

Business and Financial review

2007 has seen Xansa make significant progress against its key strategic objectives. After a period of revenue transition and restructuring we can now report that both revenues and profits have increased.

Our record in contract renewal continues and we have been successful in extending all contracts due for renewal as well as winning significant new clients. Our orderbank is the strongest it has been for many years, new services have been added to our portfolio and our leadership position in existing services has been consolidated. Our resource base has continued to grow and with over 5,000 staff now based in India, we have become one of Britain's biggest employers in our sector in that country.

Strategic goals Our strategy remains unchanged and we continue to focus on the same goals:

Goal 1 **Growing the business in the UK market**

100% renewal rate with existing clients over last three years

Orderbank grown 16% to £548.9 million, its highest rate in four years

Returned to revenue, profit and margin growth

Goal 2 **Delivering client solutions that benefit from IT and BPO convergence**

32% increase in revenues from IT enabled BPO

Continued investment to extend service portfolio eg HR outsourcing and Web solutions

Signed foundation multi-process HR outsourcing contract with Lloyds TSB

Goal 3 **Leveraging our integrated onshore and offshore capabilities**

62% salaried employees now in India

42% increase in India revenues

Increased number of public and private sector clients using our integrated delivery capability

Our strategy of focusing on growing our business in the UK is delivering results. We have successfully won new work in our traditional IT Services space and increasingly we see our clients turning to us for help in other areas of their business, covering a range of back office business services including Finance and Accounting and HR Administration. This is true in both our established private sector clients and increasingly in the public sector – a key investment area for us in recent years. Clients are looking for ways that technology can automate, streamline and standardise a whole range of their internal processes. Our skills in technology and process operations form a powerful combination enabling us to develop expert solutions to meet this growing need in the marketplace. As we identify the range of technology-enabled business services that we can deliver and that our clients will require, we believe we are well placed to continue to extend our reach and develop further leadership positions in a number of important business services.

Our clients We have had another successful year winning new clients, renewing contracts and extending relationships with existing clients. Doing more for our clients is a critical philosophy in our business and the long-term relationships we have built are testament to the value that they see us bringing to their organisations.

In the UK private sector, activity levels increased despite a highly competitive market and headcount grew by 5% to service the higher level of demand. We continued to transition our business towards greater offshore delivery and the costs of this transition have been fully absorbed within our operating expenditure. We have also made excellent progress in growing our Indian operations with almost all of our private sector clients now enjoying the benefits of our offshore capabilities. However, whilst the provision of offshore resources has become a requirement to compete in the sector, we see a distinct competitive advantage from the high level of integration that has been achieved in our onshore and offshore client delivery model over the past ten years. No other organisation can match this level of integration which creates a single and seamless face to our client with very clear accountabilities for delivery.

We continued our excellent record of contract renewals and, in particular, were pleased to extend our 12 year relationship with Co-operative Financial Services (CFS). Our new five year agreement represented a broadening of the partnership to encompass the Insurance side of the business, in addition to the bank which we had served before. Our integrated delivery capability will support CFS's business change agenda which is driving towards its vision of becoming the UK's most admired Financial Services business.

Our public sector business enjoyed another good year and grew strongly. Revenues increased by 56% to £119.4 million (2006: £76.4 million) representing around one third of our total revenues. Growth has been achieved in both central and local Government and we now work across a number of key Government departments including the Home Office, Department of Health, Department for Education & Skills (DfES) and the Cabinet Office.

Examples of major orders signed during the year include:

IT Services

Barclays – Applications management and development.
 Co-operative Financial Services – IT outsource extended to cover Co-operative Insurance Services.
 FSA† – Applications management and development.
 Northern Ireland Water Limited – Applications management and development.
 ONS – Strategic IT transformation partner.
 Tesco – IT outsource extension.
 Threshers† – IT outsource.

Finance and Accounting Outsourcing

BBC† – F&A, payroll, SAP development.
 NHS Professionals† – F&A, payroll via NHS Shared Business Services.

HR Outsourcing

Lloyds TSB – Multi-process HR outsource.

Web Solutions

The Club – Fully managed web and content management services.

†New client within the year.

