



ANNUAL REPORT & ACCOUNTS

2002

Pace Micro Technology plc
www.pace.co.uk



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ENABLING DIGITAL

Pace Micro Technology plc is at the forefront of digital television technology. The Company's primary focus is the development of innovative home gateway (set-top box) solutions for operators, broadcasters, telecommunications companies and retail markets worldwide. Pace is also developing other edge of network gateways for service providers, in particular digital IP voice gateways for low-cost integrated voice and data services.

Pace's **vision** is to be the biggest supplier worldwide of gateway technology, which it will achieve by:

- • **Creating an environment of engineering excellence, putting it at the forefront of design innovation.**
- **Continually challenging its employees to improve the way they work.**
- **Instilling quality in all aspects of the business.**
- **Building collaborative relationships with customers, suppliers and technology partners.**

Digital television is an open and international market where companies, as well as being best at what they do, must align themselves with the 'best of breed' to succeed. To fully exploit its opportunities, the Group actively maintains and develops the business relationships and strategic alliances that will deliver its technology into consumer homes.

As a result Pace is well positioned for growth as and when the market allows.

Pace's key strengths are in developing new digital gateway technology ahead of competitors and bringing it cost-effectively to market in volume to maximise operator profits. Pace's engineering teams are constantly developing the latest technologies and exploring new digital television concepts such as low-cost adapters, home gateways with integrated hard disk drives and gateways which provide digital TV to more than one room in the home.



DIRECTORS, SECRETARY AND ADVISERS

DIRECTORS

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Sir Michael Bett	Non-executive Chairman
Malcolm Myer Miller	Chief Executive
John Howard Dyson	Finance Director
Timothy James Fern	Chief Technology Officer
Neil Gaydon*	President, Pace Americas
Robert Arthur Fleming	Non-executive Director
David Richard Hood	Non-executive Director
Marvin Jones	Non-executive Director
Robert Ernest Lambourne	Non-executive Director
Robert Michael McTighe	Non-executive Director

COMPANY SECRETARY

Anthony John Dixon

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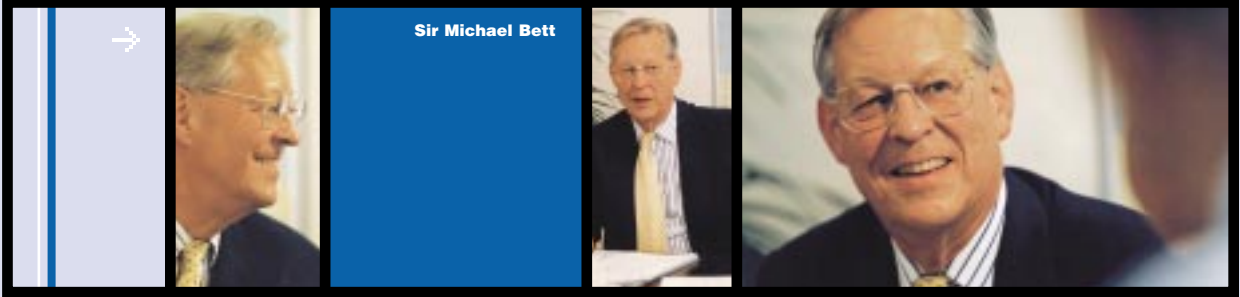
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HIGHLIGHTS

- **Results reflect turbulence in the broadcasting market and difficult trading environment faced by global digital TV operators.**
- **Unit sales declined by 19% to 2.2m units.**
- **Turnover of £351.8m (2001: £523.6m).**
- **Profit before tax, amortisation of goodwill and exceptional items of £13.1m (2001: £44.3m).**
- **Diluted earnings per share before amortisation of goodwill and exceptional items of 2.9p (2001 as restated: 13.5p).**
- **Diluted loss per share after amortisation of goodwill and exceptional items of 16.1p (2001 as restated: earnings per share of 11.1p).**
- **Maintained final dividend of 0.70p making total dividend for year of 1.10p (2001:1.05p).**
- **Restructuring process underway, resulting in further cost and overhead reductions.**
- **Entry into US market place secured with Time Warner Cable shipments.**
- **Successful launch of free-to-view products into UK and growth in Continental European retail markets.**





CHAIRMAN'S STATEMENT

Over the previous three years Pace succeeded in growing revenues and profits. The financial period under review, however, reflects the turbulence in the broadcasting industry and the difficult trading environment faced by digital TV operators globally.

Whilst the year started well, the second half reflected the decline in the global demand for home gateways (set-top boxes) and lower selling prices.

The Group has addressed the challenging commercial market place and, as announced on 15 April 2002, commenced the implementation of a restructuring process to reduce the overall cost-base of the business while maintaining vital technological investment.

RESULTS AND DIVIDEND

Profit before tax, amortisation of goodwill and exceptional items fell to £13.1m (2001: £44.3m) on turnover down 33%, to £352m. There was a loss before tax and after amortisation of goodwill and exceptional items of £29.5m (2001: profit £38.1m). Diluted earnings per share were 2.9p (2001: as restated: 13.5p) before amortisation of goodwill and exceptional items and were a loss per share of 16.1p (2001: as restated: earnings per share of 11.1p) after amortisation of goodwill and exceptional items. The exceptional items are all described below.

The Board proposes a final dividend of 0.70p (2001: 0.70p) making a total dividend for the year of 1.10p (2001: 1.05p).

EXCEPTIONAL ITEMS

Following the announced restructuring and subsequent employee consultation, the Group is in the process of reducing its workforce by approximately 20%. We expect to reduce

overheads for the coming financial year by a similar percentage. We have made a provision of £4.9m to cover the cost of asset write-offs and redundancy payments.

The Board has also reviewed the carrying value of the goodwill in VegaStream and concluded that it would be prudent to write off the balance of £17.5m. VegaStream will continue to operate at a lower level of activity, while we track the development of the market for digital IP voice.

As a result of the fall in the Company's share price it has become unlikely that the Pace Micro Technology Employee Benefits Trust will be able to pay back the loan made to it by the Company to buy shares in the market for the fulfilment of employee options. A provision of £17.5m has been set up to recognise this issue.

TRADING AND FINANCIAL REVIEW

Unit sales of Pace digital gateways fell 19% to 2.2m (2001: 2.7m). The fall in unit volume was largely concentrated in the UK, as NTL Group Limited (ntl) and Telewest substantially reduced their roll-out of digital gateways in the second half of the financial year. Following a short suspension in deliveries to ntl, shipments re-commenced in May 2002 to fulfil a 300,000 unit order by May 2003. Pace continues to be the only company shipping in volume to the UK cable operators.

BSkyB continued to require product, but at a lower level than in previous years as their

analogue to digital conversion was completed. Recent negotiations have resulted in a substantial commitment to purchase Digi-boxes over the next 12 months and significant revisions to the contractual terms under which Pace supplies the Sky+ personal video recorder to the end of 2004.

Pace's Digital Television Adapter (DTVA) for free-to-view digital terrestrial television was launched with much interest and 53,000 units were sold following its retail launch at the end of March. In the same period ITV Digital and Omne Communications Ltd went into administration at a combined cost to the Group of £1.7m.

We are convinced that investment in the USA, the world's largest market for our products, is to the long-term benefit of our Group. Therefore we are pleased to report that the Group shipped over 250,000 gateways to Time Warner Cable, delivered mostly in the last quarter of the financial year. As it will take time for these products to be installed with cable subscribers, the Group expects a much lower level of US shipments in the first half of the forthcoming year. As Pace works to establish itself in the US market, start-up losses of £11m were incurred.

Elsewhere shipments were below expectations as operators generally lacked the funding to commence significant roll-out of digital gateways. IPTV (digital TV over broadband) shipments made slow progress around the world but did make a positive contribution to income. VegaStream has continued a low level of shipments of its Voice over Internet Protocol gateways. This business is still at the start-up stage, although there are signs that its market is beginning to grow.

