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**Pace Micro Technology plc**

**Results for the year ended  
3 June 2006**

**4 September 2006**

**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 52 weeks ended 3 June 2006**

#### **SALIENT POINTS**

- Revenues for the year of £178.1m (2005: £253.3m)
- Volume shipments of 2.2m set-top boxes (2005: 3.4m)
- Loss before tax and exceptional items £15.6m (2005: profit £9.1m)
- Exceptional items of £11.9m with regard to charge against US products, restructuring costs and impairment of trade investment
- Full year gross margin of 18.0% (2005: 22.6%) (restated basis)
- Diluted loss per share of 13.0p (2005: earnings per share 6.1p)
- Net borrowings position £6.1m (2005: net cash £26.4m)
- Board and Management succession completed
- DirecTV shipments commenced, following product approval

All figures, including comparatives, are presented under IFRS.

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

“As previously announced, the full year results reflect delays emanating from new product introduction in the US, a position that is now being resolved as shipments have started to flow through.

The new Chief Executive Officer Neil Gaydon and his team have initiated a number of significant organisational changes to resolve former execution issues, improve margin performance, reduce costs and ensure Pace is best placed to grow its business.

The Board believes that with shipments to the US underway, a strong performance of the business in EMEA and Asia Pacific, and the implementation of a new lower cost, but more effective organisational structure, Pace is turning an important corner. Pace is in the final stage of field trials on the SD PVR for US cable. As the trials complete and shipments start, expected in the near future, inventory commitments will be realised and the Group will benefit from its leading technological and market position.

The Board acknowledges that there is still much work to do, but believes that the changes made since the start of the new financial year will provide greater accountability within Pace, better customer service, and more predictable engineering delivery.

Overall the markets remain strong and Pace has good support from its customers and partners. Therefore the Board is confident that the business has started to recover and will move back into profit this financial year.”

## **Chairman's Statement**

The global market for digital set-top boxes remains strong and Pace's customer base within this market includes some of the world's largest and most influential payTV operators. However, as previously highlighted, the delays in introducing leading edge products for the US market have impacted this year's results. Nevertheless, the Board is confident in the strength of the underlying business as payTV operators continue their long-term transition to digital systems and the migration to high definition (HD) platforms.

Since the year-end, the Group has made important progress in the US. Pace is now shipping its first satellite product, an HD MPEG-4 personal video recorder (PVR), to DirecTV, the world's largest satellite payTV operator. Pace's HD PVR for US cable networks has also received approval from a number of other operators and shipments have started to some of these, with approvals from other operators imminent. Pace's standard definition (SD) PVR for US cable networks is in the final stage of field trials with Comcast.

New Chief Executive Officer, Neil Gaydon, has initiated a number of significant organisational changes to resolve execution issues, improve margin performance, reduce costs and ensure Pace is best-placed to grow its business.

Over the last two months, the Group structure has been reshaped to improve customer focus, with a combined sales, product and engineering team for each customer group. This approach is more efficient as management layers have been greatly reduced while at the same time allowing new talent to come to the fore. It has also enabled a headcount reduction of over 10%, greater transparency and accountability, and a marked reduction in the number of contractors, without impacting customer deliverables.

At the same time Pace's internal processes, with particular emphasis on product development, are being overhauled. Pace's development teams are widely recognised as amongst the most talented and experienced in the industry. Nonetheless, improved processes are required to target the recent execution problems and re-establish a more customer focussed approach to product development.

The changes taking place within Pace are being driven by a strengthened executive management team. The Board and executive team are implementing new appraisal and remuneration systems to ensure Pace's people are appropriately managed and incentivised to deliver significantly improved financial performance.

## **Results and Financial Review**

This year is the first in which Pace reports under International Financial Reporting Standards. All prior year figures have been restated accordingly.

In Pace's announcement on 30<sup>th</sup> May 2006 the Board stated that for the 52 weeks to 3 June 2006, it expected a loss before taxation and exceptional items of circa £15m and revenues of circa £180m. The Board also noted that the uncertainties in predicting the 2006/07 financial year's outcome could lead to some impact on the carrying values for the results for the year to 3 June 2006.

In the year to 3 June 2006, Pace shipped 2.2m units (2005: 3.4m) and generated revenues of £178m (2005: £253m). The underlying pre-tax trading loss for the year, before exceptional charges noted below, was £15.6m (2005: profit of £9.1m).

