



## Pace plc Interim Results for the six months ended 30 June 2010

### Pace increases first half profit by 46% and announces proposed US acquisition

**Saltaire, UK, 26 July 2010:** Pace, the leading independent developer of digital TV technologies for the global payTV industry, announces its results for the six months ended 30 June 2010.

#### Financial Highlights

- Revenues increased 21% to £635.2m (six months ended 30 June 2009: £526.5m)
- Improvement in gross margin to 18.6% (six months ended 30 June 2009: 17.2%)
- Adjusted<sup>1</sup> operating margin increased to 7.5% (six months ended 30 June 2009: 6.5%)
- Profit before tax up 46% to £45.4m (six months ended 30 June 2009: £31.0m)
- Adjusted<sup>1</sup> profit before tax up 39% to £47.8m (six months ended 30 June 2009: £34.3m)
- Basic EPS of 10.7p up 43% (six months ended 30 June 2009: 7.5p), with adjusted basic EPS of 11.6p up 40% (six months ended 30 June 2009: 8.3p)
- Interim dividend of 0.725p, increased by 45% (six months ended 30 June 2009: 0.5p)
- Strong balance sheet with cash of £94.1m (at 31 December 2009: £73.5m, at 30 June 2009: £48.9m)

#### Operating Highlights

- Pace delivered a strong first half and continues to increase market share, building on its recognition by IMS as the world's number one set-top box company<sup>2</sup>
- Consistent strong demand from Pace's global payTV markets leading to increased volume shipments up 12.9% to 9.6m (six months ended 30 June 2009: 8.5m)
- The Group won new customers and launched new platforms for existing customers that included Multichoice, M7, Sky Deutschland and Astro
- Continuing to establish leadership in TV-led home networking products
- Completed acquisition of Bewan Systems SA, the Paris-based IP and cable gateways specialist

#### Proposed acquisition

- Pace today announced the proposed acquisition of 2Wire Inc, a leading provider of advanced residential gateways and associated software and services for the broadband service provider market to widen Pace's US customer base and opportunity

<sup>1</sup> Adjusted is before amortisation of other intangibles

<sup>2</sup> IMS survey of global digital set-top box shipments in 2009, published May 2010





Commenting on the results, Neil Gaydon, Chief Executive Officer, said:

“In the first half, Pace delivered excellent revenue and profit growth and increased its cash position to further strengthen the balance sheet. These results were produced despite some challenges within the supply chain, due to the skill of our operations teams, scale and strong supplier relationships.

“Pace has become the world's leading supplier of digital set-top boxes, an achievement built on our deep understanding of the payTV operators’ business and market requirements and our ability to be first to deliver the technology that enables them to bring new services to market. With today’s announcement of our proposed acquisition of 2Wire, we expect to widen out our US customer base and opportunity as well as develop Pace’s technology capability.”

## Outlook

The market demand for pay and subscription TV services continues to grow, and Pace’s increasing penetration, technology capability and geographic reach give the Board confidence in Pace’s platform for sustainable future growth.

The Group is now close to achieving its medium term 8% operating margin target, which the Board expects to be a sustainable level going forwards. Pace management will nevertheless strive to improve on this.

Given the Group’s first half performance and good visibility for the second half, the Board is in the process of revising its expectations for the 2010 financial year. In light of the Group’s operating momentum, strong market position and the ongoing demand for digital TV technologies, the Board believes Pace should have the objective of delivering annual revenue growth of at least mid-single digit over the medium term.

*Please note this outlook statement does not incorporate any financial impact as a result of the proposed acquisition of 2Wire.*

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ISO 9001:2008 – FM 35904  
ISO 14001:2004 – EMS 60224  
ISO 27001:2005 – IS 89282



## Pace plc Interim Results for the six months ended 30 June 2010

### Results Overview

Conditions in the global markets for pay and subscription TV remain positive for Pace as service operators pull on the Group's product and technology capabilities for increasingly advanced devices that deliver and monetise high quality TV-led home entertainment. In the first half of 2010, as Pace continued to deliver against strategy and leverage its operational capability, the Group delivered its ninth consecutive period of earnings growth, reporting 21% revenue growth to £635.2m (six months ended 30 June 2009: £526.5m) and a 46% increase in profit before tax of £45.4m (six months ended 30 June 2009: £31.0m).

Gross margins increased, as expected, from 17.2% to 18.6% and Pace has almost reached its medium term 8% operating margin target, setting a sustainable level for the Group going forwards from which it will seek further improvement. At the same time Pace maintained a strong balance sheet, closing the period with cash of £94.1m (at 31 December 2009: £73.5m, at 30 June 2009: £48.9m), after taking into account a net cash outflow of £4.5m relating to the acquisition of Bewan Systems SA, the Paris-based IP and cable gateways specialist<sup>3</sup>.

