



## **Pace Micro Technology plc**

### **Results for the half year ended 2 December 2006**

**5 February 2007**

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**There will be a presentation for stockbroking analysts at 9.30am at Citigate Dewe Rogerson's office, 3 London Wall Buildings, London Wall, London EC2M 5SY**

# **Pace Micro Technology plc**

## **for the 26 weeks ended 2 December 2006**

### **HIGHLIGHTS**

Performance demonstrates Pace has turned the corner, benefiting from improved financial performance and successful new product shipments worldwide. As a result revenues have more than doubled and the Company has returned to profit.

- Shipments up over 60% to 1.8 million set-top boxes (2005: 1.1 million)
- North America contributed over 50% of revenue, confirming Pace's long-term strategy to target the world's largest digital television market
- Revenue more than doubled to £180.2m (2005: £78.9m)
- Profit before tax and restructuring costs of £1.4m (2005: loss £8.9m)
- Diluted earnings per share of 0.1p (2005: loss per share of 4.6p)
- Net borrowings of £14.1m (3 June 2006: £6.1m)

### **Business:**

- US shipments have started well, complemented by continuing solid performances in EMEA and Asia Pacific
- US high definition (HD) MPEG-4 personal video recorder (PVR) demand growing
- Growth in market demand for high definition products driven by payTV operators, consumer demand and falling prices of high definition ready television displays
- Digital television market well positioned for growth due to government digital switchover plans in a number of countries
- Continued commitment to new technology development to address new ways of delivering and consuming entertainment services

### **Pace Micro Technology's Chairman, Mike McTighe, commented**

“During 2006, the Pace management team focused on the need for change within the organisation. Our actions are beginning to pay off and we are now well positioned to capitalise on our strengths.

The commercial market place is challenging as short-term demand is often unpredictable, but as a result of restructuring, we have created a more customer centric, motivated, and accountable organisation.

The Board is confident that progress will continue and that Pace remains on track to meet its expectations for the 2006/07 financial year. This is as a result of management's focus on customer relationships, technology innovation, operational excellence, delivery and profitability, coupled with greater global demand for digital products and services.”

## **Chairman's Statement**

### **Overview**

Pace has now turned the corner with successful new product shipments taking place in markets worldwide, most importantly the US. A number of significant organisational changes initiated by the new management team to resolve execution issues, improve margin performance and reduce costs are starting to deliver results. During the first half Pace's revenues have more than doubled and the Company has returned to profit.

Good progress is being made in the US, which contributed over 50% of the Group's revenues in the period, confirming Pace's long-term strategy to target the world's largest digital TV market. Pace continues to deliver its high definition (HD) MPEG-4 personal video recorder (PVR) to DirecTV and a growing number of US cable operators have purchased Pace's HD PVR. Following approval in September 2006, shipments to Comcast of Pace's standard definition (SD) PVR for US cable networks started. Elsewhere in the world there was solid growth as Pace secured business with both new and existing customers.

Improving profitability is now a key priority and progress is expected as improvements are made in product design and operational execution. As a result of work already carried out, improved margins are now being achieved in some new products, but due to the development cycle of a typical set-top box design, it will take 12 to 18 months to work through.

In the wider market, competition between payTV operators and new entrants such as telcos and operators providing video services over broadband is driving demand for new and existing products in the fight both to acquire and retain subscribers. At the same time consumers purchasing HD-ready displays are generating demand for new product solutions that combine high definition, PVR and other digital video services. Momentum is also growing in markets where analogue is being phased out with a complete switch to digital, offering further opportunities for Pace.

The new organisation structure, implemented in summer 2006, has reshaped Pace's business around its customers, enabling more effective, deeper customer relationships. The changes are placing Pace in a stronger position to win new business while at the same time enabling operational improvements in the design, manufacture and delivery of new products. This has been evidenced by a number of successful new contract wins.

### **Results and Financial Review**

With strong order growth across all regions, shipments increased to 1.8m set-top boxes (2005: 1.1m) and revenues increased to £180.2m (2005: £78.9m). Gross margin performance was in line with the Board's expectations, decreasing to 15.3% (2005: restated: 15.8%), as the business sells through products based on older and less cost-efficient designs. The current product mix includes some high volume products, in particular for the US market, with lower margins. At the same time average selling prices have risen from £72 to £100, reflecting the growing proportion of higher specification products, such as high definition PVRs, being shipped.

