	-	18.7	354.0	461.1
Asset-based securitised financing	9.7	-	-	-	-	-	9.7
Cash flow hedges	(0.9)	(0.3)	(0.3)	(0.5)	(0.4)	(3.2)	(5.6)
Interest rate swap	-	(0.1)	-	-	-	-	(0.1)
Foreign currency swaps	-	-	-	-	-	(1.0)	(1.0)
Foreign currency swaps	-	11.8	-	-	6.0	1.3	19.1

The effect of the interest rate swap and the currency swap are disclosed below. Bonds are classified as floating rate due to the effect of the interest and currency swaps.

At 31 December 2006	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
Fixed rate							
Loan notes	22.2	-	-	-	-	-	22.2
Obligations under finance leases	0.2	0.3	-	-	-	-	0.5
Floating rate							
Cash and cash equivalents	(9.7)	-	-	-	-	-	(9.7)
Overdrafts	0.5	-	-	-	-	-	0.5
Investment loan	-	-	(12.5)	-	-	-	(12.5)
Assets available for sale	-	(0.3)	-	-	-	-	(0.3)
At fair value through income statement	-	(19.8)	-	-	-	-	(19.8)
Bonds	-	-	99.2	-	-	272.8	372.0
Asset-based securitised financing	27.5	-	-	-	-	-	27.5
Interest rate swap	-	-	-	-	-	-	-
Foreign currency swap	-	-	1.0	-	-	5.4	6.4

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings). There is no impact on the Group's equity.

	Increase/ (decrease) in basis points	Effect on profit before tax £m
2007	125/(125)	(6.0)/6.0
2006	92/(92)	(3.5)/3.5

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Foreign currency risk

The Group has exposure to foreign currency risk where it has investments in overseas operations which are affected by foreign exchange movements. The Group is not generally exposed to significant foreign currency risk except in respect of its overseas operations in India which generate exposure to movements in the INR/GBP exchange rates. The Group seeks to mitigate the effect of this exposure by entering forward currency contracts (in the form of Non-deliverable Forward Contracts (NDFs)) to fix the GBP cost of highly probable forecast transactions denominated in INR.

It is the Group's policy to negotiate the terms of the hedge derivatives to match the terms of the hedged items in order to maximise hedge effectiveness.

At 31 December 2007, the Group had cash flow hedges in place to match its forecast monthly INR costs in 2008 and each year up to and including 2019. These forecast INR costs have been determined on the basis of the underlying cash flows, associated with the delivery of services under signed contracts which run to 2019. These hedges were implemented during the current year.

The following table demonstrates the sensitivity to a reasonably possible change in the INR/GBP exchange rate, with all other variables held constant, of the Group's profit before tax and the Group's equity due to changes in the fair value of the Group's forward exchange contracts.

	Increase/ (decrease) in INR exchange rate	Effect on profit before tax £m	Effect on equity £m
2007	8.2%	-	14.4
2006	n/a	-	-

Hedges

Fair value hedges

The Group has in issue fixed rate dollar and sterling bonds which it has hedged through a combination of interest rate and currency swaps.

At 31 December 2007 and 31 December 2006, the Group had an interest rate swap in place with a notional amount of £55.0m whereby it receives a fixed rate of interest of 6.44% and pays a variable rate based on 6 month LIBOR. The swap is being used to hedge the exposure to changes in the fair value of £55.0m of the Group's 6.44% bonds.

At December 2007 and December 2006, the Group had in place currency swaps whereby it receives a fixed rate of interest and pays a variable rate based on 6 month LIBOR.

The swaps are being used to hedge the exposure to changes in the value of its US dollar issued bonds. The unsecured bonds, currency and interest rate swaps have the same critical terms including the amount and the date of maturity (see note 22). The Group may, at its option, upon notice of not less than 30 days and not more than 60 days, repay at any time all or part of the notes at no more than the present value of future payments. In addition, the Group has covenanted to maintain a specified consolidated leverage ratio and a consolidated net interest expense coverage ratio.

Cash flow hedges

As noted above, the Group holds a series of forward exchange currency contracts in the form of NDFs designated as hedges of highly probable forecast transactions in INR of the Group's Indian operations.

Forward exchange contracts	Assets £m	2007 Liabilities £m	Assets £m	2006 Liabilities £m
Fair value	5.6	-	-	-

The terms of the forward currency contracts have been negotiated to match the terms of the commitments.

The cash flow hedges in respect of the highly probable forecast monthly costs denominated in INR up to 2019 were assessed to be highly effective and as at 31 December 2007, a net unrealised gain of £5.6m, with a deferred tax charge of £1.6m, was included in equity in respect of these contracts.

Credit risk

The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, available for sale financial investments, investment loan, financial assets at fair value through the income statement, investment in a joint venture and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty.

The Group has a maximum exposure equal to the carrying amount of the above receivables and instruments.

The Group has a master netting arrangement in respect of its banking facilities resulting in the legal right of set-off for its overdraft and cash balances.

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Liquidity risk

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial investments and financial assets (e.g. accounts receivable, other financial assets) and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts, bank loans, loan notes, bonds and finance leases.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2007 based on contractual payments.

At 31 December 2007	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
Loan notes	1.7	–	–	–	–	–	1.7
Obligations under finance leases	0.2	–	–	–	–	–	0.2
Overdrafts	46.1	–	–	–	–	–	46.1
Bonds	–	88.4	–	–	18.7	354.0	461.1
Asset-based securitised financing	9.7	–	–	–	–	–	9.7
Foreign currency swaps	–	11.8	–	–	6.0	1.3	19.1
	57.7	100.2	–	–	24.7	355.3	537.9

At 31 December 2006	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
Loan notes	22.2	–	–	–	–	–	22.2
Obligations under finance leases	0.2	0.3	–	–	–	–	0.5
Overdrafts	0.5	–	–	–	–	–	0.5
Bonds	–	–	99.2	–	–	272.8	372.0
Asset-based securitised financing	27.5	–	–	–	–	–	27.5
Interest rate swap	–	–	–	–	–	–	–
Foreign currency swaps	–	–	1.0	–	–	5.4	6.4
	50.4	0.3	100.2	–	–	278.2	429.1

Capital management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2007 and 31 December 2006.

The Group does not set a target level of gearing but uses capital opportunistically to add value for shareholders. The key discipline adopted by the Group is to widen the margin between the return on capital employed and the cost of that capital as shown in the business review on page 19.

The table below presents quantitative data for the components the Group manages as capital:

	2007 £m	2006 £m
Shareholders' funds	331.8	325.8
Bank overdraft	46.1	0.5
Finance leases	0.2	0.5
Unsecured loan notes	1.7	22.2
Bonds	461.1	372.0
Currency and interest rate swaps	18.0	6.4
At 31 December	858.9	727.4