With the publication of the Varney Report, the Government's strategy of electronically linking citizens with public services and the leveraging of shared services centres to bring efficiency to back office administration is clear. We have focused our investment on these two primary services and have created leadership positions in each.

■ For The Club, a consortium of the Department of Health, DfES and Cabinet Office, we are building and now operate a standardised web platform to allow citizens easier access via the internet to information and public services. An example is www.direct.gov.uk through which users can quickly find Government information across a range of subjects covering health, transport, justice, employment, tax, education and the environment. As Government rationalises its websites, the technology and services we have put in place will provide an excellent platform that other departments can leverage to reduce cost and provide a more standardised and user-friendly linkage between the citizen and the public services.

■ As leaders in the provision of shared services in Government, we have made excellent progress with NHS Shared Business Services (NHS SBS), our pioneering joint venture with the Department of Health. We have grown the number of NHS Trusts serviced by our business and since the inception of the joint venture in April 2005, transaction volumes have increased almost four-fold and the business continues to make good progress towards profitability. We can now see opportunities to broaden the range of services that the joint venture can deliver and intend to invest accordingly as such opportunities arise. This year's accounts reflect the second year of operation of the joint venture and show a loss after tax of £1.1 million (2006: £2.7 million loss).

Elsewhere in the public sector we were pleased to win a major new contract worth £85 million over ten years with the BBC to deliver outsourced Finance and Accounting services. Transfer of the services operation will take place in the first half of our next financial year. Winning such a high-profile client against strong competition is testament to the expertise we now have in the Finance and Accounting outsourcing market. With a client list in this area including the BBC, NHS and BT, we now service some of the UK's largest and highest-profile organisations.

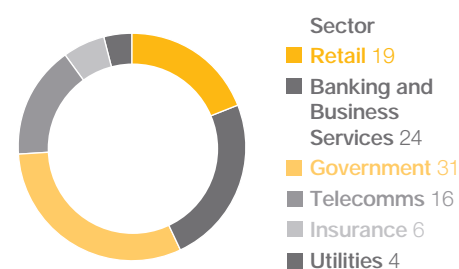
The Xansa-led Crystal Alliance, has successfully delivered and is operating commercial customer billing, customer contact services and the initial phases of mobile work management for Northern Ireland Water Limited, a Government owned company. We had in addition completed, on time, the domestic billing implementation element of this contract but were requested to defer final implementation pending an independent review of water charging in Northern Ireland commissioned by the Northern Ireland Assembly. This has had no impact on the reported results for the year. We expect there to be a degree of ongoing uncertainty over the form and timing of the introduction of domestic water charging until the review is completed.

Increase in operating profit*

8.2%



Operating profit* (£ million)



Revenue by industry %

Business performance

Financial key performance indicators	2007	2006
Revenue	£379.7 million	£357.3 million
Underlying operating profit*	£25.2 million	£23.3 million
Underlying operating profit margin*	6.6%	6.5%
Profit before tax**	£16.4 million	£13.3 million
Diluted adjusted EPS*	5.12p	4.29p
Net debt	£10.9 million	£17.7 million

*Before share-based payments and exceptional items.

**Before exceptional items.

Growth in UK workforce serving the private sector

5%

All key financial measures have improved over the last 12 months. Revenue of £379.7 million was up 6.3% from £357.3 million in 2006 and importantly continued to show sequential growth for the third successive six month period. This reflects the impact of new business wins in the year and the full year effect of new contracts started in the previous year. It also underlines the return to growth of the business after the dilutive impact of the transition of work from onshore to offshore. On an ongoing basis we continue to experience a year-on-year reduction in the revenue derived from services provided to customers as a result of the increased proportion of work delivered from India which is now more than offset by new business particularly in the public sector.

Underlying operating margins* increased from 6.5% to 6.6% due to the beneficial impact of the transition of onshore activity to offshore, the effect of a weaker rupee on our Indian cost base and improved performance in our joint venture with the Department of Health. Underlying operating profit* increased 8.2% to £25.2 million (2006: £23.3 million) and PBT** increased over 23.3% to £16.4 million (2006: £13.3 million). Diluted EPS* increased 19% to 5.12p (2006: 4.29p).