Xcom, acquired by the Group in February 2001, exceeded initial expectations, shipping a

wider range of products into more territories. We are especially pleased with the new low-cost free-to-view products they have added to our UK range. Overall the Xcom team, now responsible for Pace's business in Continental Europe and Asia, shipped products to over 24 countries, most importantly into France, Italy, North Africa, Scandinavia and the Benelux countries.

The Group's gross margin, before exceptional items, increased to 22.7% (2001: 20.1%). The increase in margin percentage arose from integration services, development fees, licensing revenues and an increase in sales of higher margin DSL and VoIP products, offset by lower margins in the USA.

The Group continued its policy of providing for all currently known, and potential, claims relating to the alleged use of the intellectual property of others. We were able once again to release part of the overall provision, following the successful conclusion to certain negotiations. In the last year the level of releases exceeded new provisions by £0.3m. There are still a small number of unresolved matters outstanding; without any admission of liability the Group has provided against these claims and the estimated cost of litigation. Having taken legal advice, the Board considers that there are defences available and claims against third parties that should mitigate the amounts being sought.

Overheads, net of other income and before amortisation of goodwill, rose to £66.1m (2001: £61.0m), an increase totally attributable to the USA. Expenditure on development increased to £36.9m (2001: £33.7m). Selling, general and other administrative expenses were £29.2m (2001: £27.3m). Actions are already underway to reduce these costs in line with the Board's expectations for business going forward.

Net assets, excluding goodwill, decreased to £65.7m (2001 as restated: £91.0m). Within net current assets of £65.0m (2001 as restated: £76.6m), net borrowings were £18.7m (2001: net cash £27.5m). The change in the cash balance came from increased finished goods stocks and from paying the first instalment of the Xcom earn-out which was £8.1m. Currently Pace is net cash positive and has £40m in existing committed credit lines. The debt collection period was 12 weeks (prior year-end: 8 weeks). The debtors included an amount of £4m that was uninsured.

Stocks at the year-end amounted to £46.7m (2001: £39.7m), comprising £15.8m of raw materials and WIP and £30.9m of finished goods. Of the finished goods £23.7m relating to ntl is valued at cost, under the Board's assumption that ntl will continue to take product according to its existing agreement. As previously announced shipments to ntl have recommenced and since the year end this ntl related stock has reduced to £19m. The stock turnover rate reduced to 8 times at year end (prior year end: 13 times).

BOARD CHANGES

Mike McTighe was appointed to the Board as a Non-executive Director on 3 June 2001. Neil Gaydon, President of Pace Americas, has been with the Group since 1995 and joined the Board on 12 June 2002.



OUTLOOK

Under pressure from financial markets and with less access to capital, operators are looking for ways to lower costs and increase income. One of Pace's strengths is its ability to develop both new low-cost solutions and also more complex gateways that increase ARPU (average revenue per unit) and reduce churn (customer returns). The new DTVA and Sky+ are examples.

Pace and BSkyB are expecting an increased rate of Sky+ shipments. As has been previously announced, the commercial agreement between the parties is that for the majority of next year the Group will invoice an amount on shipment that is below product cost and will receive a share of future subscriptions. Whilst expected to be profitable over the longer term, this will have a negative impact of £8m on pre-tax profits for the next financial year. In subsequent years Pace and BSkyB have agreed usual trading terms under which Pace will recognise full revenue at the time of shipment.

In the year just started we expect the Group's UK revenues to fall further, reflecting the difficult trading conditions. In the USA, Europe and Asia business will grow slowly. Turnover in the 2002/3 financial year is expected to be at a lower level in the first half than the second half of the year just ended, but is expected to improve in the second half to levels higher than the equivalent period as regions outside the UK develop. The impact of the continued investment in the USA and the investment in the Sky+ programme, even though expected to be profitable in the medium-term, is expected to cause the Group to be loss making in the first half of next year. The results for the year as a whole will depend as always on the appetite of the operators for product and our success in launching new products.

For the longer term, the Board believes that due to its strong core technologies and its commercial position as one of the top five global players, Pace is well positioned to exploit all opportunities in the digital TV market.

Sir Michael Bett

Non-executive Chairman

8 July 2002





CHIEF EXECUTIVE'S STATEMENT

Digital television markets have always been characterised by rapid change and until recently by rapid growth. In the last year financial markets have shortened their investment horizons and investors are looking for more realistic achievements and faster paybacks. The requirement and time for our customers to reach profitability and make debt repayment has been shortened.

Many industry players, including some of Pace's customers, have been restructured, refinanced, acquired or even ceased trading and for the first time in three years the market has contracted. These market dynamics have resulted in a sharp decline in demand.

Despite disappointments in the market, technology has continued to develop rapidly. Pace has always been at the forefront of digital TV technology and has driven new developments in low-cost customer acquisition with a series of product launches for European retail markets and cable operators. In the USA, Pace's home gateway for Time Warner Cable was approved and over 250,000 units delivered, with Pace now developing next generation high definition television (HDTV) products for future shipment.

INDUSTRY CHALLENGES

Global retrenchment and consolidation has slowed customer decisions and roll-outs. In the USA consolidation has been proposed in satellite and in cable. In Europe several media conglomerates have hit major problems and started demerger programmes. Regulatory pressure has thrown uncertainty on mergers in Italy and has prevented the liberalisation of the German cable industry. In the UK, the most heavily penetrated market, take-up of digital TV has slowed considerably as the market completes its first phase of growth.

Further industry consolidation is inevitable: there will be fewer players in the global digital

television market whether they are home gateway developers, middleware providers, broadcasters or operators. As a result, new opportunities with European operators have been slow to materialise. In the UK problems within the cable sector dramatically reduced Pace's ability to make shipments against the orders we had in hand. We will watch with interest how the UK cable companies are reorganised this year to assess any further impact it may have on Group business.

The Group's financial performance has been affected by the problems being experienced in our market and trading statements were issued in March and April. In the April statement we announced a strategic review and restructuring to reduce the Group's overall cost-base and reposition the business to capitalise on current opportunities in the USA and Europe and future global market developments. Our engineering teams will continue to develop bespoke products for major clients, converging all other products onto a handful of flexible and highly competitive platforms.

The sales and marketing teams now have a stronger regional focus. Each regional director is able to take into account the individual needs within each of Pace's international markets and ensure the most effective utilisation of our important engineering resource. Through these changes we will maintain and improve our innovative position, creating choices that enable our customers to be flexible in how they develop their business through cost-effective Pace technologies.



MARKET OPPORTUNITIES

The global market for home gateways (set-top boxes) in 2002 is expected to have reduced by nearly 20% to 29 million units¹. In this market the top five market players, one of which is Pace, continued to supply two thirds of the global market.

Looking ahead, markets are forecast to grow in 2003, although at a slower rate than was previously published. The main growth opportunities for the Group lie in the US cable market as it switches its 70 million homes² to digital and in the UK and Continental European retail markets.

Americas

The North American markets are highly attractive to our main competitors and Pace must bring to bear its unique abilities more effectively than ever before. The US market, for example, plays to a core Pace skill – the ability to deliver products into markets with high barriers to entry. To develop a home gateway that can operate on US networks to a specification that is acceptable to US cable operators is a significant task. I cannot overstate the challenges Pace has faced in achieving its breakthrough into what has the potential to become a rewarding market.

US operators have welcomed our innovative approach, which has tested their traditional providers on pricing and product design. Pace's 500 range is now being delivered to a growing proportion of Time Warner Cable's divisions, the operator's regional buying units. Our Time Warner Cable product has led the competition in size reduction, silicon integration and energy efficiency with the Pace 500 being the first US home gateway to carry the Government ENERGY STAR label.