The trading profit before exceptional charges noted below, was £1.4m (2005: loss of £8.9m). Underlying overheads, excluding restructuring costs and the impact of IAS38, were £26.1m (2005: £27.4m). Under IAS38, Pace capitalised a net £1.3m (2005: £5.5m) of development costs. Restructuring and reorganisation costs of £0.9m (2005: £1.0m) were incurred and, due to organisational restructuring, headcount fell from 660 to 592 during the period. After exceptional costs, the Group recorded a profit before taxation of £0.5m (2005: loss of £9.8m). The Board has decided not to recommend a dividend (2005: nil).

The Group finished the period with net debt of £14.1m (3 June 2006: £6.1m), due to the working capital impact of the Group's significant increase in US production and with the large volumes shipped towards the end of the half year. The Board is confident that the Group will be cash generative in the second half of the year.

### **Operating Review**

The first half of the 2006/07 financial year saw Pace work through the challenges that had been holding back deliveries on a number of new and highly complex set-top box products. These challenges were the result of delays in Pace's and third parties' software development, coupled with industry-wide difficulties in the development of silicon and software for the new MPEG-4/H.264 compression standard. The resolution of these issues has enabled the business to move forward.

## **EMEA**

Pace shipped 1.0m set-top boxes into the EMEA region (2005: 0.9m), an increase of over 10% on the comparative period. Pace has continued to work with BSkyB, recently winning new business for Digibox and the Sky+ PVR for shipment later this calendar year. In Italy, shipments of a standard definition PVR commenced to Sky Italia, alongside ongoing shipments of both high and standard definition set-top boxes.

A new contract was signed with Digiturk, a major Turkish operator, for a high definition PVR and basic set-top box. The Digiturk product now in development uses a new combination of Irdeto conditional access and OpenTV middleware. These products are expected to create a series of new business opportunities for the Group, as a number of other payTV operators will require similar solutions.

In Germany Pace's performance has been less successful following Premiere's loss of Bundesliga football rights, which has had a direct impact on the demand. Amongst the Group's European cable customers a new box for the UK market is now in testing and a new box for KDG in Germany is expected to ship later in 2007. Shipments to UPC in The Netherlands have been at a good level during the period.

Pace, along with other set top box manufacturers and broadcasters, continues to monitor the potential re-interpretation by European Union customs authorities of customs regulations that could result in the extension of import duties to interactive set-top boxes manufactured outside, but imported into, the EU. No final decision has been made so it remains impossible to quantify any potential impact. However, Pace has analysed its options against the range of possible outcomes and has plans in place to manage those outcomes.

## **Americas**

Shipments into the Americas increased significantly to 0.6m (2005: 0.1m) as Pace commenced deliveries to DirecTV and Comcast, two of the world's largest payTV operators. At the same time Pace's US customer base has expanded, with over 20 further cable operators. This is in addition to ongoing business with Rogers and Vidéotron in Canada.

Pace is also working with its US cable customers to meet a new Federal Communications Commission (FCC) regulation, requiring all cable set-top boxes to incorporate 'separable security', similar to the card-based conditional access systems used by many European payTV operators. This regulation comes into place on 1 July 2007 and Pace is on track to introduce its own range of CableCARD set-top box products.

## **Asia Pacific**

Shipments to Pace's customers in the Asia Pacific region increased to 265,000 (2005: 66,000). In Australia Pace has two customers, Foxtel and Optus. Pace remains Foxtel's lead supplier shipping both standard definition set-top boxes and the iQ PVR and has recently celebrated its one millionth box shipment. PVR shipments continue to Optus, which offers the Foxtel digital service to its customers. At Sky New Zealand, Pace has continued to ship this customer's standard box and shipments of the PVR have grown, following its launch last year.

## **Board and Executive appointments**

In January, Pace announced the appointment of a new Chief Financial Officer, Stuart Hall. Stuart will start in early April and succeed David Brocksom who left Pace on 2 February. The Board would like to thank David Brocksom for the important contribution he has made to Pace over the last three years.