The Board has considered the carrying values of the items in the balance sheet at 3 June 2006, in particular development expenditure, stock and other balance sheet values related to those US products, which had not been launched at the year-end. In considering these values, the Board has had particular regard to the future competitiveness of the products, especially where firm orders have not yet been received.

Delays in the development of the HD PVR for US cable mean that the design uses components many of which were ordered, and prices fixed, over a year ago. Newer and less expensive components are now available to use on new designs. The delay also affects the anticipated product life of the existing design. Therefore, the Board has decided to write-down the balance sheet carrying values at the year-end by £9.0m. This adjustment is shown as an exceptional stock write-down of £5.5m and an impairment charge against capitalised development cost of £3.5m.

During the year to 3 June 2006, and excluding the exceptional stock and development costs write-down, gross margin decreased to 18% (2005 restated: 22.6%). The Group has reallocated the expenses of its operations department from within cost of sales to overheads better to reflect the nature of these costs. This change is explained in Note 3 to this financial information. Margin performance remains a priority, a series of actions to drive improvements are underway with progress already made as part of the initiatives outlined above.

Overheads, excluding restructuring costs and other exceptional items, were £48.3m (2005: £48.5m). Underlying overhead spend i.e. after adjusting for the impact of the capitalisation of development expenditure under IAS38, show a year on year increase of £6.3m, reflecting the increased investment in new engineering projects incurred in the year. Further reviews are underway to drive cost savings going forward.

There are two further exceptional items: restructuring and reorganisation costs of £2.4m (2005: £0.3m) and a loss of £0.5m resulting from the write-off of the investment in VegaStream Ltd. After these exceptional costs and the exceptional inventory write-down, the Group recorded a loss before taxation of £27.5m (2005: profit of £9.0m). The Board has decided not to recommend a dividend (2005: nil).

The Group ended the year with net borrowings of £6.1m (2005: net cash of £26.4m), which largely reflects the working capital impact of an increased level of inventory held to support the roll out of product into the US.

### **Regional Operating Review**

Pace has had a disappointing year, with delivery delays on a number of new and highly complex set-top box products. The year was further characterised by industry-wide difficulties in the development by third parties of silicon and software for the new MPEG-4/H.264 compression standard. This, combined with delays in Pace's own software development, held back rollout of the Group's own advanced HD products. Pace has, however, embraced this new compression standard as it will be the industry's core technology for the next 10-15 years and Pace is now at the forefront of this change.

#### **EMEA**

EMEA remains Pace's largest market, with total shipments of 1.6m set-top boxes (2005: 2.9m). In the UK, Pace has continued to work with BSkyB, recently winning new business for Digibox and the Sky+ PVR for shipment later this calendar year. The Group also shipped, albeit in smaller quantities, into UK cable.

The Group is now benefiting from its early investment in HD, with Pace products being used to launch HD services by Premiere (Germany) and Sky Italia, two of the three major European HD launches in the year. The Pace set-top box used by Premiere was the world's most advanced satellite HD box.

Pace also continues to lead in PVR, which provides Pace with a higher average selling price and enables payTV operators to deliver new services to their customers. During the year two operators, Sky Italia and Viasat, selected Pace products for their PVR launches.

The Group commenced shipments to UPC, an important new customer and part of Liberty Global. Liberty is a leading player in European cable and now owns another Pace customer, Ntl Ireland. The new cable platform for UPC creates potential in other markets.

Pace, along with other set top box manufacturers and broadcasters, has noted 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. If and until any change is made, and the timing of its implementation clarified, it is impossible to quantify any possible impact.

#### **Americas**

Shipments into the Americas increased to 174,000 (2005: 138,000), with shipments to Time Warner Cable in the US and Rogers, Vidéotron and Sasktel in Canada.

Since the year-end, Pace has made important progress with shipments now being made to DirecTV and a number of cable operators, several of which are new customers. Pace's third new US product, an SD PVR for US cable, is now approaching the end of its Comcast field trial. As previously announced, the approval schedule for Comcast deliveries, as a result of the delays, is now outside the terms originally agreed in the contract with this customer, but the Board continues to believe that Pace will generate substantial revenues from its relationship with Comcast.