Pace's US operation in Boca Raton, Florida consists of sales and engineering staff dedicated to the development of this important aspect of our business. This team is preparing for deployment in late 2002 with Comcast Communications, Pace's second US cable customer and currently the USA's third largest operator. Comcast has revised one of the product specifications it has ordered from Pace to take advantage of the latest industry innovations, particularly HDTV and inclusion of a DOCSIS cable modem for high-speed interactive services. In addition, the team is also developing business with North American telcos and gained new business for Pace's IPTV products with Myrio Corporation and Sasktel in Canada.

Pace shipped satellite products into Nova- vision, part of the Sky Latin America platform. We also supported Netsat in Brazil.

UK and Europe

In the last year Pace's engineering team has twice updated our Digibox model for Sky Digital in the UK, each time delivering a faster and more cost-effective product through smarter component and systems integration. The innovative Sky+ personal video recorder (PVR) was also launched, which enhances the viewer experience through the integration of a hard disk drive, enabling new services such as live TV pause and recording without the need for videotapes.

ITV Digital's problems finally resulted in closure. However, the unused spectrum created a new market opportunity for low-cost retail products for free-to-view digital TV. Pace's Digital Television Adapter (DTVA) launched this segment. The UK Government has welcomed the development, as have

several other European countries, because it facilitates progress towards targets they have set for a complete switch to digital terrestrial. The UK deadline of 2010 represents a significant challenge and Pace is contributing through advice and the development of new technologies that build on the DTVA.

Pace secured a strong foothold in the European retail market through the acquisition of Xcom (now responsible for Pace's business in Europe and Asia) in 2001. Pace products, distributed using Xcom's Xsat brand, have now been sold through retail in over 24 countries, most importantly into France, Italy, North Africa, the Benelux countries and Scandinavia. To capitalise on our retail opportunities, the range has been extended with the introduction of PUMA, the world's first twin decoder digital satellite home gateway, which is now available for sale throughout Europe.

Omne Communications, a new regional cable company targeting north-west England and south-west Scotland launched using Pace's Di4000 home gateway. However, Omne struggled and went into administration less than nine months after its launch in September 2001.

→ 1. Source: **Enders Analysis 2002**
2. Source: **Informa Media 2002**

Other markets

Pace's IPTV business is now beginning to make good progress. In addition to North America, the Far East has been an important market for this team, which has gained new contracts with Chunghwa Telecom in Korea and TCC in Taiwan and for trials with Singtel in Singapore. Asia has the world's highest installation rates of digital subscriber line (DSL) technology, which telcos can utilise to deliver high-speed multimedia services, including video. Multimedia and triple-play video, voice and data services present significant revenue opportunities for telcos, but worldwide uncertainty in telecom markets has slowed investment.

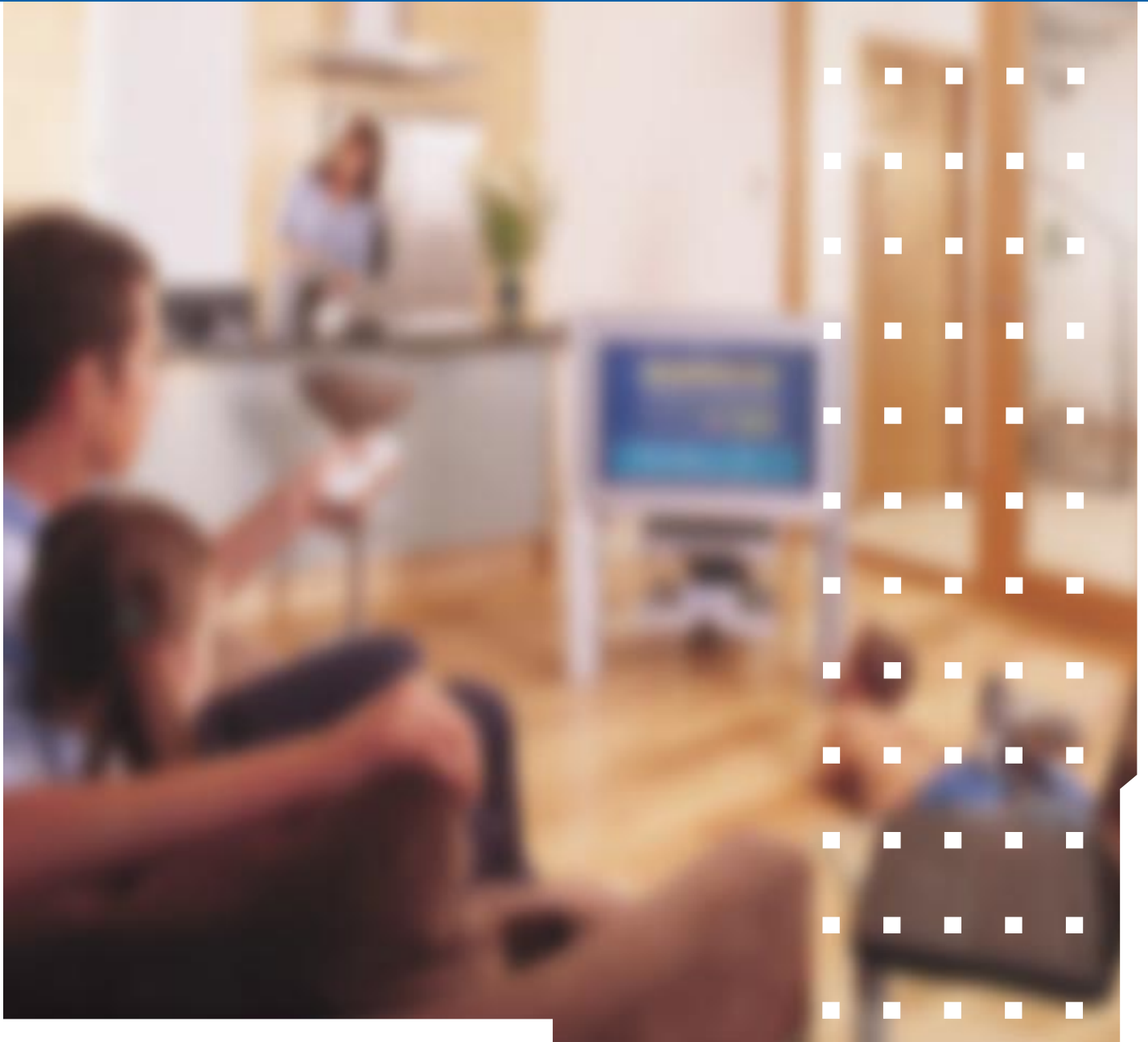
In Australasia, Pace has continued shipping satellite products to Sky New Zealand, a service that was launched in 1998. Pace also shipped cable home gateways to Optus in Australia for a large-scale trial of interactive cable services. The trials were successful, but commercial and regulatory issues have currently halted further development.

New services

Pace's Network Development team has begun to create new revenues for Pace, most importantly in the UK and USA. Their initial focus has been to extend existing customer relationships with after-sales services including software management and support and maintenance. In the US for example, the *Customcare* programme was launched, the first point of contact for any customer with enquiries or technical issues. The teams work to service levels agreed with each customer to ensure the best possible ongoing service from Pace.



Pace product designs





PACE TECHNOLOGIES

The changes and setbacks to our markets have forced an industry wide re-evaluation of what consumers want from digital and the services they are prepared to buy. Operators have re-thought the role of interactive content, their range of services and the type of home gateway they need. It is vital that Pace is at the forefront of creating and adapting their home gateway options as the industry learns and changes.

Low-cost

In the past the digital home gateway roadmap moved up a constant evolutionary path with more powerful products, capable of more services at each new launch. This is still the case, but a new trend has emerged for basic TV products pared down to the absolute essentials. In addition Pace continues to drive constant improvements in current generation technology and is setting the agenda for future trends.

The DTVA, launched in the UK to much acclaim, is just one implementation of the low-cost approach and an example of how Pace will develop product ranges around core platform specifications. The DTVA platform can be provided in cable, satellite, MMDS and terrestrial formats, making it easy and cost-effective to adapt for individual market needs.