Share-based payments Share-based payments were £3.8 million (2006: £3.8 million). This charge represents the amortisation of the fair value of share-based payments over their vesting period. The current year charge represents a true full year effect, reduced by the impact of share option lapses due to leavers from the scheme.

Net interest payable Net interest payable was £5.0 million (2006: £6.2 million). Prevailing interest rates on our UK debt during the period were approximately 7.5% (2006: 6.4%). Average borrowings increased from £36.7 million in 2006 to £40.3 million in 2007, primarily due to a change in contract payment terms on the renewal of a number of major contracts. These contracts, which were previously paid in advance, have reverted to a more normal 'in arrears' payment structure. The higher UK debt was offset by increasing Indian cash balances. In addition to this, there was a lower net finance expense arising from our pension schemes than in the prior year.

Profit before tax Profit before tax, after share based payments, but before exceptional items increased to £16.4 million in 2007 (2006: £13.3 million).

Taxation The tax charge of £3.0 million (2006: £2.8 million) on profit before tax (before share-based payments and share of joint venture's loss after tax) of £21.3 million (2006: £19.8 million) results in a tax rate of 14.1% (2006: 14.1%). Profits in our India subsidiary presently benefit from a corporate tax holiday. This Indian tax holiday expires on a site-by-site basis over the next two years and as a consequence our tax rate will increase.

Minority interest The minority interest of £0.1 million (2006: £0.3 million) represents the 0.7% residual minority interest in Xansa (India) Limited that was not acquired on the original acquisition of IIS Infotech. In prior periods the minority interest also included Barclays' interest in the Barclays Xansa Partnership Limited (BXP). The structure of this contract changed in June 2006 and there is now no minority interest in relation to BXP.

EPS Diluted adjusted earnings per share* of 5.12p (2006: 4.29p) is computed on underlying profit before tax* of £20.2 million (2006: £17.1 million).

The tax charge applied to these profits is £3.8 million, which excludes a £0.8 million tax credit (2006: £0.5 million credit) arising on the distribution of shares from the trusts since the related charge is not reflected in adjusted profit before tax*.

Growth in public sector revenues

56%

Minority interests of £0.1 million (2006: £0.3 million) are deducted to arrive at adjusted earnings* of £16.3 million (2006: £13.5 million).

The diluted earnings per share after share-based payments and exceptional items is 4.18p (2006: 2.32p).

Dividend The Board intends to propose a final dividend of 2.16p in respect of the current year. Dividend cover, defined as basic earnings per share divided by the dividend per share, has improved to 1.6 times (2006: 1.4 times). Subject to shareholder approval, the final dividend will be paid on 27 September 2007 to shareholders on the register on 6 July 2007.

Consolidated balance sheet

	2007 £ million	2006 £ million
Non-current assets		
Intangible assets	83.5	85.9
Property, plant and equipment	23.5	24.9
Investment in joint venture	7.7	8.8
	114.7	119.6
Working capital		
Inventories	–	0.2
Receivables	61.9	64.5
Payables	(77.5)	(80.2)
	(15.6)	(15.5)
Post-retirement benefit liability	(34.9)	(84.8)
Other provisions	(5.2)	(9.6)
Net borrowings	(10.9)	(17.7)
Corporate and deferred tax	6.1	13.9
Net assets	54.2	5.9

Growth in our workforce, includes contractors used on Xansa accounts

11.8%

Growth in our Indian workforce

29%

The change in non-current assets represents the depreciation charge for the year, partly offset by capital expenditure. Under IFRS, goodwill is no longer amortised but rather is subject to annual review for impairment. There was no impairment in the current year.

Investment in the joint venture of £7.7 million (2006: £8.8 million) represents our 50% investment in NHS Shared Business Services Limited (NHS SBS) with the Department of Health and comprises the share of the joint venture's net assets plus the goodwill arising on investment. The reduction reflects the fact that NHS SBS made a loss in 2007.

Overall working capital reduced by £0.1 million in the year. There were changes to the terms of certain contracts which altered their cash flow profiles. This adversely impacted debtor days but better collection across the accounts has partly mitigated this impact. Debtor days at 27 are eight lower than last year.