## **Future Markets and Technologies**

Innovation is at the core of Pace's culture and helps keep the Group ahead of the competition by exciting customers and opening up new opportunities. A good example is DirecTV. Pace was selected to launch DirecTV's cutting edge MPEG-4 HD PVR because of the Group's early investment and achievements in this new technology. By 2010 there are expected to be over 100 million HD homes worldwide and Pace is well positioned to exploit this growing market.

Pace takes a 'Managed Innovation' approach to new technology and product development, selecting projects based on robust analysis, the likely return on investment, and skill availability within Pace and at selected partners. As a result, Pace can focus on products that meet future customer requirements and exploit market opportunities based on emerging technologies, such as secure wireless video, the networked home and video over Broadband.

One example where Pace has identified a new market opportunity and created an offering is MultiDweller. This product distributes digital services – broadcast and broadband – to homes in large apartment blocks much more cost-effectively than existing solutions. With analogue switch-off fast approaching, this product could be a compelling solution for many operators. Pace is investing in further projects and new technologies to take advantage of such additional market opportunities.

### **Outlook**

As Pace celebrates its 25<sup>th</sup> anniversary during 2007 shipments are growing steadily, in particular to the US. The Board is confident that progress will continue in the second half as a result of management's focus on customer relationships, technology innovation, operational excellence, and profitability, coupled with greater global demand for digital products and services. Margin performance will be constrained in the second half as the Group continues to ship older and less cost-effective designs.

The Board acknowledges that significant progress has been made, but further improvement is necessary, especially in the area of profitability. Pace's recent restructuring programme has created a more customer focussed, motivated and accountable organisation that will enable more predictable engineering delivery and improved profitability, a key priority for the business.

Digital television markets remain strong and Pace has excellent support from its customers and partners as well as a clear plan going forward. As ever, Pace's success remains highly dependent on the success of its customers' businesses and third party technology suppliers.

The Board is confident that progress will continue and that Pace remains on track to meet its expectations for the 2006/07 financial year.

Mike McTighe  
Chairman  
5 February 2007

**CONSOLIDATED INTERIM INCOME STATEMENT**  
FOR THE 26 WEEKS ENDED 2 DECEMBER 2006

	Note	26 weeks ended 2 Dec 2006 £000	26 weeks ended 3 Dec 2005 £000	52 weeks ended 3 June 2006 £000
Revenue	2	180,217	78,940	178,095
Cost of sales:				
Before exceptional items		(152,719)	(66,430)	(145,984)
Exceptional items	3	-	-	(5,500)
<b>Total Cost of sales</b>		<b>(152,719)</b>	<b>(66,430)</b>	<b>(151,484)</b>
<b>Gross profit</b>		<b>27,498</b>	<b>12,510</b>	<b>26,611</b>
Administrative expenses:				
Research and Development expenditure		(12,225)	(9,416)	(21,433)
Other administrative expenses:				
Before exceptional items		(12,546)	(12,505)	(26,864)
Exceptional items	3	(884)	(970)	(5,883)
<b>Total Administrative expenses</b>		<b>(25,655)</b>	<b>(22,891)</b>	<b>(54,180)</b>
Other operating expenses:				
Impairment loss on trade investment	3	-	-	(505)
<b>Operating profit/(loss)</b>		<b>1,843</b>	<b>(10,381)</b>	<b>(28,074)</b>
Financial income – bank interest receivable		53	592	755
Financial expenses – bank interest payable		(1,384)	(51)	(131)
<b>Profit/(loss) before tax</b>		<b>512</b>	<b>(9,840)</b>	<b>(27,450)</b>
Tax charge	4	(288)	(264)	(1,334)
<b>Profit/(loss) after tax</b>		<b>224</b>	<b>(10,104)</b>	<b>(28,784)</b>
<b>Attributable to:</b>				
Equity holders of the Company		224	(10,104)	(28,784)
Basic earnings/(loss) per ordinary share	5	0.1p	(4.6)p	(13.0)p
Diluted earnings/(loss) per ordinary share	5	0.1p	(4.6)p	(13.0)p

All figures presented on pages 6 to 14 are unaudited.