### **Asia Pacific**

Overall, shipments increased to 400,000 (2005: 350,000 units). Pace's main customers within this region are based in Australia and New Zealand, where Pace is leading the rollout of PVR products. In Australia, the Foxtel relationship continues to be strong with Pace its lead supplier, shipping both standard set-top boxes and the iQ PVR for both cable and satellite customers. PVR shipments also commenced to Optus, which offers the Foxtel digital service to its customers. Pace was selected to launch the PVR service for Sky New Zealand, one of its longstanding customers.

### **Board and Executive appointments**

There has been significant change to the Board with the appointment of Neil Gaydon as Chief Executive Officer in April and Mike McTighe as Chairman in May. At the same time, Pat Chapman-Pincher became the Company's Senior Independent Director.

New appointments to the strengthened Executive Management team include David McKinney (Chief Operating Officer), Jill Ezard (Director of HR), Mike Pulli (President Pace Americas), Ian Sharp (President EMEA & APAC) and Helen Kettleborough (Director of Corporate Communications).

### **Future Markets and Technologies**

Consumer demand for flat panel TVs, HD, PVR services and high quality audio is growing, as is the take-up of triple play bundles of voice, video and internet.

To support satellite, cable and telco payTV operators as they work to win and retain high value customers seeking out these new products and services, Pace is developing its product range and investigating new technology opportunities. For example, broadband IP capability is being built into Pace's next generation set-top boxes and the Group is working with conditional access partners on content protection for anytime-anywhere media consumption. Work also continues on 'Multiroom' technology, enabling content distribution around the home, which is expected to support high value customer retention for operators. Additionally, progress is being seen in IPTV markets and a new Pace product is being launched shortly.

### **Outlook**

Over the last 12 months Pace has been through a difficult period, from which it is now emerging.

The Board believes that with shipments to the US underway, a strong performance of the business in EMEA and Asia Pacific, and the implementation of a new lower cost, but more effective organisational structure, Pace is turning an important corner. Pace is in the final stage of field trials on the SD PVR for US cable. As the trials complete and shipments start, expected in the near future, inventory commitments will be realised and the Group will benefit from its leading technological and market position.

The Board acknowledges that there is still much work to do, but believes that the changes made since the start of the new financial year will provide greater accountability within Pace, better customer service, and more predictable engineering delivery.

Overall the markets remain strong and Pace has good support from its customers and partners. Therefore the Board is confident that the business has started to recover and will move back into profit this financial year.

Mike McTighe  
Chairman  
4 September 2006

## CONSOLIDATED INCOME STATEMENT

FOR THE 52 WEEKS ENDED 3 JUNE 2006

	Note	52 weeks ended 3 June 2006			53 weeks ended 4 June 2005		
		Results before exceptional items £000	Exceptional items* £000	Results for the year £000	Results before exceptional items £000	Exceptional items* £000	Results for the year £000
Revenue	2	178,095	-	178,095	253,326	-	253,326
Cost of sales	4	(145,984)	(5,500)	(151,484)	(196,109)	-	(196,109)
<b>Gross profit</b>		<b>32,111</b>	<b>(5,500)</b>	<b>26,611</b>	<b>57,217</b>	<b>-</b>	<b>57,217</b>
Administrative expenses:							
Research & Development expenditure	4	(21,433)	(3,500)	(24,933)	(23,160)	-	(23,160)
Other administrative expenses	4	(26,864)	(2,383)	(29,247)	(25,359)	(145)	(25,504)
Total Administrative expenses		(48,297)	(5,883)	(54,180)	(48,519)	(145)	(48,664)
Other operating expenses:							
Impairment loss on trade investment	4	-	(505)	(505)	-	-	-
<b>Operating (loss)/profit</b>		<b>(16,186)</b>	<b>(11,888)</b>	<b>(28,074)</b>	<b>8,698</b>	<b>(145)</b>	<b>8,553</b>
Financial income – bank interest receivable		755	-	755	728	-	728
Financial expenses – bank interest payable		(131)	-	(131)	(318)	-	(318)
<b>(Loss)/profit before tax</b>		<b>(15,562)</b>	<b>(11,888)</b>	<b>(27,450)</b>	<b>9,108</b>	<b>(145)</b>	<b>8,963</b>
Tax (charge)/credit	5			(1,334)			4,717
<b>(Loss)/profit after tax</b>				<b>(28,784)</b>			<b>13,680</b>
<b>Attributable to:</b>							
Equity holders of the Company				(28,784)			13,680
Basic (loss)/earnings per ordinary share	6			(13.0)p			6.2p
Diluted (loss)/earnings per ordinary share	6			(13.0)p			6.1p

The figures for the period to 4 June 2005 have been restated from the audited UK GAAP figures presented on 12 July 2005, on which an unqualified auditors' report was given. Details on the IFRS impact on the Group's historical numbers are contained in the Group's Annual Report and Accounts. The comparatives have also been restated as disclosed in note 3.

