

Wolfson Microelectronics plc
Directors' report and financial
statements

Registered number: SC89839

31 December 2002



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Directors' report

The directors have pleasure in submitting their report and financial statements for the year ended 31 December 2002. On 28 October 2002, the company re-registered as a public limited company.

Principal activities

The company is principally engaged in the design, manufacture and supply of high performance mixed-signal integrated circuits.

Financial

The company made a profit on ordinary activities after taxation of £1,606,000 (2001: £372,000 loss). In accordance with the company's articles of association the directors recommend that dividends of £589,000 (2001: £nil) be paid and that after payment of the dividends £1,017,000 be transferred to reserves.

Review of development and future prospects

During the year the company's turnover increased by almost 100% from £11,235,000 to £22,416,000 with increased revenues each quarter. This was achieved despite difficult trading conditions in the semiconductor industry and endorsed the company's decision in 2000 to focus on the consumer electronics market. Demand for the company's audio products has continued to strengthen and the expected growth in both digital imaging and portable products has meant that the company has traded profitably each quarter.

The company has continued to expand its customer base and now includes many of the leading brand names in consumer electronics. This has been achieved by sustained investment in the company's direct sales operations in Taiwan, USA and Japan.

The company will continue to focus on the consumer electronics market and invest in additional staff and facilities to meet customer requirements for both higher performance and improved features. Although the general economic environment continues to affect most markets the company believes that there remain at present areas of potentially substantial growth within consumer electronics market.

Research and development

Research and development costs of £3,277,000 (2001: £1,910,000) were incurred on new product development and were written off as incurred during the year.

Policy and practice on payment of creditors

The company's policy is to pay suppliers within 45 days of the date of receipt of the invoice, unless terms have been specifically agreed in advance. This policy and any specific terms agreed with suppliers are made known to the appropriate staff and suppliers on request. At the year end, there were 65 days (2001: 40 days) purchases in trade creditors.

Directors' report *(continued)*

Directors

The directors who held office at the end of the year and their interests in the shares of the company at the year end were as follows:

	At 31 December 2002		At 31 December 2001 / date of appointment	
	Ordinary shares of 10p	Cumulative convertible preference shares of £1	Ordinary shares of 10p	Cumulative convertible preference shares of £1
J Carey	35,288	250,000	35,288	250,000
AD Milne	30,630	-	26,750	-
JRC Reid	9,453	-	9,453	-
JM Urwin	242	-	242	-
GR Elliott	-	-	-	-
B Rose	-	-	-	-
G Lockwood	-	-	-	-
D Tate	-	-	-	-

Mr G Lockwood and Mr D Tate were appointed to the Board on 17 January 2002 and 21 March 2002 respectively. Mr B Rose retires by rotation and, being eligible, offers himself for re-election.

Directors' report *(continued)*

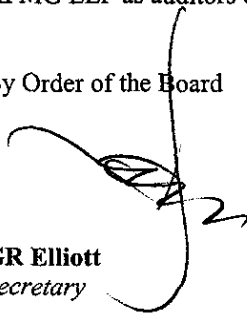
The directors at the year end had the following rights to subscribe for shares in the company:

	At 01.01.02	Exercised during year	Granted during year	At 31.12.02	Exercise price	Date from which exercisable	Expiry date
J Carey	2,000	-	-	2,000	£20.00	20.11.01	20.11.05
	2,000	-	-	2,000	£15.14	19.11.02	19.11.06
AD Milne	2,000	(2,000)	-	-	£3.00	15.12.98	15.12.02
	1,800	(1,800)	-	-	£25.00	18.08.00	18.08.04
	80	(80)	-	-	£29.02	05.09.00	05.09.04
	1,900	-	-	1,900	£15.14	17.12.02	17.12.09
	4,600	-	-	4,600	£15.00	17.12.02	23.03.11
	-	-	4,900	4,900	£20.00	20.03.05	20.03.12
	-	-	100	100	£20.00	20.03.05	20.03.12
JRC Reid	3,500	-	-	3,500	£3.00	15.12.98	15.12.05
	1,800	-	-	1,800	£25.00	18.08.00	18.08.04
	1,200	-	-	1,200	£15.14	17.12.02	17.12.09
	4,300	-	-	4,300	£15.00	17.12.02	23.03.11
	-	-	2,200	2,200	£20.00	20.03.05	20.03.12
	-	-	300	300	£20.00	20.03.05	20.03.12
JM Urwin	1,986	-	-	1,986	£3.00	15.12.98	15.12.05
	1,800	-	-	1,800	£25.00	18.08.00	18.08.04
	1,500	-	-	1,500	£15.14	17.12.02	17.12.09
	1,500	-	-	1,500	£15.00	17.12.02	23.03.11
	1,214	-	-	1,214	£15.00	23.03.04	23.03.11
	-	-	1,000	1,000	£20.00	20.03.05	20.03.12
	-	-	1,500	1,500	£20.00	20.03.05	20.03.12
GR Elliott	1,900	-	-	1,900	£15.14	03.01.03	03.01.10
	100	-	-	100	£15.00	03.01.03	23.03.11
	4,000	-	-	4,000	£15.00	23.03.04	23.03.11
B Rose	-	-	-	-	-	-	-
G Lockwood	-	-	-	-	-	-	-
D Tate	-	-	-	-	-	-	-