Pace continues to work with more customers and technologies and across more markets than any of its competitors due its deep understanding of operators' business requirements and ability to be first to market with new products and technologies. In the first half of 2010 this resulted in an increase in volume shipments of nearly 13% to 9.6m (six months ended 30 June 2009: 8.5m). This increase was achieved despite the expected industry-wide supply chain challenges that the Pace team was able to anticipate and manage, using a range of operational tools available to the business. Pace was recently named number one in the global set-top box market<sup>4</sup> and received its latest Queen's Award for Enterprise in International Trade<sup>5</sup>.

Pace has performed well across all of its global markets, with the diversified geographic revenues enhancing overall quality of earnings. In summary, 37% of product was delivered into North America (revenue £233m, six months ended 30 June 2009: £193m), 20% into South America (revenue

<sup>3</sup> The overall consideration for the Bewan transaction will not be more than €12.5 million with a maximum earn out of €2.1m

<sup>4</sup> IMS survey of global digital set-top box shipments in 2009, published May 2010

<sup>5</sup> Pace's third successive Queen's Award for Enterprise



£124m, six months ended 30 June 2009: £58m), 33% into Europe (revenue £208m, six months ended 30 June 2009: £227m) and 10% (revenue £70m, six months ended 30 June 2009: £49m) into other global markets including Africa and Asia.

High definition (HD) continues to shape the market opportunity as operators launch and evolve HD services and over 65% of products delivered in the first half were HD-ready. This is ahead of overall HD market growth, with the leading operators also launching 3D channels to win new customers and increase average revenue per user ('ARPU'). All key first half announcements were for HD platforms with operators that included Multichoice in South Africa, M7 in Luxemburg, Sky Deutschland and Astro in the Middle East. All products are now designed to use minimal energy in all modes and meet the EU's directive for power consumption, using Pace's industry-leading low environmental impact (LEI) initiative, part of an ongoing 'Design for the Environment' framework being adopted across the entire range of new Pace products.

Key to operators' success is rights to exclusive content such as the 2010 World Cup and other major sporting events that stimulate ongoing consumer demand for subscription TV and increasingly advanced set-top box capabilities. In many markets the transition from analogue to digital still has a long way to run, global HD penetration is only mid-single digit percentage, hybrid (TV services that combine broadcast and broadband content) is at an early stage of deployment, 3D is in its infancy, with whole home networking and media gateways only just gaining momentum in the most developed markets. Despite low penetration rates at present, Pace firmly believes that these technological developments will be key growth drivers for the business going forward.

North America is currently the most advanced market for digital TV technology and Pace has continued its early leadership in TV-led home networking, with the recent launch of its first product into the US market, known as Home Content Sharing (HCS). This technology enables up to nine streams of HD content to be distributed around the home from a central gateway device and is already being rolled out by US cable operators. Pay and subscription TV operators across all delivery platforms are looking at how they can establish home networking and deliver converged home entertainment and broadband services around the home. The advanced gateway devices and associated software and services that will be acquired through the 2Wire acquisition will be utilised to support these market developments.

Underpinning Pace's success is its ability to understand the wide-ranging cultural, economic and technology drivers within the overall global market for digital TV technology. By building teams in

locations close to major customer groups, Pace understands how and when to launch new concepts and enter new markets. The Group will look to widen and deepen its reach by entering new geographic markets for when digital and HD become available to mass audiences. In addition, Pace utilises new technological developments to strengthen its capabilities in the delivery of networked 'whole home' gateways, from both in-house teams and new capabilities such as those acquired through the Bewan acquisition.

### **Home Entertainment Convergence**

Pace has established a leading position in high definition technology and increasingly operators are demanding HD hybrid set-top boxes that combine broadband and broadcast content. Hybrid devices are powerful platforms that payTV operators are currently using to add libraries of on-demand and catch-up TV for their customers. These boxes can also be evolved to provide access to the open internet for over-the-top (OTT) services and internet widget applications for such things as weather reports, social networking and interactive advertising. And set-top boxes, unlike most other consumer electronic devices, can be upgraded as they operate on a managed payTV network; ensuring end-users are easily kept abreast of the rapidly changing content environment.

As the core set-top box device becomes increasingly complex, Pace believes that for some markets and operator customers, TV-led home entertainment and broadband services are moving towards an integrated, converged gateway device that moves video, voice and data content around the home. In this environment software, applications and services will become increasingly important as operators continue to deliver services through managed gateways. In this context advanced residential gateways will become increasingly important both as standalone devices and in combination with set-top box products that drive whole home networks. Pace's capability in the development of converged solutions has already been enhanced by the acquisition of Bewan Systems the Paris-based IP and cable gateways specialist and will be further developed through the proposed acquisition of 2Wire with its software and telco gateway expertise.

