Contents

Group Review

Financial summary	1998 £000	1997 £000	1996 £000	1995 £000	1994 £000
Turnover	**1,271,978**	863,666	581,470	484,484	366,548
Gross profit	**143,203**	97,935	73,954	63,171	49,867
Operating profit	**26,977**	20,449	16,342	14,182	11,597
Profit before taxation	**18,663**	15,076	12,575	11,320	9,621
Net assets	**132,028**	126,373	62,737	58,363	54,487
Net borrowings	**48,199**	25,240	33,957	22,941	13,745

Other financial information					
Gross margin	**11.3 %**	11.3 %	12.7 %	13.0 %	13.6 %
Operating margin	**2.1 %**	2.4 %	2.8 %	2.9 %	3.2 %
After tax return on equity (Note 1)	**10.0 %**	10.8 %	13.8 %	13.4 %	12.5 %
Basic earnings per share (Note 2)	**21.2 p**	21.2 p	19.8 p	18.0 p	15.8 p
Adjusted earnings per share (Note 3)	**23.5 p**	21.7 p	19.8 p	18.0 p	15.8 p
Dividends per share	**12.0 p**	10.7 p	9.9 p	9.0 p	8.1 p
Dividend cover (times)	**1.8**	1.8	2.2	2.2	2.1
Interest cover (times) (Note 4)	**4.0**	4.1	4.3	5.0	5.9
Gearing	**36.5 %**	20.0 %	54.1 %	39.3 %	25.2 %

Investment summary					
Number of franchises	**153**	118	86	79	72
Number of trading locations	**111**	89	62	51	45
Investment in new businesses £000 (Note 5)	**11,784**	48,562	4,737	6,808	3,895

Note 1 Return on equity is profit after tax as a percentage of average shareholders' funds.

Note 2 Earnings per share have been adjusted to reflect the effects of the 1997 rights issue.

Note 3 Earnings per share adjusted to eliminate the effects of notional interest and goodwill amortisation. Adjusted earnings per share is calculated using an adjusted profit after tax of £14,341,000 (1997 : £10,442,000), being profit after tax of £12,894,000 (1997 : £10,170,000),goodwill amortisation of £453,000 (1997 : £ nil) and notional interest of £1,441,000 (1997 : £397,000) less tax relief on notional interest of £447,000 (1997 : £125,000).

Note 4 Notional interest on deferred consideration has been excluded.

Note 5 Represents the investment at 31 December of new businesses acquired in that year.

Chairman's Statement

Dear Shareholder,

I am pleased to be able to report another year of increased profits for the group. Profits before tax have increased by 23.8 percent to £18.7 million from £15.1 million last year. Earnings per share of 21.2 pence are the same as for 1997. These good results have been achieved during a year of great market volatility and continued expansion of the group.

Your Board recommends a final dividend of 8.0 pence per share. Together with the increased interim dividend of 4.0 pence per share it makes a total of 12.0 pence per share compared to 10.7 pence per share in 1997. This represents an increase of 12.1 percent over 1997.

Ongoing investments in new businesses during the year culminated with our offer to purchase Evans Halshaw Holdings plc, which was completed in February 1999. The Evans Halshaw portfolio of dealerships is complementary, both geographically and in terms of brands sold. We believe that the acquisition represents a major step forward in implementing our chosen strategy for developing Market Areas and enhancing our portfolio of Boutique dealerships. We are already in the process of integrating the new business and are working towards reducing our gearing, which increased considerably as a result of the acquisition.

Registrations of new cars in the UK market in 1998 were up by 3.5 percent over 1997. However, the second half of the year saw a reduction of almost 5 percent compared to the same period of 1997. The reduction in the market in the second half led to more difficult trading conditions than had been anticipated when we announced our interim results in September. We are taking a cautious stance in respect of trading conditions for 1999 given the decline in new car registrations in the UK market in the first two months and the effect of two registration plate changes for the first time this year.

We have had another year of great change in our group and without the hard work and dedication of all our team members we would not have been able to achieve these good results for 1998. My colleagues on the Board and I again extend our thanks for their efforts over the year.

Sir Nigel Rudd
Chairman
26 February 1999

Chief Executive's Report

Trading The first half year's trading saw a rising new car market, while the second half saw year on year new car sales decline. Despite this, we managed to increase gross profits in both Market Area and Boutique businesses. The major area of growth in gross profits was in the Market Area businesses, which saw an increase of 96 percent over 1997. The Boutique businesses improved gross profits by 17 percent. Profitability in our contract hire business fell primarily as a result of a reduction of values in the used car market. The table below shows the gross profit contribution level by business type.

Gross profit table	1998 £m	1997 £m	% change
Market Areas	**74.7**	38.1	+96
Boutique businesses	**63.4**	54.2	+17
Contract hire	**5.1**	5.6	-9
Total	**143.2**	97.9	+46

Ten new greenfield sites were added during the year and contributed gross profits of £2.4 million. However, because of the relatively high fixed costs compared to activity level in these immature businesses they made an operating loss of £1.1 million.

Market Area Businesses The Market Area approach continues to be the major retailing trend in the industry and the group is firmly at the forefront of its development. Manufacturers are continuing to grant larger territories to key retailers, with one of the main benefits being that they allow retailers to reduce costs. Cost reductions by economies of scale are obtained through adjacent territories of the same manufacturer being managed by one retailer.

This approach typically operates on a hub and spoke principle, with each area usually comprising a fully integrated main dealership providing full sales and other services, together with a number of smaller satellite locations. In addition to operating Market Areas with Fiat, Ford, Vauxhall and Volvo, with the acquisition of Evans Halshaw Holdings plc we have been able to scale up our Peugeot business and create a fifth Market Area business.

Due to the time taken to assemble them, Market Areas reach profitability at a later stage than stand alone dealerships. When a Market Area is complete it is then possible to aggressively take out costs. Reductions are achieved through reduced fixed asset investment requirements, reduced working capital, improved gross margin control and reduced overhead and marketing costs.

• **The Fiat Group** The business has expanded significantly in 1998 with turnover rising to £123 million from £95 million in 1997. We have added four new sites within our Greater London Market Area at Chertsey, Croydon, Islington and Camberwell. This now completes the project in terms of sites and allows us to focus on reducing costs. In line with our strategy of taking costs out we are currently relocating certain administrative process jobs to a lower cost location outside the Market Area. In addition, with the benefit of new technology we have been able to reduce the resource required to perform some of these functions. The business made a small contribution at operating profit level in 1998.

• **The Ford Group** The Ford business has grown significantly in 1998 with turnover of £204 million which is up from £81 million in 1997. Of the five Market Areas operated only two are currently complete. These are Thames Valley, completed in 1997 and North West Home Counties completed by the addition of the Aylesbury hub site in 1998. A satellite was added to the Poole Market Area at Dorchester in 1998. An additional satellite will be added in each of the Lincoln and Poole areas to complete those in 1999. Our largest Market Area in North London has been operating in 1998 without a final hub site, which is scheduled to open in July 1999 at Edgware. A satellite at Finchley was added during 1998.

• **The Vauxhall Group** Turnover in the Vauxhall businesses was £245 million in 1998 with no comparative available for 1997 as we acquired the businesses in October 1997. One satellite was added in each of the Manchester and Bedford Market Areas during the year. In 1998 we completed changes to leadership teams as well as rationalising and reorganising the businesses as planned. The performance of the dealerships has continued to improve throughout the year as more profitable business has been transacted and costs have been reduced.

Chief Executive's Report *continued*

• **The Volvo Group** Turnover in the Volvo businesses dropped to £64 million in 1998 from £85 million in 1997. This was principally due to a reduction in new car volumes. As a consequence both new and used profits per unit were down on last year. The Volvo business made a small loss in 1998.

Boutique Businesses Our Boutiques are single point dealerships which typically sell lower volumes with brands that offer above average profit potential. We continued to expand this area of our business in 1998.

• **BMW** Turnover rose to £169 million in 1998 from £114 million in 1997. Two new BMW dealerships were acquired in February 1998 at Slough and Maidenhead. In addition, we set up a new Land Rover site at Ashford, Middlesex.

• **Jaguar /Aston Martin** Turnover increased to £124 million in 1998 from £122 million in 1997. Trading continued to be good in the UK. Our dealerships in Germany moved ahead well in the year with good growth in terms of turnover and profitability.

• **Mercedes-Benz** Turnover reduced to £94 million in 1998 from £107 million in 1997. Mercedes-Benz continued to contribute strongly to the group performance in 1998.

• **Porsche / Ferrari** Turnover increased to £53 million in 1998 from £48 million in 1997. The performance of the businesses was ahead of the previous year.