Scalability

For the European cable market Pace launched the Di300, which operators can use to provide basic payTV services or extend existing services to secondary televisions in

the home. Additionally, the Di300 creates a new opportunity for two-tier services, based on the software architecture it shares with our higher-specification Di4000. As a result operators can now target different market segments with the most appropriate home gateway for the services consumers are prepared to buy.

Scalability will be important as this more flexible approach develops. This is most important for start-ups which, while minimising initial costs, will need to 'future-proof' their technology investment with easily upgradeable products. The Di300 fulfils this important objective as its open standard interface can be used to add video-on-demand (VOD) and PVR services, a high-speed cable modem or home networking kit.

The ultimate expression of product flexibility is Siblings, our new modular home gateway concept, through which operators can stage their deployment of triple-play voice, video and data services. Using Siblings an operator could launch one service, for example broadband internet, adding further services when commercially viable through a new interconnecting Siblings unit, which is consumer installable.

Compression Standards

Despite the temporary upheaval in the digital TV industry, the underlying technology development continues apace. One example is H.26L, a new standard for compressing digital TV signals, which is much more efficient than the current MPEG-2 standard. H.26L

allows an operator to deliver around five times as many video streams using the same transmission capacity, or to use five times less capacity to deliver the same number of channels. It also allows high definition television (HDTV) to be transmitted much more cost-effectively than is the case today. This new standard will disrupt many parts of the value chain by making storage and transmission cheaper, allowing more HDTV, and making much more content available on demand over digital TV systems. Pace engineers are working with early-stage silicon to create gateways which take advantage of this standard.

Our patent portfolio continues to grow due to the Pace scheme that rewards successful applications. Pace has over 170 applications under consideration, with five granted patents.

Product applications

Development of our existing product range never stands still as we constantly look to improve performance and reduce component usage to increase both Pace's and our customers' profitability. In the US, where VOD is now seen as important to operators' future business plans, Pace has integrated the majority of the leading VOD software packages onto the Pace 500, making it even more attractive to the Time Warner Cable divisions we supply.

The HDTV market in the USA is also starting to take off. HDTV significantly increases picture quality, which will be particularly important to US cable operators

as they seek to compete against the satellite operators which have made great inroads into the digital market. Pace's HDTV product, first shown at the Cable 2002 trade show in May, was well received and includes several competitive innovations such as content protection and the ability to cope with changing formats and aspect ratios as viewers change channel.

We also continued to explore the opportunities for IP (internet protocol) based delivery. Pace's IPTV products for broadband IP network operators and telecom service providers are world leading and we are continuing to extend the product range. The new IP500 builds on this success, supporting new streaming protocols including MPEG-4, which are important to operators that want to provide multichannel video services, but suffer from limited bandwidth availability. Although today IP based delivery is mainly over telco networks, we look forward to a day when these techniques will be used in cable networks too. We are working with cable operators to prepare for this.

The VegaStream range of products, which link IP telephony networks to legacy telephone systems, has continued to move forward, but this market has not grown as fast as initially expected. We do expect there will be a market for digital voice products and the team is exploring current applications with telecommunications companies and new markets for VoIP services such as call centres.

Future technology trends in our market are difficult to predict, but a long-term move to home networking built on multichannel pay TV services is still expected. The new PUMA product is built on this principle. PUMA is a step towards the 'home hub' as consumers can watch two separate channels on two separate televisions through one single home gateway and later this year the product will be updated

to include a hard disk for PVR functionality.

Earlier this year trials of our first home networking product commenced, but have not moved forward as fast as anticipated while operators re-focus activity on the services they want to provide today. We have also begun to explore options for home networking in the USA for wired and wireless distribution of video and multimedia content around the home. Interest in the potential for Linux based products, particularly in the US, grew. Pace has developed its own Linux platform to showcase new technologies and extend our options in the development of standalone and payTV services, for example PVR and home networking products.

ALLIANCES

Adding Linux extends Pace's portfolio of middleware and operating systems. Pace was a founder member of the TV Linux Alliance which is encouraging the adoption of Linux. Pace has ported more of the industry's operating systems and middleware than any other top five competitor.

After a gap of some years Pace reintegrated the Irdeto conditional access (CA) system to meet customer demand. We are constantly working with our conditional access partners to develop new technologies. In the last year we have ported NDS' CA onto Europe's leading cable TV platform, the Di4000, and worked closely with Nagravision and other conditional access providers to drive new market offers.

The port of Microsoft's high-end platform (MSTV Advanced) was progressed for TVCabo in Portugal. Pace also worked with Microsoft on its other products such as MSTV Basic. We delivered Liberate's latest software, DTV Navigator 1.2 to our UK cable customers, the first roll-out of version 1.2 worldwide. Our

close relationship with OpenTV continued as we launched Sky+, Europe's first integrated PVR, together with NDS. We also ported OpenTV onto the Di4000 platform, which is now available with a broad range of conditional access and middleware.

Other partners came and went as the rapid commercial evolution in the sector produced new entrants and casualties.





FINANCIAL REVIEW

Intangible fixed assets

The intangible fixed assets net of amortisation were £35.8m (2001: £59.1m). These assets arose from the purchase of VegaStream and Xcom. Following the annual impairment review, the Board concluded that it would be appropriate to maintain the life of 20 years assigned to the Xcom portion of the asset, but to write off the balance of £17.5m that related to VegaStream, as Xcom is currently meeting its internal targets whereas VegaStream is not. Pace believes in the future of digital IP voice and will continue to support the activities of VegaStream as long as it meets revised targets.

Investments

The investments of £4.0m (2001: £21.5m) represent the amount owed to Pace by the Employee Benefits Trust in respect of loans made to it for the purpose of buying Pace shares in the market to meet obligations to provide shares on the exercise of share options. As a result of the decline in the Pace share price and the failure of the business to meet the required performance criteria, many of the options are not capable of being exercised, with the result that it has been necessary to take a provision of £17.5m against the outstanding loan.

Net tangible fixed assets

The net balance of £15.3m (2001: £16.8m) represents primarily plant and machinery associated with manufacturing, test and engineering development.

Stocks

The increase in stocks to £46.7m (2001: £39.7m) relates to finished goods of £30.9m (2001: £4m), of which £23.7m relates to product manufactured for ntl. Raw materials have declined to £15.8m (2001: £34.5m) as a result of the turnover slowdown and of the outsourcing of manufacturing.

Debtors

Debtors have fallen to £80.6m (2001: as restated £89.7m) as a result of the fall in turnover. As a matter of policy, Pace insures the substantial majority of its debtor balances. £4m of the balance outstanding at the year end was uninsured.

Cash

The negative cash balance of £18.7m (2001: cash of £27.5m) was due to the levels of finished goods stocks and to a payment of £8.1m to the former shareholders of Xcom in respect of the earn-out due from Xcom's performance in calendar year 2001. The Group has a total of £40m in available committed credit facilities that are adequate for its current needs. Since the year end Pace has become net cash positive.

Creditors

Creditors, excluding the negative cash balance, have fallen to £43.6m (2001: £80.9m). This reflects the reduction in turnover levels and corporation tax due.

Provisions

The level of Provisions has fallen to £18.3m (2001: £23.3m) mainly due to settlement of a major licence claim during the year.

Foreign exchange

As the majority of the Group's production costs are designated in US Dollars and there have been insufficient sales in Dollars to compensate, Pace has historically maintained a rolling programme of forward cover to meet part of its Dollar requirements. In the recent past, the Group has earned sufficient Dollars from its US sales to meet most of its short term needs and has therefore temporarily discontinued its forward cover programme. The need to purchase such derivatives will be reviewed in the light of future requirements.



MANUFACTURING AND OPERATIONS

In addition to innovations in product design, we have also reviewed our approach to manufacturing and operations. In May 2001 Pace announced its intention to complete the outsource of all product manufacturing, a process that was completed in August 2001 with the final closure of the Group's Saltaire manufacturing facility. A six-month review of Pace's future requirements for product manufacturing, new product introduction and global supply chain management was initiated to select the optimal global outsourcing partner for cost-effective, high-quality volume production.