### **Proposed acquisition**

Pace has this morning announced the proposed acquisition of 2Wire Inc, a leading provider of advanced residential gateways and associated software and services for the broadband service provider market for a cash consideration of \$475 million (£308 million). The acquisition price is inclusive of 2Wire's balance sheet cash at closing, anticipated to be approximately \$55 million

(£36 million). 2Wire is the number one supplier of advanced residential gateways in the US market. Pace believes the acquisition represents a logical extension of its successful strategy and will enhance its US business position in cable and satellite markets with entry into the tier 1 telco market. At the same time 2Wire's software and gateway expertise will support Pace's development of its home entertainment convergence strategy.

More detail on this proposed transaction is available in a separate announcement.

## **Financial Review**

In the six months to 30 June 2010, Pace shipped 9.6m set-top boxes (six months ended 30 June 2009: 8.5m) with revenues up 21% to £635.2m (six months ended 30 June 2009: £526.5m). Adjusted<sup>6</sup> profit before tax increased by 39% to £47.8m (six months ended 30 June 2009: £34.3m), with basic earnings per share 10.7p (six months ended 30 June 2009: 7.5p), up 43% and adjusted basic earnings per share 11.6p (six months ended 30 June 2009: 8.3p), up 40%. Retained profit for the period was £31.6m (six months ended 30 June 2009: £21.7m).

The first half saw strong gross margin performance, increasing to 18.6% (for the six months ended 30 June 2009: 17.2%). To satisfy the level of customer product demand, due to delays caused by the current supply chain environment, there was a greater use of air freight to deliver product on time, which was absorbed into gross margin. A substantive improvement in the supply chain is not expected until at least the end of 2011, but the Group is confident that its good order visibility and operational planning will ensure ongoing successful management of the issue. Average selling prices increased from £62 to £66, reflecting product mix and an increasing level of HD set-top boxes sold in the period.

Foreign exchange rates have continued to move significantly. At the start of the year for budgeting purposes the Group assumed foreign exchange rates based on £1: €1.12 and £1: \$1.63. To illustrate the impact of foreign exchange fluctuations on actual performance against expectations (rather than provide a constant currency comparison of H1 2010 vs H1 2009), had these rates continued throughout the first half of 2010, the Group would have delivered revenues of £613.9m. As a result of Pace's foreign exchange hedging strategy, gross and operating margins would have remained relatively unchanged at 19.4% and 8% respectively, with profit before tax of £49m.

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<sup>6</sup> Adjusted is before amortisation of other intangibles

Administrative expenses, including research and development, excluding the impact of amortisation of other intangibles, were £70.3m (six months ended 30 June 2009: £57.0m). The increase in overheads reflects the increased investment required to support the strong customer growth and includes new Bewan overheads and expanding Pace's specialist engineering centre in India. Acquisition costs of £1.5m are also included in overheads in accordance with revised accounting treatment required by IFRS 3 (2008).

Amortisation of other intangibles was £2.4m relating to trade marks and licence agreements and customer contracts and relationships arising on acquisitions. Other operating income was nil (six months ended 30 June 2009: £0.5m).

The net interest credit was £0.3m (six months ended 30 June 2009: £0.1m) reflecting the positive cash balances held throughout the period. A tax charge of £13.8m (six months ended 30 June 2009: tax charge £9.3m) represents an effective tax rate of 30.4% and reflects a blended rate between UK and higher tax rate overseas jurisdictions.

At 30 June 2010, the net working capital position was £70.4m (31 December 2009: £36.2m), inventory was £70.6m (31 December 2009: £87.0m), and trade and other receivables £279.3m (31 December 2009: £211.7m). Debtor days were 62 days (31 December 2009: 56 days), trade and other payables were £282.3m (31 December 2009: £262.6m), with creditor days of 72 days (31 December 2009: 71 days). After generating net cash of £20.6m the Group finished the period with cash of £94.1m (31 December 2009: £73.5m).

The principal risks and uncertainties facing the Group have not changed from those set out in the Annual Report and Accounts for the year ended 31 December 2009. They included: customer and market risks, product liability claims, credit risks, royalties, regulatory risks and currency risks. The full Annual Report and Accounts are available at [www.pace.com](http://www.pace.com).

## **Dividend**

Due to the ongoing strong business performance, the Board has determined to raise the level of the interim dividend by 45%, declaring an interim dividend of 0.725p per ordinary share (2009: 0.5p) that will be payable on 10 December 2010 to those shareholders on the register on 12 November 2010. This continues the progressive dividend policy that was introduced in 2009 with the intention of paying in the region of a one third, two thirds split between interim and final dividends.

