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Interim Report. 2002

Pace Micro Technology plc

www.pace.co.uk

ENABLING THE DIGITAL REVOLUTION .//

HIGHLIGHTS .//

- Turnover increased 4.9% to £215.8m (2000: £205.8m);
- Gross margin increased to 25.5% (2000: 20.5%);
- Profit before tax and amortisation of goodwill increased 20.9% to £22.2m (2000: £18.4m);
- Diluted earnings per share before amortisation of goodwill increased 32.7% to 7.22p (2000 as restated: 5.44p);
- Interim dividend per share up 14% to 0.40p (2000: 0.35p);
- Strong financial performance: Net cash £25.5m (2 June 2001: £27.5m);
- Engineering headcount increased 31% to 670 (2000: 511);
- Continued strong margin performance anticipated.

I am pleased to report on Pace's results for the half year ended 1 December 2001, a period which has seen Pace gain a foothold in the United States market and drive further significant product design improvements. The rate of deployment of set-top boxes in the international digital TV market continued to grow during the period, with Pace providing home gateways and integration technology to the broadcasters, cable operators and telecommunication companies that deliver digital TV, voice, data and interactive services into consumers' homes.

RESULTS AND DIVIDEND ./

Profit before tax and amortisation of goodwill increased 20.9% to £22.2m (2000: £18.4m). Diluted earnings per share before amortisation of goodwill were up 32.7% to 7.22p (2000 as restated: 5.44p).

The Board has declared an interim dividend per share of 0.40p (2000: 0.35p).

TRADING AND FINANCIAL REVIEW ./

Turnover from the sales of Pace digital TV home gateways and additional services grew 4.9% to £215.8m (2000: £205.8m). Shipments during the period increased by 17.2% to 1.2 million units as we continued to take market share.

Pace performed well in the UK, as the cable companies continued to convert analogue customers to digital, increasing its share of a market that has performed better than anticipated. This was aided by the successful launch of Sky+ with BSkyB, a gateway containing a hard disk drive which can pause live TV and record in digital quality. In the US, where we have begun shipments to Time Warner Cable, we believe the market will remain strong but will experience similar levels of price reduction to those delivered by Pace elsewhere in the world. Prospects with several other cable companies appear promising and it remains our goal to win a 15% share of the US cable market over the next two years.

As we announced at the Company's AGM in September, the Board believes further industry consolidation is required before we can expect significant development in Europe of pay TV set-top boxes. Xcom, our French subsidiary, whose European distribution is mainly through retail channels, has performed well, selling products in France, North Africa, Italy and Spain. Both Xcom and the IPTV division (which supplies boxes for reception of video over traditional telephone lines), continue to forge new business opportunities in Asia. Xcom has begun shipments to Taiwan and the Philippines, whilst SingTel, amongst others, are using Pace technology for their IPTV trials in Singapore.

Profitability increased significantly in the period. Gross profit increased 30.6% to £55.0m, reflecting a gross margin of 25.5% (2000: 20.5%). Operating profit, before amortisation of goodwill, increased 22.2% to £22.0m, reflecting a margin of 10.2% (2000: 8.8%).

We were able to pass on significant cost improvements to our customers and to increase percentage gross margins due to the growth in software services and the introduction of new products across the entire Pace range. Margins have also benefited from the outsourcing of our manufacturing and service and repair facilities.

We expect the outsourcing of product assembly and test to result in further improvements to our competitive position. In addition, we expect to gain advantage from other added value services provided by the sub-contract manufacturers. We believe these changes will enhance our focus on Pace's core competency of innovative, cost-effective and reliable product design.

Average price reductions of approximately 12% on the comparative period were made possible by the Group's engineering team which now numbers 670 out of total Group employees of 975. The team produces innovative designs to cost-reduce existing products and create new products and is central to Pace's continued leadership in enhanced digital TV, home networking and VoIP technologies.

Overheads, net of other income and before the amortisation of goodwill, increased by 36.8% to £32.9m. Engineering costs increased to £19.5m, 9.0% of revenue (2000: 6.7%). Selling, General and Administrative costs increased to £13.4m, 6.2% of revenue (2000: 5.1%). When compared with the second half of the last financial year, overheads have reduced by 10.8%.

We have increased to over 160 the number of patents applied for to improve our defences against intellectual property claims asserted by others. We have maintained our policy of providing for currently known and potential claims. Settlement of a major claim during the period enabled us, as last year, to release a part of our overall provision.