• **Motorbikes** Turnover increased to £19 million in 1998 from £8 million in 1997. Activity within the Motorbike division increased with the addition of four further dealerships in the year.

• **Others** Turnover of other businesses was £177 million in 1998 compared to £122 million in 1997. Included in other businesses are Peugeot dealerships which have been formed into a new Market Area group this year following the addition of six new dealerships as part of the Evans Halshaw Holdings plc acquisition in February 1999.

Contract Hire Gross profits fell to £5.1 million in 1998 from £5.6 million in 1997. This was mainly due to lower used car market prices. The fleet size increased to 11,400 in 1998 from 10,700 in 1997.

Acquisition of Evans Halshaw Holdings plc In February 1999 we completed the acquisition of Evans Halshaw Holdings plc. Evans Halshaw had been pursuing a similar strategy to Pendragon, in particular with its emphasis on Market Areas and Boutique businesses. The deal places Pendragon at the forefront of consolidation in the industry with benefits set to accrue to both manufacturer and retailer by having bigger and fewer partners.

Benefits that have been gained by the acquisition include economies of scale in terms of information technology application and working capital management and the elimination of certain duplicate costs associated with public company status as well as ongoing reductions in overhead costs. Evans Halshaw is a good geographical and brand fit, which as well as giving increased scale with manufacturers also allows us to create greater efficiencies in our franchise focused groups, with little overlap of franchise points. One additional group has been formed for Peugeot, which now has sufficient scale to warrant brand focused representation. This takes the number of our Market Area businesses to five.

Manufacturer reaction has been very encouraging and we will be working very closely with them where restructuring of the portfolio is required and where we plan to make selected disposals. The enlarged group is the market leader by turnover and is well positioned for further growth.

Chief Executive's Report *continued*

Prospects We will continue to develop our twin track approach of Boutique and Market Area businesses and strengthen our relationships with manufacturers who are seeking a brand focused approach. The Evans Halshaw integration is being undertaken by our team of Franchise Group Leaders who have already made progress towards incorporating the newly acquired businesses into the established franchise group structure of the company. Putting Evans Halshaw's franchises within this brand focused operating structure will also offer franchisees a more focused approach to the market and clearer lines of communication with the manufacturer.

As a result of this reorganisation within the enlarged group it is anticipated that the scale benefits will begin to yield an immediate benefit to profitability and cash generation. Relationships with manufacturers continue to improve as the company consolidates its number of trading partners and offers a brand focused approach.

We expect the 1999 new car market to be weaker than in 1998, with the phasing of activity difficult to predict because of the new system of two registration plate changes, in March and September. Although the market is likely to remain competitive the group is well positioned as the leading player in the sector. We will be concentrating for the remainder of the year on reducing our gearing to acceptable levels by continuing good working capital management and instituting a programme of selected disposals. Looking further ahead we will reduce our cost base through economies of scale and the application of information technology now at our disposal as a result of the acquisition of Pinewood Computers in September 1998.

With a consolidation now taking place in car distribution, our leading position and strong manufacturer relationships put us in a strong position to be able to continue the group's growth.

Trevor Finn
Chief Executive
26 February 1999

Finance Director's Report

Analysis of results Turnover rose by £408.3 million to £1,272.0 million in 1998 from £863.7 million in 1997. Operations either acquired or commenced during the year accounted for turnover of £94.2 million and businesses disposed of accounted for turnover of £28.2 million.

Gross profits rose by £45.3 million to £143.2 million in 1998, up from £97.9 million in 1997. The gross profit margin for the year remained static at 11.3 percent. Market area businesses accounted for 52 percent of dealership gross profits in 1998 compared to 39 percent in 1997.

Operating profit rose by £6.6 million to £27.0 million in 1998 from £20.4 million in 1997. Operating margin decreased to 2.1 percent from 2.4 percent the previous year. A number of factors have led to the decrease in operating margin. The ten greenfield sites opened during the year made an operating loss of £1.1 million in 1998 on turnover of £23.3 million. In addition, greenfield sites opened in 1997, along with incomplete and immature market areas, are not, as yet, contributing to their full earnings potential. A further reduction in operating margin arose in 1998 due to the application of Financial Reporting Standard No. 10 which requires goodwill arising on acquisitions during the year to be capitalised and amortised over its useful life. The effect of the goodwill amortisation was to reduce 1998 operating profit by £0.5 million.

Average borrowings rose during the year mainly due to acquisitions in 1998 and the payment of deferred consideration on businesses acquired in 1997. As a consequence, the interest charge rose by £2.7 million to £8.1 million in 1998 from £5.4 million in 1997. Notional interest on deferred consideration amounting to £1.4 million is included in the interest charge in accordance with Financial Reporting Standard No. 7. Interest cover for 1998 was 4.0 times, which is slightly down on the 4.1 times reported in 1997. The interest cover is calculated after adjusting for notional interest.

The loss on disposal of fixed assets during the year was £0.2 million. This arose principally on the sale of the Motown business in May 1998.

The tax rate for the year was 31.0 percent against 32.6 percent in 1997. The reduction in part reflects the benefit of a lower rate of statutory corporation tax for the full year.

Reported earnings per share for 1998 remained the same as 1997 at 21.2 pence. However, after adjusting for the effects of notional interest and goodwill amortisation, the 1998 figure is 23.5 pence compared to 21.7 pence for 1997. This represents an increase of 8.3 percent.

Cash flow and financing Operating cash inflow was £27.4 million in 1998 compared to £4.3 million in 1997. This improvement is due to a combination of higher profits, reduced requirement to inject working capital into new businesses and greater focus on working capital management. Net capital expenditure was £14.8 million in 1998 compared to £12.2 million in 1997. Acquisitions, net of disposals, in the year amounted to £18.6 million which comprised mainly the two BMW businesses acquired in February 1998 and the second instalment of consideration payable for the Ford and Vauxhall businesses acquired in 1997, offset by the sale of the Motown business. The Group also acquired Pinewood Computer Holdings Limited in September 1998.

Borrowings at 31 December 1998 were £48.2 million. This compares to £25.2 million at 31 December 1997. Gearing has increased to 37 percent at 31 December 1998 from 20 percent at 31 December 1997.

The acquisition of Evans Halshaw Holdings plc, which was completed in February 1999, has considerably increased the gearing of the group. Pro forma gearing of the enlarged group as at 31 December 1998 was 118 percent. The group is well financed by committed medium term bank facilities and longer term borrowings in the US Private Placement market. We expect that interest cover will remain comfortable and that the strong operating cash flow of the group, combined with improved working capital efficiency and selected disposals, should allow borrowings to be reduced to a comfortable level by the end of the year.

David Forsyth
Finance Director
26 February 1999

Directors and Advisers

Sir Nigel Rudd (52) Non-executive Chairman
Appointed non-executive chairman of Pendragon in October 1989 prior to the demerger from Williams PLC, where he is executive chairman. He is non-executive chairman of Pilkington PLC, and a non-executive director of Barclays Bank PLC.

Neil Hannah (61) Non-executive Director
Joined Pendragon in August 1993. He is executive chairman of Innes England Limited, commercial property surveyors, and is non-executive deputy chairman of the Derbyshire Building Society.

Thomas Neville (67) Non-executive Director
Joined Pendragon in October 1989. He was formerly finance director of Vickers PLC and Rolls-Royce Motors Limited. He is also a director of a number of private companies. Mr Neville intends to retire as a director on 31 December 1999.

William Rhodes (60) Non-executive Director
Joined Pendragon in October 1989 prior to the demerger from Williams PLC, where he is a non-executive director. He is also a director of a number of private companies. Mr Rhodes is the senior independent non-executive director of the company.

Trevor Finn (41) Chief Executive
Joined the vehicle division of Williams PLC in 1982 and subsequently became divisional managing director. He was appointed chief executive of Pendragon prior to the demerger from Williams.

Martin Casha (38) Operations Director
Joined the vehicle division of Williams PLC in 1982 and subsequently became a group general manager. He was appointed operations director of Pendragon in September 1995.

David Forsyth (42) Finance Director
Joined in October 1997 from Lonrho PLC where, since 1986, he held a number of senior finance positions. He is a chartered accountant.

Stephen Hopewell (39) Operations Director
Joined the vehicle division of Williams PLC in 1987 and subsequently became a group general manager. He was appointed operations director of Pendragon in August 1993.

Secretary
Hilary Sykes

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Report of the Directors

The directors present their annual report and the audited financial statements for the year ended 31 December 1998.