## Responsibility statement of the directors in respect of the half-yearly financial report

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU;
- the interim management report includes a fair review of the information required by:
  - (a) DTR 4.2.7R of the *Disclosure and Transparency Rules*, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
  - (b) DTR 4.2.8R of the *Disclosure and Transparency Rules*, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

By order of the Board

Anthony J Dixon

Company Secretary

26 July 2010

The Directors, who all served throughout the period, are:

- **Mike McTighe** – Chairman
- **Neil Gaydon** – Chief Executive Officer
- **Stuart Hall** – Chief Financial Officer
- **David McKinney** – Chief Operating Officer
- **Patricia Chapman-Pincher** – Non-executive director
- **John Grant** – Non-executive director
- **Mike Inglis** – Non-executive director

**CONDENSED CONSOLIDATED INTERIM INCOME STATEMENT**  
FOR THE 6 MONTHS ENDED 30 JUNE 2010

	Note	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
Revenue	2	635,168	526,543	1,133,442
Cost of sales		(517,320)	(435,891)	(933,965)
<b>Gross profit</b>		<b>117,848</b>	<b>90,652</b>	<b>199,477</b>
Administrative expenses:				
Research and Development expenditure		(36,135)	(31,112)	(68,832)
Other administrative expenses		(34,203)	(25,872)	(54,830)
Amortisation of other intangibles		(2,435)	(3,352)	(6,667)
Total Administrative expenses		(72,773)	(60,336)	(130,329)
Other operating income		-	508	508
<b>Operating profit</b>		<b>45,075</b>	<b>30,824</b>	<b>69,656</b>
Finance income – interest receivable		310	145	337
Finance expenses – interest payable		(23)	-	(134)
Profit before tax		45,362	30,969	69,859
Tax charge	3	(13,788)	(9,291)	(18,473)
<b>Profit after tax</b>		<b>31,574</b>	<b>21,678</b>	<b>51,386</b>
<b>Profit attributable to:</b>				
Equity holders of the Company		31,574	21,678	51,386
Basic earnings per ordinary share	4	10.7p	7.5p	17.7p
Diluted earnings per ordinary share	4	10.2p	7.3p	17.2p

All figures presented on pages 9 to 20, for the 6 months ended 30 June 2010 and 30 June 2009, are unaudited. The figures in respect of the 12 months ended 31 December 2009 are audited.

**CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE 6 MONTHS ENDED 30 JUNE 2010**

	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
<b>Profit for the period</b>	<b>31,574</b>	<b>21,678</b>	<b>51,386</b>
<b>Other comprehensive income:</b>			
Exchange differences on translating foreign operations	(3,270)	(10,747)	(9,487)
Net change in fair value of cash flow hedges transferred to profit or loss gross of tax	(10,485)	5,261	(12,551)
Deferred tax adjustment on above	3,004	(1,591)	3,718
Effective portion of changes in fair value of cash flow hedges gross of tax	29,423	(11,202)	19,645
Deferred tax adjustment on above	(9,002)	3,419	(5,307)
<b>Other comprehensive income for the period, net of tax</b>	<b>9,670</b>	<b>(14,860)</b>	<b>(3,982)</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE PERIOD</b>	<b>41,244</b>	<b>6,818</b>	<b>47,404</b>
<b>Total comprehensive income attributable to:</b>			
Equity holders of the Company	41,244	6,818	47,404