# CONSOLIDATED INTERIM BALANCE SHEET

AT 2 DECEMBER 2006

	Note	2 Dec 2006 £000	3 Dec 2005 £000	3 June 2006 £000
<b>ASSETS</b>				
<b>Non Current Assets</b>				
Property, plant and equipment		6,877	7,278	7,671
Intangible assets - goodwill		9,436	9,436	9,436
Intangible assets – development expenditure		12,570	12,972	11,286
Investments in other companies		349	777	349
Deferred tax assets		2,887	4,009	2,887
<b>Total Non Current Assets</b>		<b>32,119</b>	<b>34,472</b>	<b>31,629</b>
<b>Current Assets</b>				
Inventories		27,512	18,822	34,792
Trade and other receivables		83,192	43,413	42,337
Cash and cash equivalents		-	13,864	-
<b>Total Current Assets</b>		<b>110,704</b>	<b>76,099</b>	<b>77,129</b>
<b>Total Assets</b>		<b>142,823</b>	<b>110,571</b>	<b>108,758</b>
<b>EQUITY</b>				
Issued capital		11,627	11,487	11,576
Share premium		36,521	36,038	36,246
Translation reserve		(885)	215	240
Retained earnings		(5,072)	12,868	(5,595)
<b>Total Equity attributable to equity holders of the parent</b>		<b>42,191</b>	<b>60,608</b>	<b>42,467</b>
<b>LIABILITIES</b>				
<b>Non Current Liabilities</b>				
Interest bearing loans and borrowings		151	182	154
Provisions	6	8,972	9,310	9,284
<b>Total Non Current Liabilities</b>		<b>9,123</b>	<b>9,492</b>	<b>9,438</b>
<b>Current Liabilities</b>				
Trade and other payables		72,491	35,274	45,406
Current tax liabilities		256	220	3
Interest bearing loans and borrowings		13,930	57	5,937
Provisions	6	4,832	4,920	5,507
<b>Total Current Liabilities</b>		<b>91,509</b>	<b>40,471</b>	<b>56,853</b>
<b>Total Liabilities</b>		<b>100,632</b>	<b>49,963</b>	<b>66,291</b>
<b>Total Equity and Liabilities</b>		<b>142,823</b>	<b>110,571</b>	<b>108,758</b>

## CONSOLIDATED INTERIM STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital £000	Share premium £000	Translation reserve £000	Retained earnings £000	Total equity £000
<b>Balance at 4 June 2005</b>	11,349	35,677	150	22,576	69,752
Loss for the period	-	-	-	(10,104)	(10,104)
Employee share incentive charges	-	-	-	314	314
Movement in employee share trusts	-	-	-	82	82
Issue of shares	138	361	-	-	499
Currency translation adjustments	-	-	65	-	65
<b>Balance at 3 December 2005</b>	11,487	36,038	215	12,868	60,608
Loss for the period	-	-	-	(18,680)	(18,680)
Employee share incentive charges	-	-	-	179	179
Movement in employee share trusts	-	-	-	38	38
Issue of shares	89	208	-	-	297
Currency translation adjustments	-	-	25	-	25
<b>Balance at 3 June 2006</b>	11,576	36,246	240	(5,595)	42,467
Profit for the period	-	-	-	224	224
Employee share incentive charges	-	-	-	299	299
Issue of shares	51	275	-	-	326
Currency translation adjustments	-	-	(1,125)	-	(1,125)
<b>Balance at 2 December 2006</b>	11,627	36,521	(885)	(5,072)	42,191