Auditors

Our auditors KPMG transferred their business to a limited liability partnership, KPMG LLP, on 3 May 2002. Accordingly KPMG resigned as auditors and the directors thereupon appointed KPMG LLP to fill the vacancy arising. In accordance with section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By Order of the Board


GR Elliott
Secretary

24 April 2003

Statement of directors' responsibilities

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 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;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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



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Independent auditors' report to the members of Wolfson Microelectronics plc

We have audited the financial statements on pages 6 to 23.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 4, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board 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 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

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 company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

5 June 2003

Profit and loss account
for the year ended 31 December 2002

	<i>Note</i>	2002 £000	2001 £000 Restated
Turnover	2	22,416	11,235
Cost of sales		(11,894)	(7,044)
Gross profit		10,522	4,191
Distribution and selling costs		(3,168)	(2,065)
Research and development expenses		(3,277)	(1,910)
Administrative expenses		(1,890)	(1,028)
Other operating income		184	87
Operating profit/(loss)	3	2,371	(725)
Interest receivable and similar income	6	64	38
Interest payable and similar charges	7	(20)	(85)
Profit/(loss) on ordinary activities before taxation		2,415	(772)
Tax on profit/(loss) on ordinary activities	8	(809)	400
Profit/(loss) for the financial year		1,606	(372)
Dividends paid and proposed on equity and non-equity shares	9	(589)	-
Net additional finance costs of non-equity shares	9	-	(36)
Retained profit/(loss) for the year for equity shareholders	18	1,017	(408)

The above results relate wholly to continuing activities.

Balance sheet
as at 31 December 2002

	Note	2002 £000	2001 £000 Restated
Fixed assets			
Tangible assets	10	2,106	654
Current assets			
Stocks	11	3,374	1,351
Debtors	12	5,619	5,713
Cash at bank and in hand		3,902	2,513
		<u>12,895</u>	<u>9,577</u>
Creditors: amounts falling due within one year	13	<u>(5,081)</u>	<u>(1,739)</u>
Net current assets		<u>7,814</u>	<u>7,838</u>
Total assets less current liabilities		<u>9,920</u>	<u>8,492</u>
Creditors: amounts falling due after more than one year	14	(743)	-
Deferred income	15	<u>(291)</u>	<u>(653)</u>
Net assets		<u>8,886</u>	<u>7,839</u>
Capital and reserves			
Called up share capital	16	5,685	5,684
Share premium account	17	59	8,487
Profit and loss account	18	3,142	(6,332)
		<u>8,886</u>	<u>7,839</u>
Shareholders' funds			
Equity		3,880	2,797
Non equity		5,006	5,042
	19	<u>8,886</u>	<u>7,839</u>

These financial statements were approved by the Board of Directors on 24 April 2003 and were signed on its behalf by:


AD Milne
Director

Statement of total recognised gains and losses
for the year ended 31 December 2002

	2002 £000	2001 £000 Restated
Profit/(loss) for the financial year	1,606	(372)
Total recognised gains and losses relating to the financial year	<u>1,606</u>	<u>(372)</u>
Prior year adjustment (as explained in note 1)	<u>2,502</u>	
Total gains and losses recognised since last annual report	<u><u>4,108</u></u>	