\* The exceptional items relate principally to an inventory write down, impairment of capitalised development expenditure, restructuring costs and an impairment of a trade investment. These are explained in more detail in note 4.

# CONSOLIDATED BALANCE SHEET

AT 3 JUNE 2006

	Note	3 June 2006 £000	4 June 2005 £000
<b>ASSETS</b>			
<b>Non Current Assets</b>			
Property, plant and equipment		7,671	6,185
Intangible assets – goodwill		9,436	9,436
Intangible assets – development expenditure		11,286	7,450
Investments in other companies		349	674
Deferred tax assets		2,887	4,009
<b>Total Non Current Assets</b>		<b>31,629</b>	<b>27,754</b>
<b>Current Assets</b>			
Inventories		34,792	10,135
Trade and other receivables		42,337	51,827
Cash and cash equivalents		-	26,647
<b>Total Current Assets</b>		<b>77,129</b>	<b>88,609</b>
<b>Total Assets</b>		<b>108,758</b>	<b>116,363</b>
<b>EQUITY</b>			
Issued capital		11,576	11,349
Share premium		36,246	35,677
Translation reserve		240	150
Retained earnings		(5,595)	22,576
<b>Total Equity attributable to equity holders of the parent</b>		<b>42,467</b>	<b>69,752</b>
<b>LIABILITIES</b>			
<b>Non Current Liabilities</b>			
Interest bearing loans and borrowings		154	205
Provisions	7	9,284	9,304
<b>Total Non Current Liabilities</b>		<b>9,438</b>	<b>9,509</b>
<b>Current Liabilities</b>			
Trade and other payables		45,406	31,561
Current tax liabilities		3	49
Interest bearing loans and borrowings		5,937	56
Provisions	7	5,507	5,436
<b>Total Current Liabilities</b>		<b>56,853</b>	<b>37,102</b>
<b>Total Liabilities</b>		<b>66,291</b>	<b>46,611</b>
<b>Total Equity and Liabilities</b>		<b>108,758</b>	<b>116,363</b>

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital £000	Share premium £000	Translation reserve £000	Retained earnings £000	Total equity £000
<b>Balance at 29 May 2004</b>	11,339	35,647	-	8,152	55,138
Profit for the period	-	-	-	13,680	13,680
Employee share incentive charges	-	-	-	744	744
Issue of shares	10	30	-	-	40
Currency translation adjustments	-	-	150	-	150
<b>Balance at 4 June 2005</b>	11,349	35,677	150	22,576	69,752
Loss for the period	-	-	-	(28,784)	(28,784)
Employee share incentive charges	-	-	-	493	493
Movement in employee share trusts	-	-	-	120	120
Issue of shares	227	569	-	-	796
Currency translation adjustments	-	-	90	-	90
<b>Balance at 3 June 2006</b>	11,576	36,246	240	(5,595)	42,467

**CONSOLIDATED CASH FLOW STATEMENT**  
FOR THE 52 WEEKS ENDED 3 JUNE 2006

	52 weeks ended 3 June 2006 £000	53 weeks ended 4 June 2005 £000
<b>Cash flows from operating activities</b>		
(Loss)/profit before tax	(27,450)	8,963
Adjustments for:		
Share based payments charge	493	744
Depreciation of property, plant and equipment	4,116	4,419
Amortisation of development expenditure	13,296	11,035
Impairment of trade investments	505	-
Loss on sale of property, plant and equipment	241	1
Net financial income	(624)	(410)
Movement in trade and other receivables	9,490	9,152
Movement in trade and other payables	13,871	(9,046)
Movement in inventories	(24,657)	(129)
Movement in provisions	51	(1,653)
Cash (used in)/ generated from operations	(10,668)	23,076
Interest paid	(142)	(385)
Tax paid	(258)	(1,378)
Net cash (used in)/ generated from operating activities	(11,068)	21,313
<b>Cash flows from investing activities</b>		
Acquisition of trade investments	(180)	(674)
Purchase of property, plant and equipment	(5,862)	(3,594)
Development expenditure	(17,132)	(11,851)
Proceeds from sale of property, plant and equipment	5	6
Proceeds from exercise of employee share options	120	29
Interest received	842	728
Net cash used in investing activities	(22,207)	(15,356)
<b>Cash flows from financing activities</b>		
Proceeds from issue of share capital	796	40
Repayment of loans	(50)	(38)
Net cash generated from financing activities	746	2
<b>Net change in cash and cash equivalents</b>	(32,529)	5,959
Cash and cash equivalents at start of period	26,647	20,705
Effect of exchange rate fluctuations on cash held	2	(17)
<b>Cash and cash equivalents at end of period</b>	(5,880)	26,647