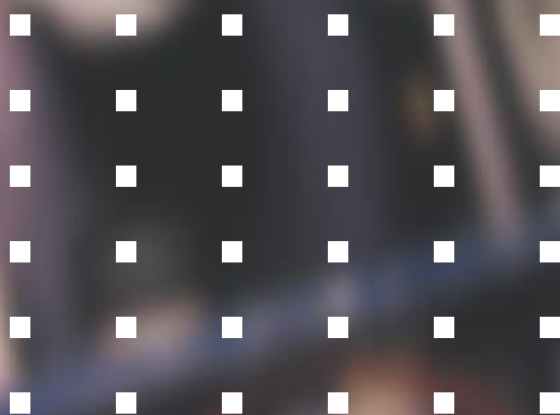
In March 2002 Solectron Corporation was selected to deliver products into Pace's core European and US markets, to streamline its supply chain, accelerate product time-to-market and ensure Pace customers have access to the latest industry innovations in manufacturing operations. Solectron is the world's largest manufacturing company, two times winner of the Malcolm Baldrige National Quality Award, and this year's winner of the prestigious Brocade CEO supplier award for electronics manufacturing services.

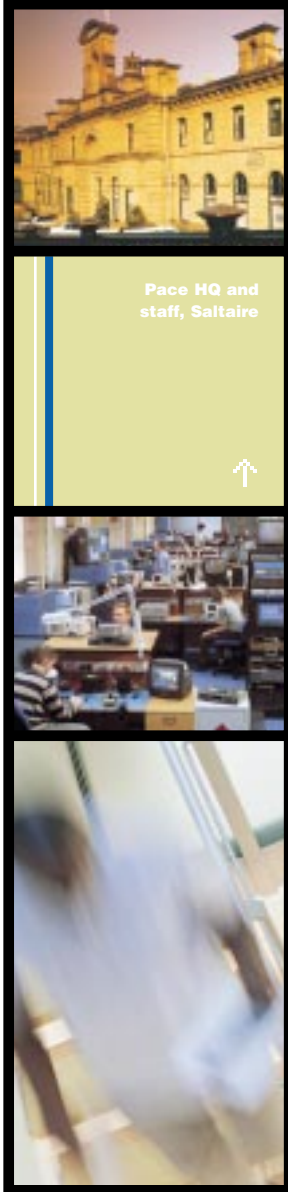
One of the first additional benefits of our relationship with Solectron is a new 'Design for Supply Chain' system. This system will reduce product cost, improve quality and reliability and increase speed to market by enabling us to incorporate the specific demands of the supply chain process into our overall product design. Pace will be one of the first companies in the world to take advantage of this approach.

Component supply, in contrast to the previous year, was stable. Neither Pace nor our manufacturing partners experienced any shortages due to market conditions, a trend we expect to continue this year, although dependent on changing demand for consumer electronic products.



Solelectron sites





PEOPLE

The Group ended the year with 956 people, a decrease of over 500, primarily due to the outsourcing of our Saltaire manufacturing facility. In what has been a difficult year for the Group, Pace's achievements would not have been possible without the ongoing commitment and skills of our people at sites in the UK, the US, France and Hong Kong.

During the first half of the year, Pace's UK-based service and repair activity was bought by industry specialist the ANovo Group. As part of the sale, approximately 50 service and repair staff transferred to the ANovo Group.

As a result of the current trading environment we have had to reduce costs. As we restructure the business to succeed in today's market fewer people are needed to achieve our objectives and we have agreed that close to 180 people, primarily in the UK, will leave the Group by the end of August 2002.



THE FUTURE

Our markets have been and will remain difficult. Growth will be slow, business will be highly competitive and new demands will be made on Pace's approach and products. However, Pace will continue to adapt, using our considerable industry expertise and relationships to create new options for retail and operator markets as well as seeking new opportunities and directions.

Turbulent conditions in the broadcasting market have caused delay and disappointment. We have taken appropriate steps to ensure that we manage an efficient and tightly run business whilst maintaining key relationships and continuing to lead in digital television technology.

For the longer term Pace is well positioned for growth as and when the market allows.

Malcolm Miller

Chief Executive

8 July 2002





PRODUCT REVIEW

Pace Micro Technology is the world's largest dedicated developer of digital home gateway technology through its work with broadcasters and operators on satellite, cable, terrestrial, IP and VoIP platforms.

Pace analogue and digital technology has been installed in over fifteen million homes worldwide since the Company was founded in 1982, through alliances with broadcasters, network operators and technology partners in the UK, USA, mainland Europe, Latin America, Australasia and the Far East.

The current range of Pace's home gateway technology includes:

SATELLITE HOME GATEWAYS

Pace's digital roots are in satellite set-top boxes, which, like all Pace products, are evolving into home gateways and this year included:

Digibox for Sky digital - Pace is currently delivering its seventh generation Sky Digibox model since launching the UK's first digital satellite service with Sky digital in 1998. Sky is now Europe's most successful digital satellite operator.

Pace engineers have continually increased the speed and performance of each new Digibox model and improved cost-effectiveness through smarter component and systems integration. The latest Pace Digibox incorporates the advanced ST5512 50 Mips (millions of instructions per second) processor designed to support interactive applications, a 256 colour on-screen display, seven-day electronic programme guide, teletext, bank card reader and a total of 20Mbytes of memory. Conditional access is provided by NDS and the gateway supports wide ranging interactive services including email, interactive

sports events, Atari games, home shopping and banking.

News Corporation Worldbox - News Corporation affiliates and other satellite operators worldwide use this gateway. Pace's Worldbox has launched digital satellite TV services in Israel and across Latin America. This year, Pace continued shipping the Worldbox to Sky New Zealand following the launch of New Zealand's first digital satellite service in 1998. The Worldbox has a 40 Mips processor and typically carries up to 6Mbytes of memory for applications. The user interface is capable of 256 colours and the gateway has several interfaces for connecting to telephones, computers and other devices. The gateway supports middleware from OpenTV and NDS.

Sky+ Personal Video Recorder (PVR) - Sky+ was launched in the UK. Sky is the first broadcaster to partner with Pace on developing integrated hard disk drive technology for a home gateway. Sky+ delivers a whole new viewing experience, enabling the recording of one digital satellite programme while watching another, pausing of live TV and automatic recording of favourite episodes without need for video tapes. Sky+ can currently store an average of 20 hours' worth of recordings and provides full access to all existing enhanced and interactive Sky digital features.

Pace's world class engineering skills were of prime importance to developing Sky+. Working closely with Sky's technology team

and other key partners, Pace integrated a 40 gigabyte capacity hard disk, dual tuners, digital audio and modem technology into a digital satellite decoder.

Sky+ is the highest specification home gateway Pace has delivered to a News Corporation operator.

CABLE HOME GATEWAYS

Pace was officially ranked third largest supplier of digital cable gateways in the world this year by industry analysts Cahners In-Stat Group.

In the UK Pace continued to deliver Di4000 cable gateways to ntl and Telewest. The Di4000 is Pace's third generation interactive cable home gateway. It enables high-speed data access and digital television services from email and home shopping to web-surfing via a 175 Mips processor and integrated high-speed cable modem. It also features 40 Mbytes of memory. As stated by IMS Research, Pace's Di4000 is the most widely deployed advanced cable home gateway in Europe today.

In the USA, Pace started delivering the Pace 500 digital cable gateway series in volume to its first US customer, Time Warner Cable. The Pace 500 gateway enables multichannel television and interactive services such as video-on-demand. It utilises a 170 Mips processor and integrates Time Warner Cable's preferred operating and conditional access system. It also has an integrated DAVIC cable modem. The Pace 500 has also been ordered by Pace's second US cable customer, Comcast Communications.