## CONSOLIDATED INTERIM CASH FLOW STATEMENT

FOR THE 26 WEEKS ENDED 2 DECEMBER 2006

	26 weeks ended 2 Dec 2006 £000	26 weeks ended 3 Dec 2005 £000	52 weeks ended 3 June 2006 £000
<b>Cash flows from operating activities</b>			
Profit/(loss) before tax	512	(9,840)	(27,450)
Adjustments for:			
Share based payments charge	299	314	493
Depreciation of property, plant and equipment	2,073	1,960	4,116
Amortisation of development expenditure	5,525	3,317	13,296
Impairment of trade investments	-	-	505
Loss on sale of property, plant and equipment	-	72	241
Net financial charges/(income)	1,331	(541)	(624)
Movement in trade and other receivables	(42,764)	8,414	9,490
Movement in trade and other payables	27,722	3,797	13,871
Movement in inventories	7,169	(8,687)	(24,657)
Movement in provisions	(1,029)	(510)	51
Cash generated from/(used in) operations	838	(1,704)	(10,668)
Interest paid	(1,215)	(51)	(142)
Tax paid	(51)	(93)	(258)
Net cash used in operating activities	(428)	(1,848)	(11,068)
<b>Cash flows from investing activities</b>			
Acquisition of trade investments	-	(103)	(180)
Purchase of property, plant and equipment	(1,280)	(3,090)	(5,862)
Development expenditure	(6,809)	(8,839)	(17,132)
Proceeds from sale of property, plant and equipment	-	-	5
Proceeds from exercise of employee share options	-	82	120
Interest received	-	572	842
Net cash used in investing activities	(8,089)	(11,378)	(22,207)
<b>Cash flows from financing activities</b>			
Proceeds from issue of share capital	326	499	796
Repayment of loans	(23)	(22)	(50)
Net cash generated from financing activities	303	477	746
<b>Net change in cash and cash equivalents</b>	(8,214)	(12,749)	(32,529)
Cash and cash equivalents at start of period	(5,880)	26,647	26,647
Effect of exchange rate fluctuations on cash held	221	(34)	2
<b>Cash and cash equivalents at end of period</b>	(13,873)	13,864	(5,880)

## NOTES

### 1. BASIS OF PREPARATION AND BUSINESS ENVIRONMENT

#### BASIS OF PREPARATION

This unaudited interim financial information is for the 26 week period ending 2 December 2006 and is prepared in accordance with International Financial Reporting Standards ("IFRS") adopted for use in the EU ("Adopted IFRS") at 2 December 2006 and under the historical cost convention as modified by the revaluation of derivative instruments.

As referred to in the Business Environment section below, the Group customarily has a level of inventory and purchase commitments, the realisation of which is not certain. As noted in the Annual Report for the year ended 3 June 2006, and as result of delays in the launch of certain products for the North American market, the Group had stock and purchase commitments for these products of £23m and £60m respectively where there were not corresponding customer approvals or purchase agreements. As a result of subsequent approvals and shipments, the Group's net exposure to such North American product has reduced to £7.7m at 5 February 2007. The Directors have considered the ongoing sales and consider that this value is likely to be realised.

The Group has put in place new borrowing facilities to January 2010, based upon 85% of relevant trade debtors, as adjusted, up to a maximum of £35m. These facilities are subject to financial performance covenants.

In managing the process from product manufacturing to customer approval over the last period, the Group has and continues to reschedule, cancel or otherwise renegotiate with its suppliers the timing and value of purchase commitments and payments, which has included the granting of security interests. The ability and willingness of suppliers to continue to work with Pace continues to be important to the management of the business.

Pace, along with other set top box manufacturers and broadcasters, continues to monitor the potential re-interpretation by European Union customs authorities of customs regulations that could result in the extension of import duties to interactive set-top boxes manufactured outside, but imported into, the EU. No final decision has been made so it remains impossible to quantify any potential impact. However, Pace has analysed its options against the range of possible outcomes and has plans in place to manage these outcomes.

The Board has prepared a working capital forecast based upon assumptions as to trading and the realisation of inventory, and the matters above, as well as building in the other circumstances noted in the Business Environment section below. The Board has also modelled a number of alternative business scenarios. Based upon these the Board has concluded that the Group has adequate working capital and that therefore it is appropriate to use the going concern basis of preparation for this financial information.

#### Interim Financial Information

The interim financial information for the 26 week periods ended 2 December 2006 and 3 December 2005 have not been audited. Figures for the 52 week period ended 3 June 2006 are extracted from the Company's statutory accounts for that financial year. These accounts, prepared under IFRS, have been reported on by the Company's auditors and delivered to the Registrar of Companies. The auditors report was unqualified and did not contain statements under Section 237(2) or (3) of the Companies Act 1985.

The preparation of interim statements in conformity with Adopted IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The note below "Business Environment" gives further detail on the nature of some of these factors.