Cash flow statement
 for the year ended 31 December 2002

	Notes	2002 £000	2001 £000
Reconciliation of operating profit /(loss) to net cash flow from operating activities			
Operating profit / (loss)		2,371	(725)
Depreciation charges		887	369
Loss on disposal of fixed assets		2	-
Increase in stocks		(2,023)	(105)
Increase in debtors		(867)	(1,801)
Increase in creditors		1,936	254
Net cash inflow / (outflow) from operating activities		2,306	(2,008)
Cash flow statement			
Net cash inflow / (outflow) from operating activities		2,306	(2,008)
Return on investments and servicing of finance	21	44	(47)
Taxation received / (paid)		164	(34)
Capital expenditure	21	(2,119)	(624)
Cash inflow / (outflow) before financing		395	(2,713)
Financing	21	994	4,709
Increase in cash in the year		1,389	1,996
Reconciliation of net cash flow to movement in net funds			
Increase in cash in the year		1,389	1,996
Cash (inflow) / outflow from financing		(928)	6
Change in net debt resulting from cash flows		461	2,002
New finance lease and hire purchase contracts		(222)	-
Net funds at start of the year		2,513	511
Net funds at end of the year	21	2,752	2,513

Notes

(forming part of the financial statements)

1. Accounting policies

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards. The company has adopted FRS 19 'Deferred tax' in these financial statements. The comparative figures have been restated accordingly. The company has followed the transitional arrangements of FRS 17 'Retirement benefits' in these financial statements.

Prior year adjustment

The accounts comply with Financial Reporting Standard 19 (FRS 19) 'Deferred tax' which has resulted in a change in accounting policy for deferred tax to a full provision basis. Previously provision for deferred tax was made to the extent that an actual liability for timing differences between the treatment of certain items for taxation and accounting purposes which had arisen but not reversed at the balance sheet date would crystallise. The adjustment has resulted in a decrease in the current year profit after taxation of £769,000 (2001 : increase of £242,000). A deferred tax asset of £1,733,000 (2001 : £2,502,000) has increased the reported net assets by this amount. The analysis of the deferred tax asset is given in note 12.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers.

Depreciation

Depreciation is provided on a straight line basis in order to write off the cost of fixed tangible assets over their estimated economic lives as follows:

Computer hardware and software	1 to 3 years
Plant and machinery	1 to 3 years
Motor vehicles	4 years
Furniture and fittings	10 years

Leased assets

Fixed tangible assets which are acquired under finance leases and similar hire purchase contracts are capitalised at the market value of the assets at the start of the lease, and are depreciated over the shorter of their estimated economic lives or the term of the lease. Outstanding obligations under the leases, net of finance charges, are included as liabilities. Operating lease costs are charged to the profit and loss account as incurred.

Government grants

Government grants receivable to assist the company with revenue costs in respect of development work are offset against these costs in the profit and loss account.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Stocks

Material stocks are valued at the lower of purchase cost and net realisable value.

Contract work in progress is stated at costs incurred, less those transferred to the profit and loss account, after deducting foreseeable losses and payments on account not matched with turnover.

Notes (continued)

1 Accounting policies (continued)

Amounts recoverable on contracts are included in debtors and represent turnover recognised in excess of payments on account.

Research and development

Expenditure on research and development is taken to the profit and loss account in the year in which it is incurred.

Taxation

The charge for taxation is based on the profit or loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Pensions

The company operates a pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those in the company. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of pensions over the anticipated average service lives of the company's employees.

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

2 Turnover

Turnover is attributable to the design, manufacture and supply of high performance mixed-signal integrated circuits.

	2002 £000	2001 £000
Turnover by geographical market		
Asia / Pacific	14,900	7,226
Americas	6,650	2,172
United Kingdom	230	992
Rest of Europe	636	845
	22,416	11,235

3 Operating profit/(loss)

	2002 £000	2001 £000
<i>The operating profit / (loss) is stated after charging:</i>		
Depreciation of fixed tangible assets	887	369
Operating lease costs		
- plant and machinery	15	11
- other	118	70
Auditors' remuneration		
- audit	12	12
- non audit services	127	45
Legal fees incurred in respect of IPO preparation	137	-
Exchange losses	336	(1)
<i>and after crediting:</i>		
Government grants	(184)	(87)
	(184)	(87)

Notes (continued)

3 Operating profit/(loss) (continued)

In addition to the above, fees of £nil (2001: £86,000) paid to the auditors in respect of non audit services were charged to the share premium account.