Pace's 500 gateway series has also achieved a number of notable firsts for the US industry. It is this market's smallest digital interactive cable gateway, the first to incorporate 'single-chip architecture' and the world's first to carry the ENERGY STAR label, having been successfully tested by the US Environmental Protection Agency (EPA) and the US Department of Energy (DOE) as meeting or exceeding the recommended energy-efficiency guidelines.

Pace's 700 cable gateway series was also developed for Comcast Communications. The 700 gateway series incorporates DigiCipher II conditional access and integrated DOCSIS cable modem. It has over 300 Mips processing power and has the option to incorporate an integrated hard disk drive for personal video recording (PVR) services.

As part of Pace's drive on scalable, low-cost technology for Continental European payTV operators, Pace launched the Di300 cable gateway. This gateway can be used as a stand-alone product to enable operators to provide basic payTV services or extend services to secondary televisions in the home. It can also be used to provide two-tier services without high support costs, as it shares common software architecture with the more advanced Pace Di4000 cable gateway.

The scalable design of the Di300 means it can also be upgraded to incorporate advanced features such as video-on-demand (VOD), high-speed broadband data and PVR services. Operators can choose to connect an external, open standard DOCSIS cable modem, hard disk drive or Gateway Expander module to the Di300's open standard interfaces. Alternatively, the Di300 can be seamlessly integrated with data or voice modules as part of Pace's Siblings modularisation concept.

Siblings - Building on the strength of Pace's Di300 'scalable' gateway, Pace has developed a new modular home gateway concept called Siblings. This concept modularises Pace's five core digital technologies; payTV, broadband modem connectivity, PVR, Voice over Internet Protocol (VoIP) and home networking to enable operators to stagger deployments of triple-play voice, video and data services. Siblings' innovative design enables modules to 'fit' neatly together in a compact case.

IP TELEVISION HOME GATEWAYS

Pace's DSL4000 gateway, deployed across more geographic markets than any other IPTV gateway, was used to launch trials and services across the Far East, North America and Europe. Major deployments included Chunghwa Telecom in Taiwan, TCC in Korea, Myrio in the US and Sasktel in Canada and trials with Singtel in Singapore. The DSL4000 provides digital television, interactive services and web surfing over standard copper telephone lines. It features high quality MPEG-2 decoding and an Ethernet interface. The television services are delivered over IP and support all industry leading video servers.

Pace also developed and launched a next generation IPTV gateway, the IP500. This gateway supports low bit-rate streaming protocols, including MPEG-4, to enable network operators to unicast or multicast video streams at 1 Mbps. These low bit-rate codecs reduce the amount of bandwidth needed to carry movies to a home and so allow telcos to deliver digital TV to many more homes than was previously possible. This evolution fundamentally changes the break-even point of IPTV businesses for telcos, and is attracting worldwide interest. An optional integrated hard disk drive will also enable network operators with bandwidth constraints to feed content from the network to the gateway at off-peak times or provide PVR or on-demand services.

RETAIL / LOW-COST

In the past year, Pace has extended its range of retail and low-cost products for the UK and Continental European retail markets.

Digital television adapter (DTVA) - The Adapter is a low-cost and compact product measuring just 185mm wide x 100mm deep x 45mm high, designed to deliver multichannel television programming for free-to-air and/or payTV services on satellite, cable or terrestrial platforms. The DTVA has a dual conditional access capability and full DVB-data compliant Electronic Programme Guide (EPG).

Pace launched its digital terrestrial DTVA in 2002, targeting the UK's digital terrestrial free-to-air market. The DTVA provides a



Above: Siblings
Middle: Digital TV Adapter
Bottom: Pace 500



low-cost and simple method to convert existing UK (analogue) televisions to digital, enabling viewers to access the growing range of free-to-air digital programmes in the UK without a monthly subscription fee. It provides the facility to channel search automatically or manually and supports interactive digital teletext and subtitles.

Pace's retail distribution of its CDTV.410 universal gateway range, aimed at the Continental European and North African free-to-air and payTV satellite, cable and terrestrial markets, has successfully established Pace's retail brand. To capitalise further on low-cost retail opportunities, Pace developed a new gateway, PUMA, the world's first twin tuner satellite gateway. Aimed at the Continental European retail market, PUMA's integration of twin tuners enables viewers to watch two separate channels on two separate televisions or record one live programme whilst watching another. The optional integration of a hard disk drive will also enable PVR functionality.

Modules for SMATV and iDTV - Pace's iDTV modules are compact devices that have been developed for existing TV designs so there is only one user interface. The module will accept any form of power supply and video output to the TV and can handle multiple conditional access systems. Similar modules are also used for SMATV and are equipped to manage multiple video streams and conditional accesses.

HOME NETWORKING

Pace's products for the networked home have been refined during the year:

Gateway Expander is the base station for the wireless, new wires or powerline networking technologies that are needed to enable two-way communication within the networked home. It is the link between the broadband network external to the home and devices within the home connected to the home network. It can be used as a stand-alone component, although the technology is increasingly likely to be integrated into the home gateway. During the year Pace demonstrated how it can be used to stream video wirelessly to several devices simultaneously. The portfolio of radio technologies used by Gateway Expander was

broadened to include the 802.11b standard which is increasingly well established worldwide and works at 11Mbps.

pcConnect is a peripheral device which connects the PC and the Gateway Expander to provide high speed internet access to the PC. This has been used for streaming to PCs and for high speed wireless internet access to PCs.

VOICE OVER IP GATEWAY

Pace's Vega gateways use Voice over Internet Protocol (VoIP) to re-route telephone conversations over data networks. By converting voice into data, the gateways provide the benefits of low-cost, high-quality voice calls in the local loop while still using existing legacy telephony equipment. Over 70 telecommunication companies worldwide have deployed or trialed Pace Vega gateways as telcos look to provide voice and other telephony features across serviced data networks to businesses. Sonera in Finland is an important telco to join Pace's customer list. Sonera has deployed the Pace Vega100 over its DSL network to provide telephony via the PC, video-conferencing, instant messaging, electronic phonebook, 'buddylist' with presence information and network gaming.

Vega 50 End-User IP Telephony Gateway is targeted at small and medium-sized enterprises, providing a gateway from the company's internal exchange, or directly from existing telephones, to the data network. The Vega 50 is designed to handle up to eight simultaneous telephone calls.

Vega 100 IP Telephony Gateway, recently deployed by Sonera, enables either 30 or 60 simultaneous telephone conversations. It is ideal for corporate network users wanting free internal and low-cost external calls. It is also targeted at service providers and carriers who want to provide cheaper IP calls to their smaller end-user customers, typically as part of a multi-applications package combining email and internet.

GLOSSARY ←

CA (Conditional Access) – an encryption/decryption process which provides access to the broadcaster's services and ensures secure purchase transactions for interactive services. Access is usually enabled by a 'Smart Card', activated by the broadcaster once a subscription is paid.

DAVIC (Digital Audio Visual Council) – a DVB-backed standard for interactive cable modems, also known as DVB-RC.

DOCSIS (Data over Cable Service Interface Specifications) – a widely used cable modem standard in the US, with a European derivative called EuroDOCSIS.

DSL (Digital Subscriber Line) – a technology that enables existing copper telephone wiring to transfer digital signals, for example, television and internet.

DVB (Digital Video Broadcasting Group) – digital television standardisation body for Europe.

EPG (Electronic Programme Guide) – the onscreen graphics used by the viewer to navigate around a digital television service to make programme selections, access additional information and use interactive services.

HDTV (High definition television) – is a television display technology that provides picture quality similar to 35mm movies with sound quality similar to that of today's compact disc.

iDTV – a television with integrated home gateway technology that is able to receive digital television services.

IPTV (Internet Protocol Television) – the provision of television and multimedia services using the same digital packet delivery systems as used over the Internet

MPEG-2 – an international standard which enables the conversion of moving pictures into a highly compressed stream of digital data for transmission,

MPEG-4 – is based on the same principles as MPEG-2, but is more advanced and provides more compression. Therefore similar quality video performance can be achieved using lower bit rates.