#### Financial Year-End

The annual financial statements are drawn up to the Saturday nearest to 31 May. The current year's financial statements will be for the 52 weeks ending 2 June 2007.

## **Reclassification**

For the 26 week period ended 3 Dec 2005, certain expenses relating to the operations department, which is responsible for overseeing manufacturing, have been reclassified from cost of sales to administrative expenses, the figures for the 52 week period ended 3 June 2006 having already been so changed. This classification better reflects the overhead nature of the costs and the Group's move to outsource more of its manufacturing and supply chain function.

## **BUSINESS ENVIRONMENT**

### **Priorities**

The Group continues to focus on:

- Operational excellence to deliver a range of quality products on time and profitably for Pace's global customer base.
- Growing deeper customer relationships by ensuring Pace has the products and services needed in order for them to be competitive and to improve their average revenue per user (ARPU).
- Utilising Pace's core skills to create innovative technology and solutions that will excite the market and drive long-term business growth.

### **Customers and Markets**

The global market for payTV products (primarily set-top box products) is growing, although concentrated within a limited number of operators, some of which are currently in an unprofitable business development phase. The payTV market is attractive, and as with most modern markets, it is highly competitive with Pace's competitors ranging from divisions of large multinational electronics companies to specialist smaller companies. There are a number of barriers to market entry, in particular a requirement for complex post-deployment support to ensure deployed set-top boxes can continue to deliver over time a payTV service as this service grows in size and sophistication.

Orders placed by Pace's payTV customers are typically large one-off orders for delivery over a number of months with supplemental orders for additional volumes. As the eventual deployment of the set-top boxes can be unpredictable, revenues can be volatile. The difficulty in predicting Pace's business flow and its risks can be exacerbated by a number of other factors including, for example, the development process for an advanced set-top box which can take over 12 months. The Group works on long lead times (e.g. four months or more) for component supply and manufacture, typical of the industry. In the US market, in particular, customers firm order lead times may be less than the component lead times. There are third party delivery risks, for example, difficulties in the delivery of components or software code, and the final go ahead for manufacture and firm contractual commitments is usually dependent on product approvals and acceptance both from the operator and sometimes from third parties. In addition, there is a requirement for frequent design revisions that take into account price deflation and introduction of new, more cost effective electronic components. The revision process places increased demand on engineering resources but, at the same time, provides a further barrier to entry to new competitors.

The combined impact of these factors, together with the need to meet customers delivery requirements, imposes risk on Pace's product introduction programme.

### **Currency Risks**

The standard 'industry currency' is the US dollar, with the majority of components and manufacturing capacity purchased in this currency. As a result, due to part of the Group's sales being in Sterling and Euros (the sale prices of which will be fixed for months in advance) the Group remains exposed to the risk of foreign currency movements. To manage this risk, the Group's treasury policy is progressively to cover cash flows when these are sufficiently certain and to seek a greater percentage of US dollar sales to provide a commercial hedge against currency exposures.

### **Interest Rate Risk**

The Group's policy is to review regularly the terms of its available short term borrowing facilities and to assess individually and manage each long-term borrowing commitment accordingly. The Group does not currently take out any interest rate swaps.

## Credit Risk

Management has a credit insurance policy in place, which provides cover over most debtors, subject to excesses, and the exposure to credit risk is monitored on an ongoing basis. The Group does not require collateral in respect of financial assets.

Deposit investments are undertaken only in liquid securities and only with counterparties that have a credit rating equal or better than the Group. Transactions involving derivative financial instruments are with counterparties with whom the Group has a signed netting agreement as well as sound credit ratings.

## Engineering

The Group is dependent on the technological skills of its employees and is working to increase the average skill base at all of the main development sites. At the same time Pace is seeking to outsource a larger part of its development and next generation cost down activity to independent development centres and design and manufacturing partners. During the last year a significant number of new products for new customers have been developed. Development costs directly attributable to these products are capitalised according to specified criteria and amortised over the product life.

To improve business effectiveness, so the Group is better able to manage the significant volume of development work currently underway and in plan, there has been a significant internal re-organisation programme. The programme has focused on organisation structures and is now focused on business processes; in particular improving the effectiveness of Pace's development process both in effectiveness of delivery and in the improvement of product cost.