Results and dividends The results of the group for the year are set out in the financial statements on pages 18 to 34. The directors recommend a final dividend for the year ended 31 December 1998 of 8.0 pence per ordinary share which, together with the interim dividend of 4.0 pence per share paid to shareholders on 9 October 1998, will make a total for the year of 12.0 pence per share. Subject to approval at the Annual General Meeting, the final dividend will be paid on 29 April 1999 to shareholders appearing on the register at the close of business on 26 March 1999. Total dividends amount to £7,316,000 leaving retained profits for the year of £5,578,000. Movements in reserves are set out in note 22 to the financial statements.

Principal activities Pendragon's principal activities throughout the year were the sale of new and used vehicles, contract hire and after sales services.

Review of operations A review of the group's activities and future developments is presented by the chief executive on pages 3 to 5. The dealership network has been extended by the businesses acquired during the year ended 31 December 1998 set out below:

Business	Location	Franchise	Date of Acquisition
Arbury Service Station	Nuneaton	Peugeot	19 January 1998
Altwood	Maidenhead	BMW	10 February 1998
	Slough	BMW	
Stratton	Eccles	Vauxhall	2 March 1998
Hamiltons Powersports	Streatham	Honda Motorcycles	8 June 1998
		Kawasaki	
		Suzuki Motorcycles	
		Yamaha	
		Piaggio	
Dorchester Ford	Dorchester	Ford	17 May 1998
Watkin	Biggleswade	Vauxhall	15 June 1998
Motex	Worcester	Harley Davidson	3 August 1998
Gainsborough Ford	Gainsborough	Ford	3 August 1998

In addition, the group acquired Pinewood Computer Holdings Limited, supplier of the group's principal dealer management software and systems, on 4 September 1998.

Directors The directors of the company are listed on page 7. In accordance with the Articles of Association of the company, Mr W W Rhodes, Mr T G Finn and Mr S N Hopewell retire by rotation and, being eligible, offer themselves for re-election. Mr Rhodes has a service contract with the company for two years from 1 January 1999. Mr Finn has a service contract with the company with a notice period and an unexpired period of service of two years. Mr Hopewell has a service contract with the company with a notice period and an unexpired period of service of six months. The retiring non-executive director does not have a notice period. Details of directors service contracts are included in the Report on Remuneration on page 13.

Year 2000 The group is currently undertaking a thorough review of all its computer and ancillary equipment to ensure year 2000 compliance. A millennium project team has been formed to review internal and external systems and regularly report to the board. The group's main dealer management systems are certified by their suppliers as being year 2000 compliant. Other minor systems are under review. All major suppliers have been asked to provide certificates of compliance for year 2000. Current indications are that the costs of year 2000 compliance will not be material. Systems upgrade and retraining costs are written off to the profit and loss account as incurred.

Report of the Directors *continued*

Substantial shareholdings At 24 February 1999 the directors had been advised of the following interests in the shares of the company.

Shareholder	Shares	%
Jupiter Asset Management Limited	6,567,776	10.8
Robert Fleming Holding Limited	5,301,601	8.7
National Westminster Bank	5,008,487	8.2
Prudential Corporation group of companies	4,433,905	7.3
Standard Life Investments	4,171,556	6.8
Aberforth Smaller Companies Trust Plc	3,628,232	6.0
Schroder Investment Management Limited	2,818,935	4.6
Legal & General Investment Management Limited	2,650,896	4.3

Employee involvement The group recognises the importance of good communications and relations with employees, as its ability to meet the needs of its customers in a profitable and competitive manner depends on the contribution of employees throughout the group. Employees are encouraged to develop their contribution to the business wherever they work. In many areas ongoing programmes, focused on quality and customer service, provide an opportunity for everyone to be involved in making improvements. Financial participation is further encouraged through a variety of bonus schemes which provide employees with rewards linked to the growth and prosperity of the business. In addition, the company communicates with its employees about its activities through a variety of channels.

Involvement also extends to the board of directors of Pendragon Pension Trustees Limited, the corporate trustee of the company's retirement and death benefits scheme, on which there are two employee representatives.

Disabled persons The group recognises its responsibilities in employing and training disabled persons and employs a number of people who are disabled, not all of whom are formally registered disabled persons in UK terms. If any employee becomes disabled it is standard practice, in all but the most extreme circumstances, to offer an alternative job and provide retraining where necessary.

The group makes every effort to ensure that disabled persons receive equal opportunities and are not discriminated against on the grounds of their disability.

Donations Charitable donations amounted to £4,940. No political donations were made.

Payments to suppliers The group's policy, in relation to all of its suppliers, is to settle the terms of payment when agreeing the terms of the transaction and to abide by those terms (provided that it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions). The group does not follow any code or standard on payment practice.

The number of days' purchases outstanding for payment by the group at 31 December 1998 was 22 days (1997 : 24 days). The company had no trade creditors.

Auditors A resolution to re-appoint KPMG Audit Plc as auditors will be proposed at the Annual General Meeting.

By order of the Board
H C Sykes
Secretary
26 February 1999

Corporate Governance

Compliance In June 1998, the Stock Exchange published the Principles of Good Governance and Code of Best Practice ("the Combined Code") which embraces the work of the Cadbury, Greenbury and Hampel Committees and became effective in respect of accounting periods ending on or after 31 December 1998.

The board of directors have complied throughout the year with the Combined Code except where described below.

Board of directors The Board of directors, comprising four executive and four non-executive directors, meets regularly throughout the year. Brief biographical details of each of the directors appear on page 7. Each of Sir Nigel Rudd, Neil Hannah, William Rhodes and Thomas Neville is considered by the Board to be independent of the company. Mr William Rhodes is recognised as the senior independent director. There is a clear separation of the functions of chairman and chief executive. The Board is responsible for overall group strategy, acquisition and divestment policy, approval of major capital expenditure projects and consideration of significant financing matters. It reviews the strategic direction of individual trading businesses, their annual budgets and their progress towards achievement of those budgets. The Board meets bi-monthly and has adopted a structure for its meetings which is reflected in the standing agenda. Between meetings, monthly information packs are circulated to directors, with similar contents. At least one third of the Board is required to retire from office by rotation at the Annual General Meeting. Whilst, in practice, each director has offered himself for re-election at least once every three years in line with the provisions of the Code, the company intends at the next available opportunity to revise its articles of association so as more accurately to reflect the Code provisions on re-election of directors. Certain of the Board's duties are delegated to committees of the Board, whose responsibilities and composition are set out below.

Remuneration and Nominations Committee The chairman of the committee is Sir Nigel Rudd. The committee is composed of the non-executive directors of Pendragon and meets at least once a year. It has written terms of reference which include making recommendations to the Board concerning the appointment of directors. The committee has responsibility for determining the remuneration packages of the executive directors in the context of the policy adopted by the Board and approving the report of the directors on remuneration. The Report on Remuneration is set out on pages 13 to16 below.

Audit Committee The chairman of the committee is Mr T Neville. The committee is composed of the non-executive directors of Pendragon and is attended, by invitation, by the finance director and representatives of the company's internal and external auditors. It meets at least three times each year. The committee's terms of reference have been revised during the year and its responsibilities include the following:

- To oversee the group's approach to internal control risk management
- To review the proposed financial statements of the company prior to publication
- To make recommendations to the Board concerning the appointment or re-appointment of auditors and their fees
- To review the scope and results of the audit
- To monitor and review the activities of the internal and external auditors, receive reports thereon and address any control weaknesses identified.

Corporate Governance *continued*

Information and advice The directors regularly receive financial and other information concerning the group's activities and performance. Each director is entitled on request to receive information to enable him to make informed judgements and adequately discharge his duties and has access to the advice and services of the company secretary on all matters of Board procedure. The directors also have an express entitlement in their terms of appointment, at the company's expense, to take independent professional advice in connection with their duties. Although no formal training programme exists, all directors are encouraged to maintain an awareness of new developments in the areas of the group's principal activities and attend appropriate briefings throughout the year. Where necessary, directors have access to professional training on matters relating to their Board or committee functions. The directors are expected to bring to bear an independent judgement on issues of strategy, performance, resource and standards of conduct. The Board includes individuals from various backgrounds with many years' experience of senior positions in listed companies.

Shareholder relations The Board is always prepared, where practicable, to enter into dialogue with institutional shareholders based on mutual understandings of their respective objectives and being mindful of the company's obligations under the Listing Rules of the London Stock Exchange. The respective chairmen of the Audit Committee and the Remuneration and Nominations Committee are available to answer shareholders' questions at the Annual General Meeting.

Internal control The Combined Code has introduced a new requirement, that the directors review the effectiveness of all internal controls, not only internal financial controls as previously. This extends the review to cover all controls including:

- financial
- operational
- compliance; and
- risk management

Whilst the Board is ultimately responsible for the group's system of internal controls and for monitoring its effectiveness, formal guidance as to the review of non-financial internal controls, as required by the Combined Code, has yet to be published. Consequently, the directors consider that they are unable to report that they have undertaken during the year a formal review of the effectiveness of the group's system of non-financial internal controls as envisaged by the Combined Code.