4 Remuneration of directors

	2002 £000	2001 £000
Directors' emoluments:		
Fees	13	1
As executives	377	335
	<u>390</u>	<u>336</u>

The emoluments of the highest paid director amounted to £111,000 (2001: £96,000). He is a member of a defined benefit pension scheme, under which his accrued pension at the year end was £55,000 (2001: £51,000).

Retirement benefits are accruing to 4 directors under the defined benefit scheme.

5 Staff costs

	2002 No	2001 No
<i>Average number of employees by activity:</i>		
Design and development	44	35
Selling and distribution	35	22
Administration	7	5
	<u>86</u>	<u>62</u>
	<u>£000</u>	<u>£000</u>
<i>Employee costs</i>		
Wages and salaries	3,306	2,308
Social security costs	241	181
Other pension costs	164	125
	<u>3,711</u>	<u>2,614</u>

6 Interest receivable and similar income

	2002 £000	2001 £000
Bank interest received	64	38

Notes (continued)

7 Interest payable and similar charges

	2002 £000	2001 £000
On bank overdraft and loan	15	85
Finance charges payable in respect of finance leases and hire purchase contracts	5	-
	<u>20</u>	<u>85</u>

8 Taxation

Analysis of charge in year:

	2002 £000	2001 £000 Restated
<i>UK corporation tax</i>		
Current tax on income for the year	12	-
Total current tax	<u>12</u>	<u>-</u>
Withholding tax suffered	28	34
R&D tax credit	-	(192)
Deferred tax (see note 12)		
Origination/reversal of timing differences	769	(242)
Tax on profit/(loss) on ordinary activities	<u>809</u>	<u>(400)</u>

Factors affecting the tax charge for the current period

The current tax charge for the period is lower (2001: higher) than the standard rate of corporation tax in the UK 30% (2001 : 30%). The differences are explained below.

	2002 £000	2001 £000
<i>Current tax reconciliation</i>		
Profit/(loss) on ordinary activities before tax	2,415	(772)
Current tax at 30% (2001 : 30%)	725	(232)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	58	1
Capital allowances for period in excess of depreciation	(116)	(63)
Other timing differences	-	(3)
Other	(2)	(11)
Utilisation of tax losses	(653)	-
Tax losses carried forward	-	308
Total current tax charge (see above)	<u>12</u>	<u>-</u>

Factors that may affect future tax charges

Tax losses are estimated to amount to approximately £5,400,000 at 31 December 2002 (31 December 2001 : £7,600,000) will be carried forward for utilisation against trading profits in future years. A deferred tax asset is recognised in respect of these losses.

Notes (continued)

9 Dividends and other appropriations

	2002 £000	2001 £000
<i>Equity shares</i>		
Participating dividend proposed	253	-
<i>Non equity shares</i>		
Dividends accrued at 5% on non-equity shares	304	-
Dividend previously appropriated (note 19)	(36)	-
Additional finance costs of non-equity shares	-	36
Participating dividend proposed	68	-
	336	36
	589	36

10 Fixed tangible assets

	Plant and machinery £000	Computer hardware & software £000	Furniture and fittings £000	Motor vehicles £000	Total £000
<i>Cost</i>					
At 1 January 2002	1,158	806	226	20	2,210
Additions	1,939	330	72	-	2,341
Disposals	(41)	(340)	(20)	-	(401)
At 31 December 2002	3,056	796	278	20	4,150
<i>Depreciation</i>					
At 1 January 2002	743	682	126	5	1,556
Charge for the year	662	193	27	5	887
Disposals	(39)	(340)	(20)	-	(399)
At 31 December 2002	1,366	535	133	10	2,044
<i>Net book value</i>					
At 31 December 2002	1,690	261	145	10	2,106
At 31 December 2001	415	124	100	15	654

Included in the total net book value of plant and machinery is £66,000 (2001: £nil); in computer hardware and software £61,000 (2001: £nil); and in fixtures and fittings £20,000 (2001: £nil) in respect of assets held under hire purchase contracts. Depreciation for the year on these assets was £7,000 (2001: £nil), £62,000 (2001: £nil) and £6,000 (2001: £nil) respectively.