Middleware – a layer of software sitting above Pace's driver layer allowing applications written using an API to be run on a gateway.

Programming environment – often known as the API (Application Programme Interface), this software enables the broadcaster to create their own unique service. For example, it allows software developer to write interactive television software that can be used in the home gateway.

SMATV – allows apartment blocks and shared housing to use a single antenna installation. Multi-user installations are common in many European countries.

VoIP – Voice Over Internet Protocol is the method by which voice is digitized and transmitted over Internet Protocol in digital packets rather than in the traditional circuit-committed protocols of the public switched telephone network.

Report of the Directors

The directors present their report to shareholders on pages 25 to 36 together with the audited financial statements for the year ended 1 June 2002. Both the current and prior period are 52 weeks.

→ PRINCIPAL ACTIVITIES

The Group's principal activities are the development, design and distribution of digital receivers and receiver decoders which provide a gateway for the reception of digital television and the reception/transmission of interactive services, telephony and high-speed data. The Group also provides support services and software applications to its gateway customers. Each of these services may be delivered over satellite, cable, terrestrial and DSL transmission systems.

→ BUSINESS REVIEW AND FINANCIAL RESULTS

A review of the Group's activities, developments and the financial results for the year are presented in the Chairman's Statement and the Chief Executive's Statement on pages 6 to 20. The consolidated profit and loss account for the year ended 1 June 2002 is set out on page 39. Profit before tax, amortisation of goodwill and exceptional items was £13.1 million (2001: £44.3 million) and after amortisation of goodwill and exceptional items was a loss of £29.5 million (2001: profit £38.1 million).

The directors recommend the payment of a final dividend of 0.70p per share (2001: 0.70p) to be paid on 25 October 2002 to shareholders on the register at the close of business on 20 September 2002. An interim dividend of 0.40p per share (2001: 0.35p) was paid on 8 April 2002. The total dividend for the year will amount to 1.10p per share (2001: 1.05p).

→ SHARE CAPITAL

Changes in the Company's share capital during the year ended 1 June 2002 are set out in note 22 to the financial statements.

→ SIGNIFICANT SHAREHOLDINGS

The Company has been notified of the following significant shareholdings as at 8 July 2002:

	Number of shares	% of issued share capital
David Hood and related family trusts	44,486,957	19.7
Schroder Investment Management Limited and related companies	29,286,224	12.9
Fidelity Investment Management Limited and related companies	25,079,498	11.1
Robert Fleming and related family trusts	8,880,178	3.9
Pace Micro Technology plc Employee Benefits Trust	7,373,104	3.3
Legal & General Investment Management Limited	6,805,461	3.0

→ DIRECTORS

The names of the current directors of the Company are shown below. Other than as described, all those listed held office throughout the year.

Sir Michael Bett, CBE

Sir Michael, aged 67, joined the Board in February 2000 and was appointed Chairman on 31 March 2000. He is also Non-executive Chairman of Compel Group plc, Non-executive Director of Eyretel plc and of Ordnance Survey. His previous career in the private, public and charity sectors has included being Chairman of Cellnet Group, Deputy Chairman of BT and Managing Director of BTUK. He is a former President of the Chartered Institute of Personnel and Development, Chairman of Save the Children Fund and Chairman of the Independent Review of Armed Forces Manpower, Pay and Conditions of Service. In July 2000, he retired as First Commissioner for the Civil Service. Currently he is Pro-Chancellor of Aston University.

Report of the Directors

continued

Malcolm Miller

Malcolm, aged 46, was appointed as Chief Executive in November 1997. He is also a Non-executive Director of Avis Europe plc. Previously, he was European Chief Executive Officer of Sega Europe Ltd and prior to that Marketing Director and then Managing Director of Amstrad plc.

John Dyson

John, aged 54, was appointed Finance Director in November 1997. He is also a Non-executive Director of IFX Power plc. Prior to his employment at the Company he was Vice President of Finance, Europe for LSI Logic Corporation. Other previous appointments included positions as Finance Director of CASE Group Plc and Norbain Plc.

Timothy Fern

Tim, aged 39, joined the Company in July 1992 from Amstrad plc. He has been a member of the Executive Committee of the Group since 1997 and in January 2001 he was appointed to the Board as Chief Technology Officer with responsibility for the Engineering function within the Group.

Robert Fleming

Rob, aged 45, joined the Company in 1983 and became Operations Director in 1984, with responsibility for production and distribution. With effect from February 1999 he assumed responsibility for the Engineering function within the Group but relinquished his executive responsibilities in May 2001. Rob remains a Non-executive Director of the Company.

Neil Gaydon

Neil, aged 42, was appointed as an Executive Director on 12 June 2002 and he is currently President, Pace Americas. He has been with Pace since 1995 and has spearheaded the development of the Company's US business since 1999. Prior to this he was Regional Sales Director EMEA and head of New Business Development and Product Marketing for the Company.

David Hood, OBE

David, aged 54, founded Pace in 1982. He was Joint Chief Executive until November 1997 when he became Advanced Technology Director. In September 1998 David became a Non-executive Director.

Marvin Jones

Marvin, aged 64, is a US citizen and was appointed as a Non-executive Director in June 2000. Previously, he was Chief Executive Officer of The National Cable Television Center and Museum, Denver, USA, an Executive Vice President of AT&T Broadband and Internet Services and President and Chief Executive Officer of TCI Communications, Inc.

Robert Lambourne

Bob, aged 50, was appointed as a Non-executive Director in June 1996 and in February 2000 was appointed Senior Independent Director. He is also Finance Director of RMC Group plc. Previously, he was an executive director of Hepworth PLC and prior to that he was Finance Director of Foseco plc.

Michael McTighe

Mike, aged 48, was appointed a Non-executive Director on 3 June 2001. Having held a number of directorships, he is currently Chairman of Red M Communications Ltd, a director of Via Networks, Inc and a Non-executive Director of Alliance & Leicester plc. Previously he was Chairman and CEO of Carrier 1 International SA and before that Executive Director and Chief Executive, Global Operations of Cable & Wireless plc.

Marvin Jones, Bob Lambourne and Malcolm Miller will retire by rotation at the Annual General Meeting (AGM), and each being eligible, will offer themselves for re-election. Neil Gaydon, having been appointed by the Board subsequent to the date of the last AGM, will hold office until the forthcoming AGM and will then offer himself for election at that meeting. Details of the executive directors' service contracts including those of the executive directors standing for election are disclosed on page 32. Bob Lambourne and Marvin Jones being Non-executive Directors, do not have service contracts.

Report of the Directors

continued

→ PAYMENT TO SUPPLIERS

It is the policy of the Group to agree terms and conditions for its business transactions with suppliers. Payment is made in accordance with those terms, subject to the other terms and conditions being met by the supplier. The Group does not follow any code or standard on payment practice. Creditor days at the end of the year for the Group were 41 days (2001: 34 days) and for the Company were 41 days (2001: 31 days).

→ RESEARCH AND DEVELOPMENT

The directors regard it as fundamental to the future success of the Group to engage in a substantial ongoing programme of research and development of new products, spending £36.9 million (2001: £33.7 million) during the year.

→ DONATIONS

During the year the Group donated £49,919 (2001: £49,894) to charitable causes. No political donations were made. Further details of the charitable and community-related activities of the Group are given on page 31.

→ SINGLE EUROPEAN CURRENCY

The Group has significant activities in Europe and predominantly transacts in the customer's local currency. The Group's systems have been adapted to meet the demands of trading with entities based in countries adopting the single European currency. The costs incurred were not material to the financial results of the Group and have been expensed as incurred in accordance with generally accepted accounting practice.

→ AUDITORS

KPMG Audit Plc held office as auditors during the year. A resolution for the re-appointment of KPMG Audit Plc will be proposed at the forthcoming Annual General Meeting.