**CONDENSED CONSOLIDATED INTERIM BALANCE SHEET**  
AT 30 JUNE 2010

	Note	30 Jun 2010 £000	30 Jun 2009 £000	31 Dec 2009 £000
<b>ASSETS</b>				
<b>Non Current Assets</b>				
Property, plant and equipment		23,481	15,813	19,550
Intangible assets – goodwill		70,784	67,261	70,360
Intangible assets – other intangibles		10,981	16,482	14,017
Intangible assets – development expenditure		29,026	27,346	28,738
Deferred tax assets		2,418	9,299	6,431
<b>Total Non Current Assets</b>		<b>136,690</b>	<b>136,201</b>	<b>139,096</b>
<b>Current Assets</b>				
Inventories		70,555	81,473	87,046
Trade and other receivables	5	279,294	175,793	211,736
Cash and cash equivalents		94,141	48,929	73,509
Current tax assets		2,209	2,898	2,621
<b>Total Current Assets</b>		<b>446,199</b>	<b>309,093</b>	<b>374,912</b>
<b>Total Assets</b>		<b>582,889</b>	<b>445,294</b>	<b>514,008</b>
<b>EQUITY</b>				
Issued capital		15,201	14,996	15,179
Share premium		39,746	37,521	39,444
Merger reserve		55,490	55,490	55,490
Hedging reserve		14,662	(7,896)	1,722
Translation reserve		248	2,258	3,518
Retained earnings		111,892	54,991	80,995
<b>Total Equity</b>		<b>237,239</b>	<b>157,360</b>	<b>196,348</b>
<b>LIABILITIES</b>				
<b>Non Current Liabilities</b>				
Other payables		-	1,969	2,232
Deferred tax liabilities		15,267	12,537	14,653
Provisions	6	22,308	15,674	19,340
<b>Total Non Current Liabilities</b>		<b>37,575</b>	<b>30,180</b>	<b>36,225</b>
<b>Current Liabilities</b>				
Trade and other payables		282,315	241,419	262,584
Current tax liabilities		8,324	4,364	4,338
Provisions	6	17,436	11,971	14,513
<b>Total Current Liabilities</b>		<b>308,075</b>	<b>257,754</b>	<b>281,435</b>
<b>Total Liabilities</b>		<b>345,650</b>	<b>287,934</b>	<b>317,660</b>
<b>Total Equity and Liabilities</b>		<b>582,889</b>	<b>445,294</b>	<b>514,008</b>

## CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital £000	Share premium £000	Merger reserve £000	Hedging reserve £000	Translation reserve £000	Retained earnings £000	Total equity £000
<b>Balance at 1 January 2009</b>	14,949	37,023	55,490	(3,783)	13,005	27,245	143,929
Total comprehensive income for the period	-	-	-	(4,113)	(10,747)	21,678	6,818
Deferred tax on share options	-	-	-	-	-	3,954	3,954
Employee share incentive charges	-	-	-	-	-	755	755
Movement in employee share trusts	-	-	-	-	-	1,359	1,359
Issue of shares	47	498	-	-	-	-	545
<b>Balance at 30 June 2009</b>	14,996	37,521	55,490	(7,896)	2,258	54,991	157,360
Total comprehensive income for the period	-	-	-	9,618	1,260	29,708	40,586
Deferred tax on share options	-	-	-	-	-	(2,109)	(2,109)
Income tax on share options	-	-	-	-	-	2,881	2,881
Dividends to equity shareholders	-	-	-	-	-	(3,206)	(3,206)
Employee share incentive charges	-	-	-	-	-	1,781	1,781
Movement in employee share trusts	-	-	-	-	-	(3,051)	(3,051)
Issue of shares	183	1,923	-	-	-	-	2,106
<b>Balance at 31 December 2009</b>	15,179	39,444	55,490	1,722	3,518	80,995	196,348
Total comprehensive income for the period	-	-	-	12,940	(3,270)	31,574	41,244
Deferred tax on share options	-	-	-	-	-	(792)	(792)
Dividends to equity shareholders	-	-	-	-	-	(2,954)	(2,954)
Employee share incentive charges	-	-	-	-	-	3,075	3,075
Movement in employee share trusts	-	-	-	-	-	(6)	(6)
Issue of shares	22	302	-	-	-	-	324
<b>Balance at 30 June 2010</b>	15,201	39,746	55,490	14,662	248	111,892	237,239

**CONDENSED CONSOLIDATED INTERIM CASH FLOW STATEMENT**  
FOR THE 6 MONTHS ENDED 30 JUNE 2010

	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
<b>Cash flows from operating activities</b>			
Profit before tax	45,362	30,969	69,859
Adjustments for:			
Share based payments charge	3,075	755	2,536
Depreciation of property, plant and equipment	4,558	3,401	7,607
Amortisation of development expenditure	17,784	17,210	39,529
Amortisation of other intangibles	2,435	3,352	6,667
Profit on sale of property, plant and equipment	-	(600)	(600)
Net financial income	(287)	(145)	(203)
Movement in trade and other receivables	(50,818)	55,216	21,295
Movement in trade and other payables	19,769	(41,196)	(12,984)
Movement in inventories	17,002	(24,244)	(28,792)
Movement in provisions	5,746	(7,875)	(1,268)
Cash generated from operations	64,626	36,843	103,646
Interest paid	(23)	-	(134)
Tax paid	(9,568)	(4,244)	(12,439)
Net cash generated from operating activities	55,035	32,599	91,073
<b>Cash flows from investing activities</b>			
Acquisition of subsidiaries, net of cash acquired	(6,792)	-	-
Purchase of property, plant and equipment	(8,420)	(5,386)	(12,416)
Proceeds from disposal of property, plant & equipment	-	949	949
Development expenditure	(19,820)	(19,265)	(42,370)
Interest received	310	147	337
Net cash used in investing activities	(34,722)	(23,555)	(53,500)
<b>Cash flows from financing activities</b>			
Proceeds from issue of share capital	324	545	2,651
Dividend paid	-	-	(3,206)
Proceeds from exercise of employee share options	-	1,359	2,354
Purchase of own shares by employee benefit trust	(6)	-	(4,046)
Net cash generated from/(used in) financing activities	318	1,904	(2,247)
<b>Net change in cash and cash equivalents</b>	20,631	10,948	35,326
Cash and cash equivalents at start of period	73,509	37,717	37,717
Effect of exchange rate fluctuations on cash held	1	264	466
<b>Cash and cash equivalents at end of period</b>	94,141	48,929	73,509