A Task Force has been established by the ICAEW to develop guidance on internal control. The Board will seek to ensure that the group is compliant with such guidance when it is issued.

However, the directors have continued to follow existing guidance and have reviewed the effectiveness of the group's internal financial control system during the financial year ended 31 December 1998 in relation to the Criteria for assessing effectiveness described in "Internal control and financial reporting" issued by the Working Group on Internal Control in December 1994. This involved considering a report summarising the reviews and monitoring work carried out by the internal audit team.

The internal control systems are designed to meet the group's particular needs and the risks to which it is exposed, and by their nature can only provide reasonable but not absolute assurance against misstatement or loss.

The key components designed to provide effective internal control within the group are set out below.

• **Management structure** Pendragon is a large multi-site multi-franchise retailer of motor vehicles and ancillary services operating through a franchise grouping structure. Each franchise group head participates in a monthly operational meeting attended by an operations director. Finance, legal, personnel and other disciplines are also represented.

• **Financial reporting** There are comprehensive management reporting disciplines which involve the preparation of financial plans by all operating units. The plans are reviewed by executive management and are subsequently passed to the Board for approval. Monthly actual results are reported against the approved plans.

• **Investment appraisal** The group has a clearly defined framework for capital expenditure including appropriate authorisation levels beyond which such expenditure requires the approval of the executive directors and, for larger capital projects and acquisitions, the Board. There is a prescribed format for capital expenditure applications which places heavy emphasis on the commercial and strategic logic for the investment, and demands a detailed financial presentation of the business case. As a matter of routine, projects are also subject to post-investment appraisal after an appropriate period.

• **Functional reporting** The group has identified a number of key areas which are subject to periodic reporting to the Board. These include treasury operations, corporate taxation matters and value added tax. Other areas are given particular emphasis through the operation of appropriately constituted teams which meet regularly. These include information strategy and risk management, the latter including legal and insurance matters.

• **Internal audit** The group has an internal audit function with a team responsible to the group internal audit manager. The scope of internal audit covers a wide variety of operational matters and, as a minimum, ensures compliance with the group's standard accounting and financial reporting policies. The group internal audit manager has a dual reporting responsibility to operational management and to the Audit Committee. The direct reporting route to management ensures that appropriate actions are taken quickly and can be reported back to the Audit Committee. The work of the internal audit team encompasses all businesses within the group and is directed towards higher risk areas and includes reviews of the integrity of monthly reporting, monitoring of adherence to group operating and financial procedures and reviews of major projects undertaken by the group.

Going concern The directors are satisfied that the group is in a sound financial position with adequate resources to continue in operation for the foreseeable future. In forming this view, the directors have reviewed budgets and other financial information. The financial statements of the group have therefore been prepared on the basis that the group is a going concern.

Business at the Annual General Meeting The annual report and the financial statements of the company are despatched to shareholders, together with a letter from the chairman and Notice of the Annual General Meeting, giving the requisite period of notice, being not fewer than 20 working days before the date of the Annual General Meeting. The chairman's letter contains a summary of the business at the Annual General Meeting, at which a separate resolution is being proposed for each substantive matter. The results of votes taken on a poll will be declared at the Annual General Meeting (or any adjournment thereof). Where a vote is taken on a show of hands, the chairman of the meeting will also disclose the level of proxies received for and against the resolution and any abstentions.

Report on Remuneration

Compliance In the view of the Board, the company has throughout the year complied with the relevant provisions of the Combined Code, except where described below. In framing the company's remuneration policy, full consideration has been given to those provisions and the recommendations of the Remuneration and Nominations Committee ("the Remuneration Committee"), which consists solely of the non-executive directors and operates in accordance with the Code.

Remuneration policy The remuneration policy recognises the need to attract and retain executive directors with levels of remuneration that are arrived at responsibly and reward them fairly, when compared with similar organisations. Salaries are set to ensure that directors are motivated to achieve high levels of performance.

Service contracts Each executive director has a service contract with the company. The executive directors' service agreements contain provisions regarding remuneration, holiday and sick pay entitlements, restrictions and disciplinary matters. Executive directors other than the Chief Executive have six month rolling notice periods. The notice period for the termination of the Chief Executive's service agreement is two years. The availability of service contracts on two-year rolling terms for directors in similar positions to Mr Finn in comparator organisations is widespread. Having regard to these market conditions, the Board considers it both appropriate and reasonable to have a two year notice period in Mr Finn's case and that it is neither in the company's nor shareholders' interests to reduce this. In accordance with the terms of the executive directors' service agreements, compensation for early termination is limited to liquidated damages equivalent to the emoluments (excluding bonus but including provision of other benefits) for the unexpired period of notice. This would be in full and final settlement of all claims other than in respect of share options and pension arrangements. Each non-executive director has a service contract with the company providing for appointment for a two year period with no notice periods required by either party. The appropriateness of re-appointments of non-executive directors is reviewed by the Board.

Salaries Salaries are reviewed annually by the Remuneration Committee as from 1 January each year. Executive directors also receive further benefits which include two cars, one of which is fully expensed, and private health care. The Remuneration Committee may recommend that the company makes additional payments to executive directors each year in the form of a discretionary bonus. When considering whether or not to recommend any such payment, the Committee takes into account the individual performance of the director over the immediately preceding financial year. The salary, together with any bonus, is the only pensionable element of the executive directors' remuneration packages. Fees for non-executive directors are agreed by the Board. Awards of bonus are limited to 70 percent of the director's salary for outstanding performance and, when made, have typically been at levels of between 10 and 30 percent of salary. These levels are not such as to render the total remuneration unreasonable or excessive in the context of the company's sector. The Combined Code Schedule A requires that in general, annual bonuses should not be pensionable. However, the Board regards the bonus element as an important motivational and retention feature of the executive directors' remuneration packages. If awarded, bonuses come to be regarded by directors as part of their on target earnings and for this reason are treated as pensionable.

Share option scheme The Pendragon Executive Share Option Scheme ("the Scheme") is an Inland Revenue approved scheme adopted by the company in 1989. In accordance with its terms, employees (including executive directors) may receive options at current market value. Options are exercised, subject to the achievement of certain criteria relating to the performance of earnings per share, between three and ten years after grant.

Report on Remuneration *continued*

Details of options held by directors are shown below.

	Number of options At 31.12.97	Exercised during year	At 31.12.98	Exercise price (pence)	Exercise Period
Sir Nigel Rudd	-	-	-	-	- -
T G Finn	-	-	5,887*	293.00	01.07.2003 to 31.12.2003
M S Casha	35,492	-	35,492	295.84	29.04.1997 to 28.04.2004
D R Forsyth	-	-	5,887*	293.00	01.07.2003 to 31.12.2003
N G Hannah	-	-	-	-	- -
S N Hopewell	27,533	-	27,533	170.95	11.10.1994 to 10.10.2001
	50,703	-	50,703	295.84	29.04.1997 to 28.04.2004
T Neville	-	-	-	-	- -
W W Rhodes	-	-	-	-	- -
Total	113,728	-	125,502		

*Options granted under the Pendragon 1998 Sharesave Scheme.

The middle market price of Pendragon PLC ordinary shares at 31 December 1998 was 153.5 pence, and the range during the year was 126.0 pence to 312.5 pence.

Details of all share options granted during the year are set out in note 21 to the financial statements on page 31 below.

The Remuneration Committee has reviewed the appropriateness of the Scheme, which expires in November 1999. The Board considers that it is appropriate and beneficial to the group and its shareholders to renew the Scheme and has recommended the adoption of replacement executive share option schemes, one of which is to be an Inland Revenue approved scheme, and the other an unapproved scheme in accordance with current practice. These are referred to below as "the New Schemes". The adoption of the New Schemes requires the approval of the shareholders and there is included in the special business to be proposed at the Annual General Meeting a resolution for the approval of the New Schemes. Details of the New Schemes and resolution are set out in the separate letter from the Chairman to shareholders and Notice of Annual General Meeting enclosed with this report.

Report on Remuneration *continued*

Directors' remuneration

	Salary/ fees	Bonus	Benefits	Total emoluments excluding pensions		Pension contributions	
				1998	1997	**1998**	1997
	£000	£000	£000	**£000**	£000	**£000**	£000
Executive directors							
T G Finn	330	65	21	**416**	328	**40**	54
M S Casha	135	30	14	**179**	126	**15**	21
D R Forsyth	95	20	21	**136**	24	**9**	3
S N Hopewell	135	-	14	**149**	128	**15**	21
Non-executive directors							
Sir Nigel Rudd	60	-	16	**76**	60	-	-
N G Hannah	25	-	11	**36**	25	-	-
T Neville	25	-	-	**25**	25	-	-
W W Rhodes	12	-	13	**25**	25	-	-
Former executive director							
I Wheeler (resigned 1 October 1997)	-	-	-	-	70	-	21
Total 1998	817	115	110	**1,042**	-	**79**	-
Total 1997	769	-	42	-	811	-	120

The benefits provided are made up of cars and fuel, a contribution to home telephone, private medical insurance, and, in the case of Mr Forsyth, professional subscriptions and relocation expenses.