## NOTES

### 1 Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards 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 a result of delays in the launch of US products, at 3 June 2006 these inventories and commitments were at much higher levels than usual. The Group inventories included £23 million after provisions, and there were purchase commitments of c£60 million, in respect of these products, the sales of which were not certain, either through pending approvals or through a lack of contractual certainty, or both. At 4 September 2006, approvals and contracts had been obtained in respect of a significant proportion of this value; of which there remains a total inventory and purchase commitment value, after provisions, of c£16m which is pending approvals and further c£14 million as yet unmatched by customer commitments. The Directors have considered the ongoing approvals process and negotiations with customers and have concluded that this value is likely to be realised.

The Group has bank facilities to September 2007, based upon 50% of relevant trade debtors, as adjusted, up to a maximum of £25 million. These facilities are also subject to product approval and certain performance covenants which conditions, by their nature, introduce a degree of estimation into the determination of facility availability.

In managing the product manufacturing schedule to the approval process 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 work with Pace continues to be important to the management of the business.

As noted in the Chairman's statement, no decision in respect of any changes in the EU import duty classification has yet been reached. Such a decision could have a material impact on the future performance of the business in respect of its EU operations, depending upon the nature of the change and the timing of any implementation.

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. In particular the Board has noted the importance to the realisation of inventory and cash of shipments expected in the near future of the SD PVR for US cable as referred to in the Chairman's statement. The Board has also modelled a number of alternative business scenarios. Based upon these, whilst recognising that there is uncertainty, 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 these financial statements.

#### **International Financial Reporting Standards**

EU law (IAS Regulation EC 1606/2002) requires that the annual consolidated financial statements of the company, for the 52-week period ending 3 June 2006, be prepared in accordance with International Financial Reporting Standards ("IFRS") adopted for use in the EU ("Adopted IFRS").

Consequently these financial statements have been prepared on the basis of the recognition and measurement requirements of IFRS in issue that are either endorsed by the EU and effective (or available for early adoption) at 3 June 2006, being the Group's first annual reporting date at which it is required to use Adopted IFRS.

An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Group together with a summary of significant accounting policies is provided in a note to the Group's Annual Report and Accounts. This note includes reconciliations of equity and profit or loss for the comparative periods under UK Generally Accepted Accounting Practices ("UK GAAP") to those reported for those periods under IFRS.

The financial information set out in this document does not constitute the company's statutory accounts for the 52 week period ended 3 June 2006, or the 53 week period ended 4 June 2005, but is derived from the 2006 accounts. Statutory accounts for 2005, which were prepared under UK GAAP, have been delivered to the Registrar of Companies, and those for 2006, prepared in accordance with IFRS adopted by the EU, will be

delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include any references to any matters to which the auditors drew attention by way of emphasis without qualifying their reports and (iii) did not contain statements under section 237(2) or (3) of the Companies Act 1985.

## **Business Environment**

### ***Strategy***

The Group continues to develop its set-top box strategy on three fronts:

- To develop increasingly technologically advanced products
- To match the geographic spread of its business with that of the global payTV operator market
- To identify and exploit opportunities for additional recurring revenue streams

### ***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, customer firm order lead times may be less than 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 order commitments are 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 customer 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 over a six month period, 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 Groups does not take out any interest rate swaps.

### ***Credit Risk***

Management has a credit 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 allowed 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 counter parties 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 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, which is ongoing. The programme has focussed on organisation structures and is now focussed on business processes; in particular improving the effectiveness of Pace's development process.