Notes (continued)

11 Stocks

	2002 £000	2001 £000
Material stocks	3,374	1,351

12 Debtors

	2002 £000	2001 £000 Restated
Trade debtors	3,135	2,368
Prepayments and accrued income	202	273
Amounts recoverable on contracts	185	126
Other debtors	364	252
Deferred tax asset	1,733	2,502
Tax recoverable	-	192
	5,619	5,713

The elements of deferred taxation are as follows:

	2002 £000	2001 £000 Restated
Difference between accumulated depreciation and capital allowances	104	220
Tax losses	1,629	2,282
Deferred tax asset	1,733	2,502

The deferred tax asset represents the estimate of losses that will be utilised in the foreseeable future based on the current levels of profitability.

13 Creditors: due within one year

	2002 £000	2001 £000
Bank loan (note 14)	333	-
Trade creditors	3,197	1,467
Corporation tax	12	-
Other taxes and social security	112	62
Obligations under finance leases and hire purchase contracts	74	-
Accruals and deferred income	728	210
Dividends payable	625	-
	5,081	1,739

Notes (continued)

14 Creditors: amounts falling due after more than one year

	2002 £000	2001 £000
Bank loan	639	-
Obligations under finance leases and hire purchase contracts	104	-
	<u>743</u>	<u>-</u>

Analysis of debt

	2002 £000	2001 £000
Debt can be analysed as falling due:		
In one year or less, or on demand	407	-
Between one and two years	407	-
Between two and five years	336	-
	<u>1,150</u>	<u>-</u>

The bank term loan is repayable in instalments of £27,778 per month commencing in December 2002. Interest is payable monthly on a floating rate basis. The loan is secured by a bond and floating charge, registered 26 September 1988, over the whole assets of the company.

The maturity of obligations under finance leases and hire purchase contracts is as follows:

	2002 £000	2001 £000
Within one year	74	-
In the second to fifth years	104	-
	<u>178</u>	<u>-</u>

Commitments under operating leases payable in the next year are as follows:

	Property £000	Other leases £000	Total £000	2001 £000
On leases which expire within one year	18	6	24	-
On leases which expire in two to five years	112	16	128	15
On leases which expire in over five years	-	-	-	70
	<u>130</u>	<u>22</u>	<u>152</u>	<u>85</u>

There were no capital commitments at the end of the financial year for which no provision has been made (2001: £nil).

Notes (continued)

15 Deferred income

	2002 £000	2001 £000
Advance on levies	291	653

In September 1997 the company entered into a joint product development and related service agreement. Under the terms of this agreement the company received an advance payment of \$2,000,000 against which future levies would be deducted. The advance payment is interest free and is not repayable.

16 Share capital

	At 31 December 2002		At 31 December 2001	
	No.	£000	No.	£000
<i>Authorised</i>				
<i>Equity shares</i>				
Ordinary shares of 10p each	1,068,313	107	1,068,313	107
'B' Ordinary shares of 10p each	18,607	2	18,607	2
<i>Non equity shares</i>				
Deferred shares of £1 each	296,312	296	296,312	296
Convertible preference shares of £1 each	5,509,996	5,510	5,509,996	5,510
		<u>5,915</u>		<u>5,915</u>
<i>Allotted, called up and fully paid</i>				
<i>Equity shares</i>				
Ordinary shares of 10p each	684,244	69	678,064	68
'B' Ordinary shares of 10p each	18,607	2	18,607	2
<i>Non equity shares</i>				
Deferred shares of £1 each	296,312	296	296,312	296
Convertible preference shares of £1 each	5,318,496	5,318	5,318,496	5,318
		<u>5,685</u>		<u>5,684</u>

During the year 6,180 ordinary shares of 10p each were issued for a total consideration of £66,000 in respect of the exercise of employee share options.

Shareholders' rights

The cumulative convertible preference shares carry a right to a fixed cumulative preferential dividend of 5% per annum on the nominal value of those shares and on any accrued dividends in priority to any payment of dividend to the holders of any other class of shares in issue. The dividend accrues on a daily basis from the date of issue of the cumulative convertible preference shares.

Subject to payment of accrued dividends on the cumulative convertible preference shares, a participating cumulative cash dividend equal to 20% of the net profit for the financial year is payable to the holders of the ordinary shares, B ordinary shares and the cumulative convertible preference shares.

Deferred shares have no rights to dividends.