In addition to services as non-executive director, Mr Hannah provides commercial property advice to group companies under a retainer arrangement. In 1998 he earned benefits to the value of £11,193 in the form of the provision of a car under this arrangement.

Pension rights The assets of the Pendragon Pension Plan established for the benefit of the group's eligible employees are held separately from those of the group by trustees. The Plan operates through a trustee company of which Mr W W Rhodes is chairman. The management of the Plan's assets is delegated to a specialist independent investment manager and there is no investment of Plan assets in shares of Pendragon PLC. The executive directors participate on a non-contributory basis in the Pendragon Pension Plan.

Pension benefits earned by the directors:

	Pension earned at the year end	Pension earned in the year	Pension entitlement transfer value for the year
	£000	£000	£000
Executive directors			
T G Finn	93	18	213
M S Casha	23	2	22
D R Forsyth	2	1	5
S N Hopewell	21	2	21

Report on Remuneration *continued*

The pension benefits shown are those which would be paid annually on retirement, based on service to 31 December 1998. The benefits do not allow for any retained benefits which the directors may have relating to previous employment. The increase in the accrued pension for the year ended 31 December 1998 excludes the statutory revaluation of the accrued pension at December 1997.

The transfer values have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and exclude directors' contributions.

In the case of D R Forsyth the pension benefits are based on his pensionable salary limited by the Inland Revenue earnings "cap" imposed by the Finance Act 1989 (currently £87,600 per annum).

Members of the scheme have the option to pay Additional Voluntary Contributions. Neither the contributions nor the resulting benefits are included in the above table.

D R Forsyth received an additional service credit during the year in respect of a transfer of funds from a previous employer's arrangement. This has been excluded from the above figures.

The increase in accrued pension during the year excludes any increase for inflation.

Directors' Interests The interests of the directors and those of their families in the shares of the company (all of which were beneficial) at 31 December 1998 were as set out below:

	31 December 1998 Shares	31 December 1997 Shares
Sir Nigel Rudd	798,610	572,610
T G Finn	801,251	600,251
M S Casha	71,000	20,000
D R Forsyth	87,995	5,595
N G Hannah	72,000	31,000
S N Hopewell	16,000	16,000
T Neville	40,000	40,000
W W Rhodes	252,669	238,669

There were no changes to the directors' interests above between 31 December 1998 and the date of this report.

Directors' Responsibilities Statement

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and the group will continue in business.
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Auditors' Report to the members of Pendragon PLC

We have audited the financial statements on pages 18 to 34.

Respective responsibilities of directors and auditors The directors are responsible for preparing the Annual Report including, as described above, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

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. 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 or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We review whether the statement on pages 10 to 12 reflects the company's compliance with those provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the company's corporate governance procedures or its internal controls.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 December 1998 and the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor

26 February 1999

Consolidated Profit and Loss Account

Year ended 31 December 1998

	Notes	1998 £000	1997 £000
Turnover	2,3		
Existing operations		**1,201,068**	863,666
Acquisitions		**70,910**	-
		1,271,978	863,666
Cost of sales	3	**(1,128,775)**	(765,731)
Gross profit		**143,203**	97,935
Net operating expenses	3	**(116,226)**	(77,486)
Operating profit	3,4		
Existing operations		**24,789**	20,449
Acquisitions		**2,188**	-
		26,977	20,449
Loss on disposal of fixed assets		**(239)**	-
Profit on ordinary activities before interest		**26,738**	20,449
Net interest payable	7	**(8,075)**	(5,373)
Profit on ordinary activities before taxation		**18,663**	15,076
Taxation	8	**(5,769)**	(4,906)
Profit for the financial year		**12,894**	10,170
Dividends	9	**(7,316)**	(5,725)
Retained profit for the financial year	22	**5,578**	4,445
Earnings per ordinary share	10	**21.2p**	21.2p
Diluted earnings per ordinary share	10	**21.1p**	21.1p

All amounts relate to continuing operations.

Movements in reserves are shown in note 22.

The notes on pages 23 to 34 form part of these financial statements.

Consolidated Balance Sheet

At 31 December 1998

	Notes	1998 £000	1997 £000
Fixed assets			
Intangible assets	12	**5,606**	-
Tangible assets	13	**108,877**	104,501
		114,483	104,501
Current assets			
Stocks	15	**207,880**	159,486
Repurchase commitments	16	**84,349**	69,270
Debtors	17	**73,018**	66,423
Cash at bank and in hand		**1,150**	2,067
		366,397	297,246
Creditors: amounts falling due within one year	18	**(261,910)**	(209,257)
Net current assets		**104,487**	87,989
Total assets less current liabilities		**218,970**	192,490
Creditors: amounts falling due after more than one year	19	**(86,362)**	(64,916)
Provisions for liabilities and charges	20	**(580)**	(1,201)
Net assets		**132,028**	126,373
Capital and reserves			
Called up share capital	21	**15,242**	15,242
Share premium account	22	**74,697**	74,697
Other reserves	22	**9,331**	9,331
Profit and loss account	22	**32,758**	27,103
Equity shareholders' funds		**132,028**	126,373

Approved by the Board of Directors on 26 February 1999 and signed on its behalf by:

T G Finn
Chief Executive

D R Forsyth
Finance Director

The notes on pages 23 to 34 form part of these financial statements.

Consolidated Cash Flow Statement

Year ended 31 December 1998

	Notes	1998 £000	1997 £000
Cash flow from operating activities	24	**27,432**	4,268
Interest received		**539**	13
Interest paid		**(7,346)**	(4,883)
Returns on investments and servicing of finance		**(6,807)**	(4,870)
Taxation		**(3,404)**	(4,420)
Payments to acquire tangible fixed assets		**(36,051)**	(33,533)
Receipts from sales of tangible fixed assets		**21,263**	21,344
Capital expenditure and financial investment		**(14,788)**	(12,189)
Business acquisitions	23	**(13,320)**	(26,445)
Deferred consideration paid		**(11,654)**	-
Business disposal	23	**6,349**	-
Acquisitions and disposals		**(18,625)**	(26,445)
Equity dividends paid		**(6,767)**	(3,950)
Net cash flow before financing		**(22,959)**	(47,606)
Financing			
Issue of ordinary share capital		-	59,108
Cost of issue		-	(2,785)
Repayment of unsecured bank loans		**(13,997)**	(22,000)
Unsecured bank loans		**36,069**	10,314
Net cash inflow from financing		**22,072**	44,637
Movement in cash and overdrafts	25	**(887)**	(2,969)
Reconciliation of net cash flow to movement in net debt			
Movement in cash and overdrafts		**(887)**	(2,969)
Cash (inflow) / outflow from (increase) / decrease in debt financing		**(22,072)**	11,686
Movement in net debt in the year		**(22,959)**	8,717
Net debt at 31 December 1997		**(25,240)**	(33,957)
Net debt at 31 December 1998		**(48,199)**	(25,240)

The notes on pages 23 to 34 form part of these financial statements.

Group Statement of Total Recognised Gains and Losses

For the year ended 31 December 1998

	1998 £000	1997 £000
Profit for the financial year	12,894	10,170
Currency translation differences on foreign currency net investments	77	38
Total recognised gains and losses relating to the year	12,971	10,208

The reported profit for the year is not materially different from the profit on an unmodified historical cost basis.

Group Reconciliation of Movements in Shareholders' Funds

For the year ended 31 December 1998

	1998 £000	1997 £000
Profit for the financial year	12,894	10,170
Dividends	(7,316)	(5,725)
	5,578	4,445
Exchange adjustment	77	38
Issue of ordinary share capital (net of costs)	-	56,323
Goodwill	-	(1,098)
Negative goodwill	-	3,928
Net addition to shareholders' funds	5,655	63,636
Opening shareholders' funds	126,373	62,737
Closing shareholders' funds	132,028	126,373

The notes on pages 23 to 34 form part of these financial statements.