Net assets increased to £161.2m (2 June 2001 as restated: £150.1m). Within net current assets of £87.2m (2 June 2001 as restated: £76.6m), net cash was £25.5m (2 June 2001: £27.5m). The Company has lines of credit totalling £70m for its needs. Debtors have risen as a result of Pace providing additional credit to certain customers. Stocks reduced as a result of the outsourcing of manufacturing.

DEFERRED TAX ./

Pace has adopted the policy of providing in full for deferred tax on all timing differences as required by the new UK Accounting Standard, FRS 19. To reflect the new policy the comparative figures have been restated, with the effect of a reduction in profit after tax for the first half of last year of £1.1m and for the whole of last year of £2.7m. There was no significant impact on the results of the current period.

OUTLOOK ./

We enjoyed strong unit growth in the first half of the fiscal year, and look forward to continued growth over the next six months. The lower pricing environment, where Pace has been reducing its average prices by between 10% and 20%, will impact revenues for the full year, which should be broadly similar to last year. Pace expects to show strong gross margin performance by virtue of its design competence and lean cost structure. During the second half of calendar 2002 we expect the market to strengthen as customer roll-out rates accelerate and we remain confident of significant new contract wins, particularly in the US.

The Board believes that Pace continues to be well placed within its market and the longer-term outlook for our industry sector remains positive.

Sir Michael Bett
Chairman

8 January 2002

FOR THE 26 WEEKS ENDED 1 DECEMBER 2001

	Note	26 Weeks Ended 1 Dec 2001 (unaudited) £000	26 Weeks Ended 2 Dec 2000 Restated (unaudited) £000	52 Weeks Ended 2 June 2001 Restated (audited) £000
Turnover	1	**215,808**	205,832	523,641
Cost of sales:				
Recurring		**(160,844)**	(163,737)	(418,453)
Exceptional item		**-**	-	(4,529)
Gross profit		**54,964**	42,095	100,659
Other operating income and charges		**(34,272)**	(24,582)	(62,698)
Operating profit		**20,692**	17,513	37,961
Net interest receivable		**176**	337	107
Profit on ordinary activities before taxation		**20,868**	17,850	38,068
Tax on profit on ordinary activities	2	**(6,139)**	(6,329)	(13,608)
Profit on ordinary activities after taxation		**14,729**	11,521	24,460
Dividends payable	4	**(859)**	(750)	(2,269)
Retained profit for the financial period		**13,870**	10,771	22,191
Basic earnings per ordinary share	3	**6.82p**	5.46p	11.48p
Diluted earnings per ordinary share	3	**6.62p**	5.21p	11.06p
Dividend per ordinary share	4	**0.40p**	0.35p	1.05p

The results from the current period derive from continuing operations.

RESULTS BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEM

	£000	£000	£000
Operating profit	**22,033**	18,027	44,182
Profit on ordinary activities before taxation	**22,209**	18,364	44,289
Basic earnings per ordinary share	**7.44p**	5.70p	14.01p
Diluted earnings per ordinary share	**7.22p**	5.44p	13.50p

AT 1 DECEMBER 2001

	Note	1 Dec 2001 (unaudited) £000	2 Dec 2000 Restated (unaudited) £000	2 June 2001 Restated (audited) £000
Fixed assets				
Intangible		**55,151**	20,892	59,097
Tangible		**18,045**	15,952	16,842
Investments	5	**22,327**	15,611	21,537
		95,523	52,455	97,476
Current assets				
Stocks		**27,177**	65,926	39,693
Debtors	6	**134,136**	99,938	89,746
Cash at bank and in hand		**26,263**	18,738	28,373
		187,576	184,602	157,812
Creditors: amounts falling due within one year		**(100,343)**	(110,792)	(81,194)
Net current assets		**87,233**	73,810	76,618
Total assets less current liabilities		**182,756**	126,265	174,094
Creditors: amounts falling due after more than one year		**(2,197)**	(4,566)	(629)
Provisions for liabilities and charges	8	**(19,370)**	(20,090)	(23,336)
Net assets		**161,189**	101,609	150,129
Capital and reserves				
Called up equity share capital		**11,292**	11,138	11,288
Share premium account		**35,123**	54,445	35,085
Shares to be issued		**19,000**	2,323	21,871
Merger reserve		**36,827**	-	36,827
Profit and loss account		**58,947**	33,703	45,058
Total shareholders' funds		**161,189**	101,609	150,129