Notes (continued)

16 Share capital (continued)

Shareholders' rights (continued)

The holders of cumulative convertible preference shares are entitled at any time to convert all or any such shares into fully paid ordinary shares on the basis of notionally aggregating the nominal value of such shares in order to subscribe for ordinary shares at a price per ordinary share which is currently £28. The directors may effect conversion in such manner as they may determine, including by consolidating the cumulative convertible preference shares into one undesignated share and sub-dividing each consolidated share into shares of 10 pence each which shall be re-designated as ordinary shares and non-voting deferred shares. The cumulative convertible preference shares will be converted into ordinary shares automatically on the occurrence of a Qualifying Public Offer or Listing as defined in the Articles of Association.

The 'B' ordinary shares shall be converted into ordinary shares at the rate of one ordinary share for each one 'B' ordinary share in the event of a Listing, as defined in the Articles of Association. The directors may however determine to effect conversion, on a similar basis, by redeeming the 'B' ordinary shares at a price equal to the subscription price paid or they can convert by means of consolidating the 'B' ordinary shareholding and then subdividing into ordinary shares at the applicable conversion rate. Any balance shall be re-designated as 'A' deferred shares.

On a return of assets on liquidation or otherwise, the assets available for distribution to its members shall first be applied in paying to the cumulative convertible preference shareholders the nominal value of the issued and outstanding convertible preference shares plus any accrued dividends whether or not such dividend has been earned or declared. Secondly, in paying to the deferred shareholders as a class 114p per share. Thirdly, in paying to the holders of ordinary and B ordinary shares a sum equal to £28 per share. Fourthly, in paying to the holders of ordinary, 'B' ordinary and cumulative convertible preference shares the balance of assets available for distribution *pari passu*.

The cumulative convertible preference shares shall be redeemed by the company on the fourth anniversary of the date of issue of the shares at an amount equal to the nominal value of the shares plus accrued dividends thereon. There are also events, specified in the Articles of Association, which can result in the early redemption of these shares.

Further details regarding the rights of each class of share are set out in the Articles of Association of the company.

Options

The company's directors and employees have been granted options over ordinary shares under employee share option schemes as follows:

	At 1 January 2002	Exercised	Granted	Lapsed	At 31 December 2002
First scheme	47,306	(2,200)	-	(100)	45,006
Second scheme	16,640	(3,880)	16,700	(50)	29,410
EMI scheme	36,274	(100)	14,150	(200)	50,124

The above options are held under executive share option schemes and are exercisable between 15 December 1998 and 20 March 2012 at prices ranging between £3.00 and £29.02 per share. The directors' interests in share options are set out on page 3.

Notes (continued)

17 Share premium account

	£000
At beginning of year	8,487
Premium on new shares issued	65
Transfer to profit and loss account reserve	(8,493)
At end of year	59

The cancellation of the share premium account was approved by the Court of Session on 13 June 2002 enabling a transfer to the profit and loss account.

18 Profit and loss account

	£000
At beginning of year, as previously reported	(8,834)
Prior year adjustment (note 1)	2,502
At beginning of year, as restated	(6,332)
Retained profit for the financial year for equity shareholders	1,017
Additional finance costs of non-equity previously appropriated from equity interests (note 9)	(36)
Transfer from share premium account (note 17)	8,493
At end of year	3,142

19 Reconciliation of movements in shareholders' funds

	Equity £000	Non equity £000	Total £000
New shares issued, less expenses	66	-	66
Profit retained for equity shareholders	1,017	-	1,017
Additional finance costs of non-equity previously appropriated from equity interests	-	(36)	(36)
Net addition to shareholders' funds	1,083	(36)	1,047
Opening shareholders' funds (originally £5,337,000 before prior year adjustment of £2,502,000)	2,797	5,042	7,839
Closing shareholders' funds	3,880	5,006	8,886

In previous periods the cumulative dividends attributable to the convertible preference shares were appropriated to non-equity shareholders' funds, as required by Financial Reporting Standard 4, as the company did not have distributable reserves to pay these dividends. As the company now has distributable reserves the cumulative dividends have been accrued in the current period.

Notes (continued)

20 Pensions

During the year the company established a defined contribution pension scheme. The pension cost charge for the period represents contributions payable by the company to the scheme and amounted to £2,000. Contributions amounting to £nil were payable to the scheme and are included within creditors.

The company also operates a pension scheme providing benefits based on final pensionable pay, contributions being charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the company. During the financial year this scheme was closed to new entrants. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent valuation was at 2 January 2001. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments (7.0% p.a.) and the rates of increase in salaries (5.0% p.a.) and pensions (5.0% p.a.).