Company Balance Sheet

Year ended 31 December 1998

	Notes	1998 £000	1997 £000
Fixed assets			
Investments	14	108,863	18,863
Current assets			
Debtors	17	56,540	112,433
Cash at bank		174	7,643
		56,714	120,076
Creditors: amounts falling due within one year	18	(5,686)	(4,798)
Net current assets		51,028	115,278
Total assets less current liabilities		159,891	134,141
Creditors: amounts falling due after more than one year	19	(35,670)	(10,000)
Net assets		124,221	124,141
Capital and reserves			
Called up share capital	21	15,242	15,242
Share premium account	22	74,697	74,697
Other reserves	22	13,863	13,863
Profit and loss account	22	20,419	20,339
Equity shareholders' funds		124,221	124,141

Approved by the board of Directors on 26 February 1999 and signed on its behalf by:

T G Finn
Chief Executive

D R Forsyth
Finance Director

The notes on pages 23 to 34 form part of these financial statements.

Notes to the Financial Statements

1. Accounting policies

(a) Accounting convention The financial statements have been prepared in accordance with applicable accounting standards using the historical cost convention.

(b) Basis of consolidation The consolidated financial statements include the financial statements of Pendragon PLC and all its subsidiary undertakings made up to 31 December 1998.

(c) Accounting for acquisitions The results of companies and businesses acquired are included from the effective date of acquisition. The purchase consideration is allocated to assets and liabilities on the basis of fair value at the date of acquisition.

(d) Turnover Turnover represents sales invoiced to third parties and income from contract hire operations when acting as agent, all exclusive of value added tax.

(e) Contract hire and leasing Profit arising on contract hire agreements is recognised on the termination of each agreement.

(f) Tangible fixed assets and depreciation Freehold land is not depreciated. Depreciation is provided to write off the cost less the estimated residual value of other tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Freehold buildings - 2% per annum (except in the case of assets under the course of construction)
Leasehold properties - 2% per annum or over the period of the lease if less than 50 years
Fixtures, fittings and office equipment - 10 - 20% per annum
Plant and machinery - 10 - 33% per annum
Motor vehicles - 20 - 25% per annum

(g) Stocks

(i) Consignment vehicles in respect of which finance charges are levied are regarded as being effectively under the control of the group and, in accordance with Financial Reporting Standard No. 5, are included within stocks on the balance sheet even though legal title has not yet passed to the group. The corresponding liability is included in creditors.

(ii) Motor vehicles (including consignment and demonstrator vehicles) and parts stocks are stated at the lower of cost and net realisable value.

(h) Repurchase commitments As part of its normal trading activities the group has contracted to repurchase, at predetermined values and dates, certain vehicles previously sold or let under operating leases or similar arrangements. The group's residual interest in these vehicles is included in current assets and the related liability is included as 'repurchase commitments' within creditors.

(i) Deferred taxation Provision is made for deferred taxation on timing differences, under the liability method, except where the liability is not expected to arise in the foreseeable future.

(j) Foreign currencies Profit and loss accounts in foreign currencies are translated into sterling at the average rates of exchange ruling for the relevant financial period. Assets and liabilities are translated at exchange rates ruling at the balance sheet date. Exchange differences arising on consolidation of the net investments in overseas subsidiary undertakings are taken to reserves, as are the exchange differences on the group's long term foreign currency borrowings and commitments used to finance the group's overseas investments. All other exchange gains or losses are taken to the profit and loss account as they arise.

(k) Pensions The regular cost of the group's defined benefit pension scheme is expensed in order to allocate the cost of providing the pensions, recognising any actuarial surplus or deficiency (where appropriate), over the working lives of the relevant employees.

(l) Investments Investments held as fixed assets are stated at cost less provision for any diminution in value.

(m) Capitalisation of finance costs Gross finance costs directly attributable to the construction of tangible fixed assets are capitalised as part of the cost of those assets.

(n) Goodwill Goodwill represents the excess of the fair value of consideration given over the fair value of the identifiable net assets acquired. Goodwill arising on acquisitions before 1 January 1998 was eliminated against reserves on acquisition. In accordance with the transitional rules of Financial Reporting Standard No. 10, this treatment has continued to be applied to such acquisitions. On a subsequent disposal or termination of a previously acquired business, the profit or loss on disposal or termination is calculated after charging the amount of any related goodwill not written off through the profit and loss account, including any previously taken direct to reserves. Goodwill arising on acquisitions since 1 January 1998 is capitalised and amortised to nil by equal instalments over its estimated useful life.

2. Turnover

All turnover arises from the group's principal activities, which are the sale of new and used vehicles, contract hire activities and after sales services. All material turnover originates in the United Kingdom from the group's principal activities.

3. Turnover, cost of sales, net operating expenses and operating profit

	Existing operations £000	Acquisitions £000	1998 Total £000	1997 Total £000
Turnover	1,201,068	70,910	**1,271,978**	863,666
Cost of sales	1,066,609	62,166	**1,128,775**	765,731
Gross profit	134,459	8,744	**143,203**	97,935
Net operating expenses:				
Distribution costs	75,719	4,610	**80,329**	52,383
Administrative expenses	48,040	2,669	**50,709**	33,345
Other operating income	(14,089)	(723)	**(14,812)**	(8,242)
	109,670	6,556	**116,226**	77,486
Operating profit	24,789	2,188	**26,977**	20,449

4. Operating profit

(a) Operating profit has been arrived at after charging:

	1998 £000	1997 £000
Depreciation of tangible fixed assets	**8,182**	6,180
Amortisation of goodwill	**453**	-
Auditors' remuneration:		
Audit fees - group	**77**	70
Audit fees - parent company	**2**	2
Operating lease rentals:		
Hire of plant and machinery	**624**	158
Property	**5,156**	2,020
(b) Other operating income comprised:		
Commissions receivable	**14,556**	8,074
Sundry income	**256**	168
	14,812	8,242

Payments to KPMG Audit Plc and its associates during the year ended 31 December 1998 for non audit services amounted to £28,000 (1997 - £76,000).

Notes to the Financial Statements *continued*

5. Employees

The average number employed by the group in the following areas was:

	1998 Number	1997 Number
Sales	1,456	811
After sales	2,636	1,872
Administration	929	568
	5,021	3,251

Costs incurred in respect of these employees were:	1998 £000	1997 £000
Wages and salaries	78,489	50,216
Social security costs	6,988	4,360
Other pension costs	1,688	969
	87,165	55,545

6. Directors

Total emoluments of directors (including pension contributions) amounted to £1,121,000 (1997 - £931,000).
Information relating to directors' emoluments, share options and pension entitlements is set out in the Report on Remuneration on pages 13 to 16.

7. Net interest payable

	1998 £000	1997 £000
Interest payable and similar charges:		
Bank loans and overdrafts	4,815	2,930
Other loans - manufacturer stocking loans	2,691	2,206
Notional interest on deferred consideration on acquisitions	1,441	397
	8,947	5,533
Less: amount capitalised	(333)	(147)
	8,614	5,386
Interest receivable:		
Bank interest receivable	(539)	(13)
	8,075	5,373

8. Taxation

	1998 £000	1997 £000
UK corporation tax at 31.0% (1997 - 31.5%)	6,151	4,217
Overseas taxation	517	-
Deferred taxation	(899)	689
	5,769	4,906

Notes to the Financial Statements *continued*

9. Dividends

	1998 £000	1997 £000
Ordinary shares		
Interim paid 4.0p per share (1997 - 3.6p)	2,439	1,397
Final proposed 8.0p per share (1997 - 7.1p)	4,877	4,328
	7,316	5,725

10. Earnings per share

Earnings per ordinary share are based on profits after taxation of £12,894,000 (1997 - £10,170,000) and on the weighted average number of shares in issue for the year ended 31 December 1998 of 60,964,152 (1997 - 48,083,960) ordinary shares of 25p each.

Diluted earnings per ordinary share are based on profits after taxation of £12,894,000 (1997 - £10,170,000) and on the weighted average number of shares in issue for the year ended 31 December 1998 of 61,037,144 (1997 - 48,109,255) ordinary shares of 25p, being 60,964,152 (1997 - 48,083,960) shares in issue and 72,992 (1997 - 25,295) dilutive shares in respect of outstanding share options.

11. Profit and loss account of the company

In accordance with the exemption allowed by Section 230 of the Companies Act 1985, the profit and loss account of the company is not presented. The profit after taxation attributable to the company dealt with in its own accounts for the year ended 31 December 1998 is £7,396,000 (1997 - £3,873,000)

12. Fixed assets - intangible assets

Group	**Goodwill £000**
Cost	
At 31 December 1997	-
Additions	6,059
At 31 December 1998	6,059
Amortisation	
At 31 December 1997	-
Amortised during the year	453
At 31 December 1998	453
Net book value	
At 31 December 1998	5,606
At 31 December 1997	-

Goodwill on dealerships acquired is amortised over a period of 10 years.