## **NOTES**

### **1 BASIS OF PREPARATION**

This unaudited interim financial information is for the 6 month period ended 30 June 2010 and is prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the EU and under the historical cost convention as modified by the revaluation of derivative instruments.

The statutory annual financial statements for the year ended 31 December 2009 were prepared in accordance with adopted IFRS.

As required by the Disclosure and Transparency Rules of the Financial Services Authority the condensed set of financial statements has been prepared applying the accounting policies and presentation that were applied in the preparation of the Company's published consolidated financial statements for the year ended 31 December 2009, except as noted below.

### **INTERIM FINANCIAL INFORMATION**

The condensed financial information is not the Company's statutory accounts. The interim financial information for the 6 month periods ended 30 June 2009 and 30 June 2010 has not been audited but has been reviewed by the auditors. Their review report for the 6 month period ended 30 June 2010 is set out on page 19. The comparative figures for the financial year ended 31 December 2009 are not the company's statutory accounts for that financial year. Those accounts have been reported on by the company's auditors and delivered to the registrar of companies. The report of the auditors was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

### **SIGNIFICANT JUDGEMENTS, KEY ASSUMPTIONS AND ESTIMATION UNCERTAINTY**

The preparation of interim statements 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.

Key sources of estimation uncertainty and critical accounting judgements are as follows:

#### **Warranties**

Pace provides product warranties for its set-top boxes. 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.

A provision for warranties is recognised when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities. The level of warranty provision required is reviewed on a product by product basis and provisions adjusted accordingly in the light of actual performance.

#### **Royalties**

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.

A provision for royalties is recognised where 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. 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. The provision is based on the latest information available.

## **SIGNIFICANT JUDGEMENTS, KEY ASSUMPTIONS AND ESTIMATION UNCERTAINTY (CONTINUED)**

### **Operating segments**

Following the introduction of IFRS 8 Operating Segments, effective for accounting periods beginning on or after 1 January 2009, the Directors have determined that, based on its internal reporting framework and management structure, it has only one reportable segment. Such determination is necessarily judgmental in its nature and has been determined by management in preparing the financial statements. The level of disclosure of segmental and other information is determined by such assessment.

### **Intangible assets**

The Group business includes a significant element of research and development activity. Under accounting standards, principally IAS38 Intangible Assets, there is a requirement to capitalise and amortise development spend to match costs to expected benefits from projects deemed to be commercially viable. The application of this policy involves the ongoing consideration by management of the forecasted economic benefit from such projects compared to the level of capitalised costs, together with the selection of amortisation periods appropriate to the life of the associated revenues from the product.

Such considerations made by management are a key judgement in preparation of the financial statements.

### **Contingent liabilities**

#### **1. EU Import duty classification**

Pace, along with other set top box manufacturers and broadcasters, has continued to monitor the re-interpretation by European Union customs authorities of customs regulations that could result in the extension of import duties to interactive set-top boxes with hard disk drives manufactured outside, but imported into, the EU. On 7th May 2008 the Nomenclature Committee of the European Commission issued an Explanatory Note "EN" (0590/2007) to the Combined Nomenclature setting out their view that set-top boxes with a hard drive should be classified under Customs Tariff heading 8521 90 00 and so subject to a 13.9% ad valorem duty on importation to the European Union. As a consequence, Pace is potentially exposed to a retrospective Customs Duty liability in respect of such set-top boxes it has imported.

Having previously obtained Binding Tariff Information ("BTI") rulings from HMRC, which provide protection in respect of much of the potential period of retrospective application of duty on relevant products and having taken legal advice, management's opinion is that the retrospective application of the Explanatory Note would not be supportable in law.

As of the date of this announcement, an assessment has been received from HMRC in an amount of £7.7m. Having taken legal advice management's best estimate is that no material outflow of economic benefit would be required to discharge this obligation. Accordingly Pace, in common with other affected importers, is carrying out an appeal against the retrospective assessment made to defend its position on this matter. As such, at 30 June 2010 any potential liability should be considered contingent.