The most recent actuarial valuation showed that the value of the scheme's assets was £2,774,400 at 2 January 2001. This represented 116.8% of the benefits that had accrued to members, after allowing for expected future increases in earnings. A bulk transfer from a previous scheme was received after the valuation date. The valuation allowed both for the transferred liabilities and the discounted value of the transferred assets. The future contributions of the company and employees will be 7.6% and 6.0% of earnings respectively.

The pension charge for the period in respect of the defined benefit scheme amounted to £162,000 (2001: £125,000).

Whilst the company continues to account for pension costs in accordance with Statement of Standard Accounting Practice 24 'Accounting for Pensions costs', under FRS 17 'Retirement benefits' the following transitional disclosures are required:

The most recent full actuarial valuation was as at 2 January 2001. The actuary has estimated the liabilities of the scheme as at 31 December 2002 and as at 31 December 2001, to take account of the requirements of FRS 17, based on this valuation. Scheme assets are stated at their market value at 31 December 2002 and at 31 December 2001. The major financial assumptions used to calculate scheme liabilities under FRS 17 are:

	31 December 2002	31 December 2001
	Projected unit	Projected unit
Valuation method		
Rate of increase in salaries	4.25%	4.25%
Rate of increase in pensions in payment and deferred pensions	5.00%	5.00%
Discount rate applied to scheme liabilities	5.75%	5.87%
Inflation assumption	2.50%	2.60%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

Scheme assets

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

Notes (continued)

20 Pensions (continued)

	Long term rate of return expected at 31 December 2002	Value at 31 December 2002 £000	Long term rate of return expected at 31 December 2001	Value at 31 December 2001 £000
Equities	7.5%	2,282	7.5%	2,766
Other – Property	4.0%	52	4.0%	23
Total market value of assets		2,334		2,789
Present value of scheme liabilities		(3,973)		(3,296)
Deficit in the scheme		(1,639)		(507)
Related deferred tax asset		492		152
Net pension liability		(1,147)		(355)

The amount of this net pension liability would have a consequential effect on reserves.

Movement in deficit during the year:

	2002 £000
Deficit in scheme at beginning of year	(507)
Current service cost	(239)
Contributions paid	148
Gains and losses on any settlements or curtailments	73
Other finance income	17
Actuarial loss	(1,131)
Deficit in the scheme at end of year	(1,639)

If FRS 17 had been fully adopted in these financial statements the pension costs for the defined benefit scheme would have been:

	2002 £000
Current service cost	239
Gains/losses on settlements or curtailments	(73)
	166

Notes (continued)

20 Pensions (continued)

Analysis of amounts included in other finance income/costs

	2002 £000
Expected return on pension scheme assets	216
Interest on pension scheme liabilities	(199)
	<u>17</u>

Analysis of amount recognised in statement of total recognised gains and losses

	2002 %	2002 £000
Actual return less expected return on scheme assets		(900)
Percentage of year end scheme assets	38.6	
Experience gains and losses arising on scheme liabilities		(118)
Percentage of present value of year end scheme liabilities	3.0	
Changes in assumptions underlying the present value of scheme liabilities		(113)
Percentage of present value of year end scheme liabilities	2.8	
		<u>(1,131)</u>
Actuarial loss recognised in statement of total recognised gains and losses		<u>(1,131)</u>

21 Notes to cash flow statement

Analysis of cash flows

	2002 £000	2001 £000
Returns on investments and servicing of finance		
Interest received	64	38
Interest paid	(15)	(85)
Interest element of finance lease payments	(5)	-
	<u>44</u>	<u>(47)</u>
Capital expenditure		
Purchase of tangible fixed assets	(2,119)	(624)
Financing		
Proceeds of share capital issues, net of expenses	66	6,125
Redemption of shares	-	(1,410)
Bank term loan received	1,000	-
Bank term loan repayment	(28)	-
Capital element of finance lease payments	(44)	(6)
	<u>994</u>	<u>4,709</u>

Notes *(continued)*

21 Notes to cash flow statement *(continued)*

Analysis of changes in net funds

	At 1 January 2002 £000	Cash flows £000	Other non cash changes £000	At 31 December 2002 £000
Cash at bank	2,513	1,389	-	3,902
Bank term loan	-	(972)	-	(972)
Finance lease and hire purchase contracts	-	44	(222)	(178)
	<u>2,513</u>	<u>461</u>	<u>(222)</u>	<u>2,752</u>