13. Fixed assets - tangible assets

Group	Land & buildings £000	Plant & equipment £000	Motor vehicles £000	Total £000
Cost				
At 31 December 1997	84,331	25,684	14,816	**124,831**
Additions - existing operations	9,890	6,330	20,164	**36,384**
- acquisitions	2,798	675	-	**3,473**
Exchange adjustments	87	30	39	**156**
Disposal of business	(5,484)	(1,399)	-	**(6,883)**
Disposals	(2,929)	(2,487)	(19,841)	**(25,257)**
At 31 December 1998	88,693	28,833	15,178	**132,704**
Depreciation				
At 31 December 1997	5,367	12,801	2,162	**20,330**
Exchange adjustments	6	23	4	**33**
Charge for the year	1,353	4,431	2,398	**8,182**
Disposal of business	(439)	(758)	-	**(1,197)**
Disposals	(389)	(1,150)	(1,982)	**(3,521)**
At 31 December 1998	5,898	15,347	2,582	**23,827**
Net book value				
At 31 December 1998	82,795	13,486	12,596	**108,877**
At 31 December 1997	78,964	12,883	12,654	**104,501**

Land and buildings at net book value comprise:	**1998 £000**	1997 £000
Freehold	**65,852**	65,178
Long leasehold	**12,808**	11,140
Short leasehold	**4,135**	2,646
	82,795	78,964
Motor vehicles at net book value comprise:		
Service loan vehicles	**6,210**	6,535
Capitalised contract hire fleet	**-**	8
Other vehicles	**6,386**	6,111
	12,596	12,654

Freehold land with a cost of £28,380,000 (1997 - £25,160,000) has not been depreciated during the year.

Cumulative interest charges of £997,000 (1997 - £664,000) have been capitalised as construction costs and included in land and buildings. Land and buildings include £6,406,000 (1997 - £3,288,000) in respect of building projects currently under construction. Fixed assets include motor vehicles held for the purpose of operating lease business of £ nil (1997 - £48,000) with related depreciation of £ nil (1997 - £40,000).

Future capital expenditure which has been contracted for but not yet provided in the financial statements amounted to £2,462,000 (1997 - £1,085,000).

Notes to the Financial Statements *continued*

14. Fixed assets - investments

Company	Shares in subsidiary undertakings £000	Loans to subsidiary undertakings £000	Total £000
At 31 December 1997	18,863	-	**18,863**
Additions	-	90,000	**90,000**
At 31 December 1998	18,863	90,000	**108,863**

Shares in subsidiary undertakings are stated at cost. Pendragon PLC owns directly or indirectly 100 percent of the issued share capital of the following principal subsidiaries, which trade in the country of incorporation noted below:

Name	**Activity**
Incorporated in Great Britain:	
Alloy Racing Equipment Limited	Motor vehicle dealer
Arena Auto PLC	Motor vehicle dealer
Derwent Vehicles Limited	Motor vehicle dealer
Pendragon Motor Group Limited*	Motor vehicle dealer
Pendragon Contracts Limited	Contract hire and fleet management
Excalibur Motor Finance Limited	Motor vehicle finance
Pinewood Computer Holdings Limited	Computer systems and services
Incorporated in Germany:	
Jaguar Autohaus Kronberg GmbH	Motor vehicle dealer
Autohaus Avalon Jaguar GmbH	Motor vehicle dealer

**Direct subsidiary of Pendragon PLC.*

15. Stocks

	1998 £000	1997 £000
New and used vehicles	**109,348**	88,773
Consignment vehicles	**84,206**	58,522
Vehicle parts and other stocks	**14,326**	12,191
	207,880	159,486

Consignment vehicles exclude new vehicle stocks held by the manufacturers to the order of the group, which are not capable of bearing a finance charge, amounting to £ nil (1997 - £599,000)

16. Repurchase commitments

	1998 Total £000	1997 Total £000
Within one year	**34,373**	28,798
Between one and two years	**29,219**	22,787
Over two years	**20,757**	17,685
	84,349	69,270

The directors consider that losses arising from disposal of the vehicles for less than the repurchase value will not occur, and accordingly no provision for such losses is made in the financial statements.

In addition to the repurchase commitments shown above, the group has entered into other contingent repurchase arrangements set out in note 28.

Notes to the Financial Statements *continued*

17. Debtors

	1998 £000	1997 £000
(a) Group		
Trade debtors	42,599	41,069
Other debtors	18,000	14,749
Prepayments	12,419	10,605
	73,018	66,423
(b) Company		
Amounts owed by subsidiary undertakings	56,535	112,335
Advance corporation tax recoverable	-	66
Other debtors	5	32
	56,540	112,433

Amounts falling due after more than one year included above are:

(a) Group		
Advance corporation tax recoverable	-	66
Less amount offset against deferred taxation provision	-	(66)
	-	-
(b) Company		
Advance corporation tax recoverable	-	66

18. Creditors: amounts falling due within one year

	1998 £000	1997 £000
(a) Group		
Unsecured loans	10,000	11,997
Unsecured bank loans and overdrafts	2,963	2,993
Consignment vehicle liabilities	84,206	58,522
Repurchase commitments (see note 16)	34,373	28,798
Payments received on account	3,272	3,798
Trade creditors	71,109	52,267
Dividends payable	4,877	4,328
Corporation tax	5,698	2,094
Advance corporation tax	610	1,082
Other taxation and social security	4,847	3,279
Consideration payable to Lex Retail Group Limited	12,127	10,213
Accruals and deferred income	27,828	29,886
	261,910	209,257
(b) Company		
Bank loans and overdrafts	25	-
Dividends payable	4,877	4,328
Advance corporation tax	610	66
Other creditors	174	404
	5,686	4,798

19. Creditors: amounts falling due after more than one year

	1998 £000	1997 £000
(a) Group		
Unsecured bank loans (repayable between one and two years)	623	1,676
Unsecured bank loans (repayable between two and five years)	3,093	10,641
Unsecured bank loans (repayable after five years)	32,670	-
Repurchase commitments (see note 16)	49,976	40,472
Consideration payable to Lex Retail Group Limited	-	12,127
	86,362	64,916
(b) Company		
Unsecured bank loans (repayable between two and five years)	3,000	10,000
Unsecured bank loans (repayable after five years)	32,670	-
	35,670	10,000

20. Provisions for liabilities and charges

The amounts of deferred tax in the financial statements are as follows:

	Provided		Unprovided	
	1998 £000	1997 £000	1998 £000	1997 £000
Tax allowances in excess of depreciation	926	1,404	-	-
Other timing differences	(346)	(296)	-	-
Advance corporation tax recoverable	-	(66)	-	-
	580	1,042	-	-

The movement in the provisions for the year is as follows:

	Deferred tax £000	Closure costs £000	Total £000
At 31 December 1997	1,042	159	1,201
Profit and loss account	(899)	-	(899)
Acquisitions	371	-	371
Utilised	-	(159)	(159)
Advance corporation tax recoverable	66	-	66
At 31 December 1998	580	-	580

21. Called up share capital

	1998 £000	1997 £000
Authorised:		
80,000,000 (1997 - 80,000,000) ordinary shares of 25p each	20,000	20,000
Allotted, called up and fully paid:		
60,964,152 (1997 - 60,964,152) ordinary shares of 25p each	15,242	15,242

21. Called up share capital continued

Movements in the number of options to acquire ordinary shares under the executive share option scheme, together with exercise prices and the outstanding position at 31 December 1998 were as follows:

Exercise period	Exercise price per share	At 31 December 1997 Number	Granted Number	Lasped Number	At 31 December 1998 Number
11 October 1994 to 10 October 2001	170.95p	27,533	-	-	27,533
29 April 1997 to 28 April 2004	295.84p	167,327	-	(94,930)	72,397
17 March 2001 to 16 March 2008	308.00p	-	478,500	(49,500)	429,000
9 October 2001 to 8 October 2008	127.00p	-	465,500	(36,500)	429,000
9 October 2001 to 8 October 2008	127.00p	-	271,000	(8,000)	263,000
1 July 2003 to 31 December 2003	293.00p	-	1,094,174	(172,728)	921,446
1 July 2005 to 31 December 2005	293.00p	-	366,743	(48,840)	317,903
		194,860	2,675,917	(410,498)	2,460,279

On 17 March 1998 options over 478,500 ordinary shares of 25p were granted to employees (excluding directors) under the Pendragon Executive Share Option Scheme at an exercise price of 308.0p per share.

On 4 June 1998 options over 1,460,917 ordinary shares of 25p were granted pursuant to the 1998 Pendragon Sharesave Scheme at an exercise price of 293.0p per share.