#### **2. Writ Issued against Company**

A writ has been issued against the Company by a former customer relating to the supply of set top boxes in 2000/01. The amount claimed is circa \$7.2m. The Directors believe that they have good defences to the claim and therefore, in the absence of any liability, no provision has been made. In addition on 15 July 2007 Pace filed a counterclaim for circa \$10m against this former customer and a related third party.

## SIGNIFICANT JUDGEMENTS, KEY ASSUMPTIONS AND ESTIMATION UNCERTAINTY (CONTINUED)

### NEW ACCOUNTING POLICIES IN THE PERIOD

#### Accounting for business combinations

From 1 January 2010 the Group has applied IFRS3 (2008) in accounting for business combinations. The change in accounting policy has been applied prospectively and had a negative impact of 0.5p on earnings per share in the current period.

For acquisitions on or after 1 January 2010, the Group measures goodwill as the fair value of the consideration transferred (including the fair value of any previously held equity interest in the acquiree) and the recognised amount of any non-controlling interests in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

See note 7 for the application of the new policy to the business combination that occurred during the period.

#### GOING CONCERN

The Group has in place borrowing facilities to December 2011 to a maximum of £35m. These facilities are subject to financial performance covenants.

The Board has prepared a working capital forecast based upon assumptions as to trading and has concluded that the Group has adequate working capital, will meet the financial performance covenants and that therefore it is appropriate to use the going concern basis of preparation for this financial information.

### 2 Segmental and revenue disclosures

	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
The geographical analysis of revenue by destination is as follows:			
United Kingdom	13,208	41,192	84,368
Europe	195,407	185,839	343,765
North America	232,809	192,771	429,085
Latin America	124,195	57,733	121,471
Rest of world	69,549	49,008	154,753
	<u>635,168</u>	<u>526,543</u>	<u>1,133,442</u>

#### Consideration of IFRS 8 Operating Segments

IFRS 8 requires consideration of the Chief Operating Decision Maker ("CODM") within the Group. In line with Group's internal reporting framework and management structure, the key strategic and operating decisions are made by the Board of Directors, who review internal monthly management reports, budget and forecast information as part of this. Accordingly the Board of Directors are deemed to be the CODM.

The Group operates through a number of operating segments, being groupings of "Customer Account Teams" underpinned by the conditional access technology used in the set-top box. With the exception of

the Networks Customer Account Team, which is newly established and not currently material to the Group, each Customer Account Team is involved in the design and distribution of set-top boxes to major PayTV Operators and retailers.

In line with the disclosures in the 2009 Financial Statements, the Group has again considered the overriding core principles of IFRS 8 and has determined that it is appropriate to aggregate the operating segments into one reportable segment for the purposes of disclosure in the financial statements. This position will be monitored as the Group develops.

The following shows the segmental information.

<b>Segmental information</b>	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
Total external revenue for reportable segments	628,345	531,016	1,142,097
Total assets for reportable segments	375,724	281,943	325,127
Profit or loss			
Total profit or loss for reportable segments	66,912	57,462	94,669
Other non Customer Account Team specific profit or loss	5,482	(3,691)	2,804
Unallocated amounts:			
Other corporate expenses	(24,884)	(19,595)	(21,150)
Amortisation of intangibles	(2,435)	(3,352)	(6,667)
Interest	287	145	203
Consolidated profit before tax	45,362	30,969	69,859
<b>3 Tax charge</b>			
	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
The tax charge is based on the estimated effective rate of taxation and represents:			
Total current tax charge	(15,394)	(7,056)	(17,462)
Total deferred tax credit/ (charge)	1,606	(2,235)	(1,011)
Tax charge	(13,788)	(9,291)	(18,473)

#### 4 Earnings per ordinary share

Basic earnings per ordinary share have been calculated by using profit after taxation, and the average number of qualifying ordinary shares of 5p in issue of 294,128,571 (2009: 288,483,268).

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 308,836,368 (2009: 295,633,623).