## Third Party and Other Risks

Pace provides product warranties for its set-top boxes. Although it is difficult to make accurate predictions of potential failure rates or the possibility of an epidemic failure, as a warranty estimate must be calculated at the outset of a product before field deployment data is available, these estimates improve during the lifetime of the product in the field.

Pace's products incorporate third party technology, usually under licence. Inadvertent actions may expose Pace to the risk of infringing third party intellectual property rights. Potential claims can still be submitted many years after a product has been deployed. Any such claims are always vigorously defended.

The Group outsources its manufacture to third party specialist electronics manufacturers, in particular to Solecron Corporation and to Asustek.

## Regulatory

Like all other businesses, the Group remains exposed to changes in the regulatory environment, including potential modifications in import duty regimes, discussions on which have been and continue to be held. The Company has managed the implementation of the EU WEEE and RoHs directives in the period.

## 2 Revenue

	26 weeks ended 2 Dec 2006 £000	26 weeks ended 3 Dec 2005 £000	52 weeks ended 3 June 2006 £000
The geographical analysis of revenue by destination is as follows:			
United Kingdom	29,913	40,064	64,446
Continental Europe	31,747	23,191	56,517
Far East and Australasia	19,818	5,176	38,309
North America	98,739	10,509	18,823
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	180,217	78,940	178,095

### 3 Exceptional items

	26 weeks ended 2 Dec 2006 £000	26 weeks ended 3 Dec 2005 £000	52 weeks ended 3 June 2006 £000
Exceptional charge in respect of US product	-	-	9,000
Restructuring and reorganisation costs	884	970	2,383
Impairment loss on trade investment	-	-	505
	<u>884</u>	<u>970</u>	<u>11,888</u>

The restructuring and reorganisation charges in all periods relate to a restructuring programme within the Group.

An exceptional charge was made in the 52 weeks ended 3 June 2006 following the delay in the delivery of US product, which charge was reflected as a £5.5m inventory write down and a £3.5m charge against capitalised development costs. The US product relates to the HD PVR product for the US cable market, where delays have affected the anticipated product life. The impairment loss in the 52 weeks ended 3 June 2006 related to the Company's investment in VegaStream Limited.

### 4 Tax charge

	26 weeks ended 2 Dec 2006 £000	26 weeks ended 3 Dec 2005 £000	52 weeks ended 3 June 2006 £000
United Kingdom corporation tax at 30%	-	-	-
Overseas tax	288	264	212
Deferred tax	-	-	1,122
	<u>288</u>	<u>264</u>	<u>1,334</u>

The tax charge is based on the estimated effective rate of taxation on trading for the period and represents:

### 5 Earnings/(loss) per ordinary share

Basic earnings/(loss) per ordinary share have been calculated by reference to the profit/(loss) after taxation, and the average number of qualifying ordinary shares of 5p in issue of 224,533,942 (2005: 220,428,226).

Diluted earnings/(loss) per ordinary share vary from basic earnings/(loss) per ordinary share due to the effect of the notional exercise of outstanding share options. The diluted earnings/(loss) are the same as basic earnings/(loss). The diluted number of qualifying ordinary shares was 225,959,720 (2005: 224,995,218).

## 6 Provisions

	Royalties under negotiation (see below) £000	Onerous contracts £000	Warranties £000	Total £000
At 3 June 2006	6,262	493	8,036	14,791
Charge for the period	1,852	-	3,339	5,191
Utilised	(1,253)	(493)	(4,432)	(6,178)
At 2 December 2006	6,861	-	6,943	13,804
<i>Due within one year</i>	-	-	4,832	4,832
<i>Due after more than one year</i>	6,861	-	2,111	8,972

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.

## 7 Contingent liabilities

A writ has been issued against the Company by a former customer relating to the supply of set top boxes in 2000/01 in respect of a claim to a maximum liability of c£7.5m. The Directors believe that they have good defences to such a claim and therefore no provision has been made.

### Circulation to shareholders

**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, or online at [www.pacemicro.com](http://www.pacemicro.com).**

**There will be an analysts' presentation on 5th February 2007 at 9.30am at Citigate Dewe Rogerson's office at 3 London Wall Buildings, London Wall, London, EC2M 5SY.**