On 9 October 1998 a parallel grant was made to those holders of options granted 17 March 1998 who remained eligible at that date at an exercise price of 127.0p per share. This was justifiable given that the objective of the Executive Scheme in retaining and motivating option holders was unlikely to be met by the 17 March 1998 grant. At the time of exercise of an option under the parallel grant an equivalent number of options granted under the March grant will lapse and vice versa. Accordingly, there has been no increase in the aggregate number of shares subject to options following the parallel grant. No options were granted to directors under the parallel grant.

In addition to the above on 9 October 1998 options over a further 271,000 ordinary shares of 25p were granted to employees (excluding directors) under the Pendragon Share Option Scheme at an exercise price of 127.0p per share.

Each of the grants of share options made under the Executive Share Option Scheme during the year prescribed an earnings per share performance criterion. In each case, it is a precondition to the exercise of such options that the growth in the company's earnings per share over the prescribed three year period must exceed by at least 2 percent per annum compound the annual rate of inflation as shown by the RPI Index.

22. Reserves

	Share premium account £000	**Other reserves £000**	**Profit and loss account £000**
(a) Group			
At 31 December 1997	74,697	9,331	27,103
Retained profit	-	-	5,578
Exchange adjustment	-	-	77
At 31 December 1998	**74,697**	**9,331**	**32,758**
(b) Company			
At 31 December 1997	74,697	13,863	20,339
Retained profit	-	-	80
At 31 December 1998	**74,697**	**13,863**	**20,419**

Cumulative goodwill written off to reserves at 31 December 1998 amounted to £7,622,000 (1997 - £7,622,000).

The cumulative amount of negative goodwill written to reserves at 31 December 1998 amounted to £3,928,000 (1997 - £3,928,000).

Notes to the Financial Statements *continued*

23. Acquisitions and disposals

(a) Acquisitions

The group acquired from various vendors throughout the year trading assets for Arbury Service Station for £870,000 on 19 January 1998, Altwood BMW for £7,345,000 on 10 February 1998, Stratton Vauxhall for £858,000 on 2 March 1998, Hamiltons Powersports for £764,000 on 8 June 1998, Dorchester Ford for £295,000 on 17 May 1998, Watkin Biggleswade for £15,000 on 15 June 1998, Gainsborough Ford for £508,000 and Motex Harley Davidson for £413,000 on 3 August 1998, and Pinewood Computers for £2,053,000 on 4 September 1998. All consideration was satisfied in cash. The acquisitions have been accounted for by the acquisition method of accounting.

Net assets at date of acquisitions:

	Book value at acquisition £000	Revaluation £000	Other £000	Fair value at acquisition £000
Tangible fixed assets	4,559	(1,086)	-	**3,473**
Stocks	5,889	(20)	-	**5,869**
Debtors	2,090	-	-	**2,090**
Creditors	(3,725)	-	(75)	**(3,800)**
Deferred tax	(371)	-	-	**(371)**
	8,442	(1,106)	(75)	**7,261**
Goodwill				**6,059**
Consideration (including costs)				**13,320**
Consideration satisfied by cash				**13,121**
Costs of acquisition				**199**
Fair value of consideration				**13,320**

The fair value adjustments above principally arose for the following reasons:

i) Revaluations representing the restatement of certain properties and stocks acquired to their estimated market values.

ii) Other adjustments principally representing the recognition of unprovided amounts in respect of other liabilities.

Contributions to cashflow from acquisitions

The businesses acquired during the year contributed £4,354,000 to the group's net operating cash flows, paid £181,000 in respect of servicing finance and utilised £152,000 for capital expenditure.

(b) Disposals

Net assets at date of disposal:	Net book value £000
Tangible fixed assets	**5,686**
Stocks	**881**
Creditors	**(31)**
	6,536
Loss on sale	**(187)**
Proceeds satisfied in cash	**6,349**

Notes to the Financial Statements *continued*

24. Net cash flow from operating activities

	1998 £000	1997 £000
Operating profit	**26,977**	20,449
Depreciation	**8,182**	6,180
Goodwill amortisation	**453**	-
Loss / (profit) on disposal of fixed assets	**421**	(67)
(Increase) in stocks	**(17,722)**	(17,876)
(Increase) in debtors	**(4,571)**	(14,294)
Increase in creditors	**13,738**	9,476
Other	**(46)**	400
	27,432	4,268

25. Analysis of net debt

	Cash at bank and in hand £000	Overdrafts and other borrowings £000	Total £000	Other borrowings Due within one year £000	Other borrowings Due after one year £000	Total £000
At 31 December 1997	2,067	(2,993)	(926)	(11,997)	(12,317)	**(25,240)**
Net cash flow	(917)	30	(887)	-	-	**(887)**
Financing and liquid resources	-	-	-	1,997	(24,069)	**(22,072)**
At 31 December 1998	1,150	(2,963)	(1,813)	(10,000)	(36,386)	**(48,199)**

26. Lease commitments

Operating leases

Annual lease payments due in 1999 under operating leases of the group according to the period in which the lease expires, are as follows:

	Property		Other leases	
	1998 **£000**	1997 £000	**1998** **£000**	1997 £000
Within one year	**353**	68	**177**	429
Between one and five years	**1,537**	451	**170**	117
Over five years	**3,802**	1,832	**196**	4
	5,692	2,351	**543**	550

27. Pensions

Pendragon PLC contributes to the Pendragon Pension Plan, a defined benefit retirement and death benefits scheme for its eligible employees. The assets of the Plan are held separately from those of the company. The pension cost is assessed in accordance with the advice of a qualified actuary using the projected unitary method.

The latest valuation was carried out at 5 April 1996. The total market value of the assets was £7,879,000. The actuarial value of the assets was 114 percent of the combined value of accrued benefits after allowing for expected future increase in earnings. For the purposes of this valuation it was assumed that the return on investments would exceed the rate of increase of salaries by 2 percent per annum, the rate of increase of pensions in payment by 5 percent per annum and the rate of dividend growth by 4.5 percent per annum. The surplus revealed is to be amortised over the average remaining service lives of the members as a reduction to the regular cost. The next actuarial valuation will be carried out as at 5 April 1999.

Total pension costs for the year were £1,688,000 (1997 - £969,000).

28. Contingent liabilities

(a) The company has entered into cross - guarantees with its bankers whereby it guarantees payment of bank borrowings in respect of subsidiary undertakings.

(b) The company has given performance guarantees in the normal course of business in respect of subsidiary undertaking obligations.

(c) Bank guarantees in favour of third parties amounting to £2,287,000 (1997 - £2,529,000) have been counter - indemnified by the group.

(d) The group has arranged external financing for a number of vehicles where customers have an option to purchase the vehicle from the finance company at a predetermined value at the end of each agreement. The group has undertaken to repurchase the vehicle from the finance company in place of the customer if the customer does not exercise the option to purchase. The total value of the contingent repurchases is as follows:

	1998	1997
	£000	£000
Within one year	**2,122**	5,099
Between one and two years	**6,211**	3,436
Between two and five years	**5,812**	3,691
	14,145	12,226

The directors consider that losses arising from disposal of the vehicles for less than the repurchase value will not occur, and accordingly no provision for such losses is made in the financial statements.

29. Post balance sheet events

Since 1 January 1999 and at 25 February 1999 the group has acquired 97.9 percent of the issued share capital of Evans Halshaw Holdings plc for a total consideration, before expenses, of £81.9 millon. Procedures have been put in place such that the remaining shares will be acquired.

30. Related party transactions

The company has transactions with its subsidiary undertakings in the form of dividends and loans only.

Shareholder Information

Stock classification The ordinary shares of the company are traded on the London Stock Exchange. Information concerning the day to day movement of the share price can be found on the London Stock Exchange's Topic Information service on pages 266 (mid-price) and 52037 (SEAQ).

1999 Financial calendar

Ex-dividend date for 1998 proposed final dividend	22 March 1999
Record Date for 1998 proposed final dividend	26 March 1999
Annual General Meeting	26 April 1999
Payment date for 1998 proposed final dividend	29 April 1999
Interim results for 1999 announced	September 1999
Final results for 1999 announced	March 2000
Interim dividend for 1999 payable	October 1999
Final dividend for 1999 payable	April/May 2000

With effect from 1 January 1999 dividend payments will be made by means of Banker's Automated Clearing Services (BACS), due to the withdrawal of the Bulk Distribution Scheme (BDS) hitherto used by the company for payment of dividends.

Low cost share dealing service Barclays Stockbrokers Limited offers private individuals a low cost telephone conversation and postal service for dealing in the company's shares. They will purchase and sell shares at a commission of 1 percent plus stamp duty where applicable, subject to the minimum dealing charge of £10 per transaction. Details of the scheme can be obtained by telephoning 0345 777400 (calls are charged at local rates and this telephone number can be accessed only from within the United Kingdom).