The adoption of IAS 19 results in the Group's post-retirement benefit liability being included as a liability in the balance sheet. The net deficit has been reduced from £84.8 million to £34.9 million. This movement was principally attributable to a strengthening in equity markets which increased the value of the pension plan assets, an increase in the levels of contribution above the annual service charge, an increase in corporate bond yields which are used to determine the liability discount rate and the revision of assumptions on pension commutation based on current experience.

*Before share-based payments and exceptional items, but including share of joint venture's loss after tax.

**Before exceptional items.

Renewal rate with our existing client base:

100%

Growth in earnings per share*

19.3%

*Before share-based payments and exceptional items.

Other provisions, representing our supply commitment to the joint venture and liability for vacant property, reduced as a result of their utilisation in the period. Corporate and deferred tax reduced over the period due to the reduction in the post-retirement benefit liability.

Cash flow Underlying operating cash inflow of £24.0 million (2006: £15.3 million), calculated after capital expenditure but before cash flows relating to exceptional items, exceeded the outflows of £6.3 million (2005: £3.9 million) in respect of interest and tax, resulting in operating free cash flow of £17.7 million (2006: £11.4 million).

	2007 £ million	2006 £ million
Operating free cash flow	17.7	11.4
Dividends paid to Xansa shareholders	(8.3)	(7.8)
Exceptional items	(3.1)	(4.1)
Other movements	0.5	(1.4)
Change in net debt	6.8	(1.9)
Net borrowings at start of period	(17.7)	(15.8)
Net borrowings at end of period	(10.9)	(17.7)

The current year exceptional items represent the cash outflow in respect of the Group's vacant properties for which a charge was taken in prior years.

Overall the Group ended the year with net borrowings of £10.9 million (2006: £17.7 million) comprised cash and deposits of £43.9 million (2006: £33.3 million) offset by bank loans and overdrafts of £54.8 million (2006: £51.0 million).

Treasury policy The Group holds financial instruments for two principal purposes. Firstly, to finance its operations and secondly to manage interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flow from operations, short-term borrowings and longer term loans from banks. Derivative financial instruments (principally forward currency contracts) are used in order to manage these currency risks.

The Group's key financial risks encompass liquidity and refinancing risk, interest rate movements and currency exchange rate movements. These risks are managed by the Finance Director under policies approved by the Board, which are summarised below. These policies have remained unchanged since April 2006. A Finance Committee of the Board receives reports on the Group's treasury activities, policies and procedures. The treasury function is not a profit centre and its activities are subject to internal audit.

Non-financial Key Performance Indicators

	2007	2006
Headcount (excluding external contractors)		
UK	3,586	3,794
India	5,038	3,920
People poll		
UK	2.7	2.7
India	2.1	2.2

Headcount, which is a key measure of the level of activity in our business, grew strongly. Our workforce balance has continued to shift towards India and at the year end 62% (2006: 56%) of our salaried employees were based in India. Year end contractor numbers were also lower.

People poll, our annual survey open to all employees, measures the level of engagement our staff have in our business. The survey enables us to gauge the views of our employees on a range of issues and to put in place plans to address their concerns. Results range from 1 (excellent) to 5 (poor) and our aim is to achieve and maintain a score below 2.5.

Principal risks and uncertainties Executive management throughout the Group use a common set of tools to identify, report and manage risk. This process is well-established and reviewed by the Board on a regular basis. The principal risks and the actions taken to mitigate against them are set out below.

Xansa has a long and trusted relationship with its major clients. In the last year 64% of our revenue came from clients that we have worked with for over five years. We have set a strategic objective to broaden our customer base and as noted earlier have had a number of notable successes in this endeavour. Our ongoing account management model seeks to highlight opportunities aimed to enhance our long-term, value adding relationships with our clients.

Most relationships and contracts we enter into are for the long-term and a number involve the delivery of new applications and services. A critical success factor is the provision of a robust project control environment to deliver successful operational and commercial outcomes. We have a well tested governance framework and project reviews are regularly conducted by independent reviewers as well as being subject to management oversight.