### **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 project 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 Solectron Corporation. Solectron manufactures a significant percentage of the Group's products at plants in Romania, Mexico and Shenzhen in China.

### **Regulatory**

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

## **2 Revenue**

	52 weeks ended 3 June 2006 £000	53 weeks ended 4 June 2005 £000
The geographical analysis of revenue by destination is:		
United Kingdom	64,446	106,269
Continental Europe	56,517	98,095
Asia Pacific	38,309	24,547
North America	18,823	23,531
Rest of the World	-	884
	<hr/>	<hr/>
	178,095	253,326
	<hr/>	<hr/>

## **3 Reclassification**

During the period, certain expenses relating to the operations department, which is responsible for overseeing manufacturing, have been reclassified from cost of sales to administrative expenses, and the prior period comparatives adjusted accordingly. 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. The amount reclassified was £3,779,000 (2005: £3,703,000).

#### 4 Exceptional items

	52 weeks ended 3 June 2006 £000	53 weeks ended 4 June 2005 £000
Exceptional charge in respect of US product	9,000	-
Restructuring and reorganisation costs	2,383	325
Release regarding reference to Financial Services and Markets Tribunal	-	(180)
Impairment loss on trade investment	505	-
	<u>11,888</u>	<u>145</u>

As referred to in the Chairman's statement an exceptional charge has been made following the delay in the delivery of US product, which charge is reflected as a £5.5m inventory write down within cost of sales and a £3.5m charge against capitalised development costs.

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

Previously the Company was party to a reference to the Financial Services and Markets Tribunal. Following the settlement of the matter in the 53 weeks ended 4 June 2005 a net release was made from the provision originally established.

The impairment loss relates to the Company's investment in VegaStream Limited. This company encountered financial difficulties and, following a decision not to make any further investments, a provision has been made against the carrying value of the investment.

#### 5 Tax (charge)/credit

	52 weeks ended 3 June 2006 £000	53 weeks ended 4 June 2005 £000
The tax (charge)/credit is based on the estimated effective rate of taxation on trading for the period and represents:		
United Kingdom corporation tax at 30%	-	-
Overseas tax	(212)	(240)
Adjustment in respect of a prior year (see below)	-	4,760
Deferred tax	(1,122)	197
	<u>(1,334)</u>	<u>4,717</u>

Following the agreement of an outstanding Corporation Tax matter with the Inland Revenue in the UK, a one-off tax credit was taken in the 53 weeks ended 4 June 2005 in respect of a prior year.

#### 6 (Loss)/earnings per ordinary share

Basic (loss)/earnings per ordinary share have been calculated by reference to the (loss)/profit after taxation, and the average number of qualifying ordinary shares of 5p in issue of 221,742,588 (2005: 219,164,009).

Diluted (loss)/earnings per ordinary share vary from basic (loss)/earnings per ordinary share due to the effect of the notional exercise of outstanding share options. The diluted earnings are the same as basic (loss)/earnings. The diluted number of qualifying ordinary shares was 224,618,352 (2005:

223,763,782).

## 7 Provisions

	Royalties under negotiation (see below) £000	Onerous contracts £000	Warranties £000	Total £000
At 4 June 2005	6,440	1,139	7,161	14,740
Charge for the period Utilised	245 (423)	443 (1,089)	4,745 (3,870)	5,433 (5,382)
At 3 June 2006	6,262	493	8,036	14,791
<i>Due within one year</i>	-	493	5,014	5,507
<i>Due after more than one year</i>	6,262	-	3,022	9,284

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.

## 8 Contingencies

Under the Waste Electrical and Electronic Directive producers of electrical goods, including set-top boxes, are financially responsible for specified collection, recycling, treatment and disposal of past and future electronic products. It is not currently possible to estimate the Company's existing liability or future expenses resulting from the related WEEE legislation, as the Company awaits clarification from all individual European member states of specific requirements and policies.

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, in the absence of any liability, no provision has been made.

### **Circulation to shareholders**

**The Annual Report and Accounts will be posted to shareholders as soon as practicable and will be available to the public from the Company's registered office at Pace Micro Technology plc, Victoria Road, Saltaire, West Yorkshire, BD18 3LF.**

**There will be an analysts presentation on 4 September 2006 at 9.30am at Citigate Dewe Rogerson's office, 3 London Wall Buildings, London Wall, London EC2M 5SY.**