To better reflect underlying performance, adjusted earnings per share is also calculated (adjusting profit after tax to remove amortisation of other intangibles, post tax) as below:

	6 months ended 30 Jun 2010 £000	6 months ended 30 Jun 2009 £000	12 months ended 31 Dec 2009 £000
Adjusted basic earnings per ordinary share	11.6p	8.3p	19.3p
Adjusted diluted earnings per ordinary share	11.0p	8.1p	18.7p

#### 5 Trade and other receivables

	30 Jun 2010 £000	30 Jun 2009 £000	31 Dec 2009 £000
Trade receivables	251,651	160,931	205,204
Other receivables	24,492	12,193	4,139
Prepayments and accrued income	3,151	2,669	2,393
	<u>279,294</u>	<u>175,793</u>	<u>211,736</u>

#### 6 Provisions

	Royalties under negotiation £000	Warranties £000	Other £000	Total £000
At 31 December 2009	10,947	19,510	3,396	33,853
Charge for the period	3,279	9,537	1,090	13,906
Acquisitions	-	-	1,874	1,874
Utilised	(335)	(7,580)	(518)	(8,433)
Exchange adjustments	(361)	(679)	(416)	(1,456)
At 30 June 2010	<u>13,530</u>	<u>20,788</u>	<u>5,426</u>	<u>39,744</u>
<i>Due within one year</i>	-	12,010	5,426	17,436
<i>Due after more than one year</i>	13,530	8,778	-	22,308

Other provisions relate to onerous leases from acquisition, deferred contingent consideration and retirement provisions in Pace France business.

## 7 Acquisition in the period

The acquired business in the period relates to Bewan Systems SA, the Paris-based IP and cable gateways specialist ("Bewan"). Founded in 1996, Bewan is a leading European supplier of secure network solutions and unified communications, for the home and office users as well as for Telecoms and Internet operators. A 100% interest was purchased on 7 April 2010.

The consideration payable is made up of:

	£000
Initial consideration – cash	9,063
Deferred and contingent consideration	1,874
Acquisition consideration payable	<u>10,937</u>

The deferred and contingent consideration relates to an earn-out agreement, for which the maximum payable amount has been recognised above (the minimum earn out being nil). Based on current expectations the directors expect the maximum earn out to be achieved.

The Group incurred acquisition related costs of £0.2m related to external legal and professional fees and due diligence costs. These amounts have been included in administrative expenses in the Group's condensed consolidated income statement.

The acquisition has been accounted for using the purchase method as required by IFRS 3 (2008). The provisional fair value of net assets acquired and goodwill and intangible assets arising was as follows:

	Book value prior to acquisition £000	Fair value adjustments £000	Fair value of net assets/ (liabilities) acquired £000
Intangible fixed assets – development expenditure	-	143	143
Intangible fixed assets – other	-	450	450
Tangible fixed assets	229	-	229
Deferred tax liability	-	(64)	(64)
Cash	4,524	-	4,524
Other current assets	3,421	-	3,421
Current liabilities	(3,577)	-	(3,577)
Non-current liabilities	(145)	-	(145)
Total net assets acquired	<u>4,452</u>	<u>529</u>	<u>4,981</u>
Goodwill recognised			<u>5,956</u>
Total investment cost (as above)			<u>10,937</u>

The fair value adjustments include an adjustment to capitalised development expenditure to align accounting methodologies and the recognition of separately identified intangibles, which consists of balances relating to trademarks and brands.

Goodwill recognised on acquisition is attributable to the skills and technical talent of the acquired business workforce, and the synergies expected to be achieved from integrating the business into the existing business.

From the date of acquisition (7 April 2010) to 30 June 2010, the contribution of Bewan to the Group results was as follows:

	£000
Revenue	3,680
Loss before tax and amortisation	(17)

Proforma results for the Group for the 6 month period ended 30 June 2010, on the basis that the acquisition had been made at the beginning of the period, are as follows:

	£000
Revenue	639,099
Profit before tax and amortisation	47,835

The above figures do not include the amortisation of the separately identified intangibles, which consists of a £35,000 charge in the period to 30 June 2010. The intangible assets are being amortised over 3 years.

#### **8. Post balance sheet event**

On 26 July 2010 the Group announced the proposed acquisition of 2Wire Inc., a leading provider of software, services and advanced residential gateways for the broadband service provider market, for a cash consideration of \$475 million (£308 million).

Further details of the proposed acquisition are provided in a separate announcement issued on 26 July 2010.

# INDEPENDENT REVIEW REPORT TO PACE PLC

## *Introduction*

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2010 which comprises the condensed consolidated interim income statement, the condensed consolidated interim statement of comprehensive income, the condensed consolidated interim balance sheet, the condensed consolidated interim statement of changes in shareholders' equity, the condensed consolidated interim cash flow statement and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

***This report is made solely to the Company in accordance with the terms of our engagement to assist the company in meeting the requirements of the Disclosure and Transparency Rules ("the DTR") of the UK's Financial Services Authority ("the UK FSA"). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.***

## *Directors' responsibilities*

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FSA.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the EU. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

## **Our responsibility**

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

## *Scope of review*

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2010 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

Chris Heard  
For and on behalf of KPMG Audit Plc  
**Chartered Accountants**  
Leeds  
26 July 2010