Attracting and retaining high quality staff in India and in the UK is critical to our business model. Our recruitment, induction and training programmes aim to increase employee skills and loyalty and the new opportunities created as a result of our growing operations provides a rewarding career environment for staff and ensures attrition does not become unmanageable. Owing to the competitive nature of the offshore industry in India, we actively manage the impact of local wage inflation on operating margins through the mix of onshore and offshore staff, levels of experience and seniority and leveraging our infrastructure cost base.

Liquidity and refinancing risk The Group's policy is to ensure that forecast funding requirements can be met within available committed facilities at a reasonable cost. To do this the Group seeks to arrange committed funding at a variety of maturity dates from a range of sources.

During 2007 Xansa renegotiated its banking facilities and now has in place a revolving credit facility (RCF) of £85 million and a stand-by letter of credit facility of £15 million. In addition, the RCF element of the facility can be increased by up to a further £15 million. The facility, which is for a three-year term, was agreed in early April and became operational on 23 May 2007.

As a consequence, the Group's total indebtedness is shown as a current liability as the facility in place at the balance sheet date was due to expire within one year.

Average Group net debt during the period was £40.3 million (2006: £36.7 million). This represents the net of UK borrowings of £55.4 million (2006: £44.3 million) and sterling equivalent cash balances held in India of £15.1 million (2006: £7.6 million).

Peak UK borrowings during the year were £71.5 million (2006: £63.0 million), which represented 89% of available capacity under the then current facility.

Subsequent to the year end Xansa entered into a framework agreement, the intention of which is to effect the sale and lease back of our property assets in India. This agreement, which will be executed in phases, is expected to raise up to £35 million (before expenses and taxes) which will be used to reduce Group bank borrowings. The timing of each phase is dependent on achieving certain regulatory clearances.

Interest rate movement Interest rate policy has the objective of minimising net interest expense and the protection of the Group from material adverse movements in interest rates. Throughout the year to April 2007, the Group borrowed at floating rates only. The Group had in place an interest rate cap which was purchased in September 2004 and which expired in May 2007. Interest on borrowings of £20.0 million was protected against increases in three-month LIBOR above 5.25% until May 2007.

Surplus cash from operations is invested in short-term bank deposits at market interest rates. Credit risks on bank deposits are minimised by restricting such investment activity to banks which are rated A1 or P1, with a maximum investment limit with any one bank of £20.0 million. Credit risks on derivative financial instruments are limited by the use of counterparty limits.

Credit risk Xansa's customer base predominantly comprises blue-chip companies and public sector entities. The Directors regularly review the creditworthiness of significant customers and credit references are obtained for significant new customers where relevant. The Directors do not consider that the Company is exposed to any significant credit risk.

Currency Although the Group's client base is largely based in the UK, it has a significant investment in India. On translation into sterling, movements can affect the Group balance sheet and income statement. Group policy is to minimise balance sheet translation exposures, where fiscally efficient, by financing working capital in local currency. The Group has transactional currency exposures where sales or purchases by an operating unit are in currencies other than in that unit's functional currency. Where billing arrangements are in foreign currency Group policy is that committed transactional exposures are hedged into the business's functional currency. These hedging transactions have a term of less than a year and do not qualify for hedge accounting under IAS 32/39.

Outlook In a competitive market our first mover advantage in integrated delivery is serving us well, with our onshore/offshore delivery model creating a compelling business case for our clients and differentiating us. We have returned to revenue growth and are confident this can continue. Our orderbank at £549 million is the highest it has been for a number of years.

Our key service lines are aligned to the faster growing segments of the market and we anticipate further contract wins to consolidate our leadership position in these areas. This will help drive continued progress in underlying margins, albeit that the recent fluctuations in the rupee exchange rate may impact the rate of progress.

Our public sector business has continued its rapid progress growing by 56% in the last year. Although this market has seen some slowdown, we expect activity levels to pick up towards the end of 2007. Our track record and demonstrable expertise in providing cost effective solutions mean that we are well placed to continue our success in this market.

The innovative property deal we announced in May will progressively allow us to reduce our level of debt. This will enable new investment in innovative business models such as NHS SBS that will drive future growth.

It has been a year of continuing success in the transition of our business from an onshore IT outsourcing provider to an integrated onshore/offshore business services provider and we continue to view our future and our prospects with confidence.