FOR THE 26 WEEKS ENDED 1 DECEMBER 2001

	Note	26 Weeks Ended 1 Dec 2001 (unaudited) £000	26 Weeks Ended 2 Dec 2000 (unaudited) £000	52 Weeks Ended 2 June 2001 (audited) £000
Net cash inflow from operating activities	9	**8,717**	3,563	34,731
Returns on investments and servicing of finance		**290**	423	(19)
Taxation		**(3,295)**	(1,673)	(9,220)
Capital expenditure and financial investment		**(6,094)**	(10,223)	(22,618)
Net cash outflow from acquisition		**-**	-	(1,504)
Equity dividends paid		**(1,503)**	(1,265)	(2,020)
Cash flow before financing		**(1,885)**	(9,175)	(650)
Financing		**(92)**	1,518	1,742
(Decrease)/Increase in cash in the period		**(1,977)**	(7,657)	1,092

Reconciliation of net cash flow to movement in net funds			
(Decrease)/Increase in cash in the period	**(1,977)**	(7,657)	1,092
Cash flow from decrease in debt	**2**	72	83
Movement in net funds in the period	**(1,975)**	(7,585)	1,175
Net funds at start of period	**27,484**	26,309	26,309
Net funds at end of period	**25,509**	18,724	27,484

ANALYSIS OF CHANGES IN NET FUNDS

	At 2 June 2001 £000	Cashflow £000	At 1 Dec 2001 £000
Cash at bank and in hand	**28,373**	(2,110)	26,263
Bank loans and overdrafts	**(886)**	133	(753)
	27,487	(1,977)	25,510
Finance leases	**(3)**	2	(1)
	27,484	(1,975)	25,509

01 TURNOVER

	26 Weeks Ended 1 Dec 2001 (unaudited) £000	26 Weeks Ended 2 Dec 2000 (unaudited) £000	52 Weeks Ended 2 June 2001 (audited) £000
The geographical analysis of turnover by destination is as follows:			
United Kingdom	**193,087**	178,389	443,975
Europe	**13,504**	15,570	35,250
Far East (including Australasia)	**3,032**	5,009	17,368
North America	**1,557**	1,442	2,653
Rest of the World	**4,628**	5,422	24,395
	215,808	205,832	523,641

02 TAX ON PROFIT ON ORDINARY ACTIVITIES

	26 Weeks Ended 1 Dec 2001 (unaudited) £000	26 Weeks Ended 2 Dec 2000 Restated (unaudited) £000	52 Weeks Ended 2 June 2001 Restated (audited) £000
The tax charge is based on the estimated effective rate of taxation for the period and represents:			
United Kingdom corporation tax at 30%	**4,828**	6,417	13,529
Overseas tax	**831**	80	458
Deferred tax (see note 7)	**480**	(168)	(379)
	6,139	6,329	13,608

03 EARNINGS PER ORDINARY SHARE

Basic earnings per ordinary share have been calculated by reference to the profit before and after the amortisation of goodwill and exceptional item, and after taxation, and the average number of qualifying ordinary shares of 5p in issue of 216,092,015 (2000: 211,197,977).

Diluted earnings per ordinary share vary from basic earnings per ordinary share due to the effect of the notional exercise of outstanding share options. The diluted earnings are the same as basic earnings. The diluted number of qualifying ordinary shares was 222,575,396 (2000: 221,304,028).

04 DIVIDENDS PAYABLE

The directors have declared an interim dividend of 0.40p per share (2000: 0.35p per share). The dividend, which amounts to £859,000 (2000: £750,000), will be paid on 8 April 2002 to shareholders registered on 8 March 2002.

05 INVESTMENTS

An amount of £22,327,000 (2000: £15,611,000) is held by the Pace Micro Technology Employee Benefits Trust and the QUEST in respect of own shares purchased to satisfy options granted to employees.

06 DEBTORS

Debtors include a deferred tax asset of £6,965,000 (2000 as restated: £7,233,000), of which £4,734,000 (2000 as restated: £6,234,000) is due after more than one year.

07 PRIOR YEAR ADJUSTMENT

The policy for calculating deferred tax has been changed during the period in order to comply with FRS19 "Deferred Tax", which requires full provisioning on all timing differences. In prior years, the policy adopted was one of partial provisioning. The comparative figures in the financial statements have been restated to reflect the new policy.

	26 Weeks Ended 2 Dec 2000 (unaudited) £000	52 Weeks Ended 2 June 2001 (audited) £000
Profit and Loss Account		
Deferred Tax	1,126	2,652
Decrease in profit for the period	1,126	2,652
Balance Sheet		
Debtors	3,810	2,284
Increase in net assets	3,810	2,284

The change in accounting policy has had no material effect on the profits reported for the period to 1 December 2001.

08 PROVISIONS FOR LIABILITIES AND CHARGES

	Royalties under negotiation (see note 10) £000	Onerous contracts £000	Warranties £000	Contingent cash consideration £000	Total £000
At 2 June 2001	17,430	524	3,382	2,000	23,336
Net (credit)/charge for the period	(1,220)	354	3,137	-	2,271
Utilised	(936)	(524)	(4,777)	-	(6,237)
At 1 December 2001	**15,274**	**354**	**1,742**	**2,000**	**19,370**

The directors consider that to disclose the amounts unused on the settlement of claims during this period would be seriously prejudicial to other royalty claims and onerous contracts currently under negotiation, in litigation or in dispute. Accordingly the directors have aggregated amounts released unused with additional provisions made in the period in order to arrive at the net charge for the period shown above.

09 NET CASH INFLOW FROM OPERATING ACTIVITIES

	26 Weeks Ended 1 Dec 2001 (unaudited) £000	26 Weeks Ended 2 Dec 2000 (unaudited) £000	52 Weeks Ended 2 June 2001 (audited) £000
Operating profit	**20,692**	17,513	37,961
Exceptional item	**-**	-	4,529
Operating profit before exceptional item	**20,692**	17,513	42,490
Exchange differences	**19**	15	(150)
Goodwill amortisation	**1,341**	514	1,692
Depreciation	**4,199**	3,446	9,780
Profit on sale of tangible fixed assets	**(98)**	(26)	(86)
Decrease/(Increase) in stocks	**12,515**	(45,145)	(15,446)
(Increase) in debtors	**(45,169)**	(26,579)	(12,511)
Increase in creditors	**19,184**	52,142	7,525
(Decrease)/Increase in provisions for liabilities and charges	**(3,966)**	1,683	1,437
Net cash inflow from operating activities	**8,717**	3,563	34,731

10 CONTINGENT LIABILITY

The owners of patents covering technology allegedly used by the Group have indicated claims for royalties relating to the Group's use (including past usage) of that technology. Whilst negotiations over these liabilities continue, they are not concluded. The directors have made provision for the potential royalties payable based on the latest information available. Having taken legal advice, the Board considers that there are defences available that should mitigate the amounts being sought. The Group will vigorously negotiate or defend all claims but, in the absence of agreement, the amounts provided may prove to be different from the amounts at which the potential liabilities are finally settled.

11 BASIS OF PREPARATION

The accounts for the 26-week period ended 1 December 2001 have not been audited, nor have the accounts for the 26-week period ended 2 December 2000. They comply with relevant accounting standards and have been prepared on a consistent basis using the accounting policies set out in the 2001 Annual Report and Accounts. The figures for the 52-week period ended 2 June 2001 do not constitute the Group's statutory accounts for that period but have been extracted from the statutory accounts, which have been filed with the Registrar of Companies, and then restated to reflect the adoption of the provisions of FRS 19 'Deferred Tax'. The auditors have reported on those accounts and that report was unqualified and did not contain a statement under Section 237(2) or (3) of the Companies Act 1985. The accounts for the full year will be for the 52-week period ending 1 June 2002.

INTRODUCTION

We have been instructed by the company to review the financial information set out on pages 6 to 10 and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

DIRECTORS' RESPONSIBILITIES

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where they are to be changed in the next annual accounts in which case any changes, and the reasons for them, are to be disclosed.

REVIEW WORK PERFORMED

We conducted our review in accordance with guidance contained in Bulletin 1999/4: *Review of interim financial information* issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

REVIEW CONCLUSION

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the 26-week period ended 1 December 2001.

KPMG Audit Plc
Chartered Accountants
Leeds

8 January 2002

Copies of this Interim Report will be sent shortly to shareholders and are available on application to the Registered Office: Pace Micro Technology plc, Victoria Road, Saltaire, Shipley, West Yorkshire, BD18 3LF.

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