→ ANNUAL GENERAL MEETING

The Annual General Meeting of the Company will be held on 10 September 2002 at the offices of ABN AMRO Hoare Govett, 250 Bishopsgate, London EC2M 4AA. Full details of the business to be transacted at the meeting will be set out in the Notice of Annual General Meeting.

Corporate Governance

The Combined Code issued by the UK Listing Authority establishes fourteen Principles of Good Governance, which are split into four areas described below: Directors; Directors' Remuneration; Accountability and Audit; and Relations with Shareholders. The directors believe that the Company has complied throughout the year with Section 1 of the Combined Code. The Board confirms that it has established the procedures necessary to implement the guidance "Internal Control: Guidance for Directors on the Combined Code" and that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company.

→ DIRECTORS

The Group is controlled through the Board of Directors which comprises four executive and six non-executive directors who bring a wide range of skills and experience to the Board. Biographical details of all directors are to be found on pages 25 and 26. The Chairman, Sir Michael Bett, is mainly responsible for the running of the Board. The responsibilities of the Chief Executive, Malcolm Miller, focus on running the Group's business and implementing Group strategy. The Chief Executive is assisted in managing the business on a day-to-day basis by the Executive Committee as further described below. All the non-executive directors are independent of management and make a significant contribution to the functioning of the Board, thereby helping to ensure that no one individual or group dominates the Board's decision making process. In addition, the Board has appointed Bob Lambourne as the Senior Independent Director. All directors are able to take independent professional advice at the Company's expense in the furtherance of their duties, if necessary.

The Board has a formal schedule of matters specifically reserved to it and normally meets monthly. It is responsible for overall Group strategy, acquisition and divestment policy, approval of major capital expenditure projects and consideration of significant financing matters. It reviews the strategic direction of the Group and conducts formal strategy reviews together with other senior executives within the Group twice a year.

All directors, in accordance with the Combined Code, submit themselves for re-election at least once every three years.

The Board has established the following committees, each of which has written terms of reference, which specify its authority and duties:

- The Audit Committee comprises five non-executive directors: Sir Michael Bett, Rob Fleming, Marvin Jones, Mike McTighe and Bob Lambourne (Chairman). The Committee receives and reviews reports from management and from the auditors relating to the interim and annual accounts and the control systems in use throughout the Group. The Committee met five times during the year. Meetings are held by the Committee with the auditors without executive management being present at least once a year.
- The Executive Committee is chaired by Malcolm Miller as Chief Executive. The Committee meets monthly and ensures that the strategy, plans and policies previously agreed or delegated by the Board are implemented.

The Committee comprises all of the executive directors together with the following senior executives:

Francis Brochon	President, Xcom
Anthony Dixon	Director of Legal Services
Maggie Pedder	Director of Personnel
Nigel Stacey	Director of Group Operations
Andrew Trott	CEO, VegaStream
Andrew Wallace	Director of Marketing
Graham North	Regional Director UK

- The Remuneration Committee is comprised of non-executive directors David Hood, Marvin Jones, Mike McTighe and Bob Lambourne and is chaired by Sir Michael Bett. The Committee is responsible for setting the remuneration of the executive directors and other members of the Executive Committee including making recommendations regarding the grant of share options. The members of the Committee have no personal interest, other than as shareholders, in the matters to be decided, no potential conflicts of interest arising from cross-directorships and no day-to-day involvement in the running of the business. The Committee met twice during the year.
- The Nominations Committee comprises non-executive directors Rob Fleming, David Hood, Marvin Jones, Mike McTighe and Bob Lambourne, together with Malcolm Miller, and is chaired by Sir Michael Bett. Its purpose is to consider and make recommendations to the Board regarding the appointment of new directors.

Corporate Governance

continued

→ DIRECTORS' REMUNERATION

The Remuneration Committee reviews the performance of the executive directors and other members of the Executive Committee as a prelude to recommending their annual remuneration, bonus awards and award of share options to the Board for final determination. The final determinations are made by the Board as a whole but no director plays a part in any discussions concerning his own remuneration.

The Remuneration Report of the Board to Shareholders is set out on pages 32 to 36 and includes the remuneration policy of the Group and details of directors' incentive payments and the related performance criteria.

→ ACCOUNTABILITY AND AUDIT

Operational and Financial Reporting

A detailed review of the performance of the Group's business is contained in the Chief Executive's Statement. This statement, together with the Chairman's Statement and the Report of the Directors, is intended to present a balanced assessment of the Group's position and prospects. The directors' responsibility for the financial statements is described on page 37.

→ INTERNAL CONTROLS

Overall responsibility for the Group's system of internal control rests with the Board of Directors. The Board has delegated certain of its powers to the Audit Committee to review the effectiveness of the systems of control and to receive reports from auditors and management as appropriate.

During the year and up to the date of this report, the Board carried out a review of the effectiveness of the Group's internal controls. The reviews were undertaken in accordance with the Joint Working Group's guidance under the following headings and were aimed at clearly identifying the systems already in place and the action plans necessary to improve areas of control weakness.

• The control environment

Subject to those powers and limits of authority reserved by the Board, and to the Group policies and guidelines they have established, the conduct of the business of the Group is delegated within a clearly defined organisational structure and approved level of authority. The Board has also adopted a code of ethics, which has been incorporated in the Employee Handbook issued to all members of staff, to emphasise the directors' commitment to upholding the highest standards of integrity and personal conduct in all matters concerning the Group.

• Risk assessment

The directors and senior managers are responsible for identifying and monitoring sources of potential business risk and financial risk, and for taking such preventative and protective actions as they consider necessary to manage effectively such risks. During the year the internal audit function of the Group has conducted a risk assessment review of the Group's business in conjunction with the Executive Committee. The Board has received and considered this review as part of an annual risk and control assessment.

The Group's systems are designed to identify and manage rather than eliminate significant business risks, including the risk of failure to achieve business objectives and can only provide reasonable not absolute assurance against material misstatement or loss. During the year the Group has continued its risk management initiatives, which are embedding the principles of risk awareness and management further into the Group's processes.

Business risks are identified, evaluated and managed through functional line management reporting to divisional meetings, monthly Executive Committee meetings and Board meetings as appropriate. Each member of the Executive Committee is required to highlight and report on any significant business risks identified within their sphere of responsibility. The internal audit function contributes by monitoring internal controls, by performing regular, independent reviews of key business risks and monitoring actions taken to address such matters and by carrying out detailed process reviews of systems, identifying and recommending improvements where appropriate.

The key business risks associated with the timely completion of long-term development projects and on-going business risks, including alleged infringement of third party intellectual property rights, are managed by cross-functional teams of senior employees. Business continuity plans addressing physical risks to the Group's development sites are reviewed and updated quarterly.

Company-wide initiatives have been launched including Continuous Improvement and the Pace Reliability Council, with a view to attaining the highest standards in quality and reliability from design to manufacture and beyond.

Corporate Governance

continued

- **Financial control and information systems**

The Group's strategic direction is reviewed regularly by the Board and plans, budgets and performance targets are reviewed and approved at least annually. Directors receive monthly summaries of financial results which compare actual performance with targets, together with detailed management reports which identify the reasons for variances and the progress achieved. Forecasts are revised on a regular basis in line with actual and expected performance.

- **Control procedures**

Financial control procedures have been developed for all of the main business functions and have been documented in a procedures manual. Authorisation limits for purchases and capital expenditure are clearly specified and procedures are in place for minimising exposure to potential weaknesses in the receipt, handling and despatch of goods. The Group's Saltaire premises have received accreditation for BSI ISO 9001 and it is the intention to extend this to include the Cambridge and Boca Raton sites.

- **Monitoring systems**

Monitoring of the internal control systems is carried out by internal audit staff on a continual basis.

Although no system of internal financial control can provide absolute assurance against material misstatement or loss, the Group's systems are designed to provide the directors with reasonable assurance that transactions are authorised and completely and accurately recorded, that assets are safeguarded and that material errors, irregularities and actions contrary to Group policies and directions are either prevented or promptly discovered.

→ GOING CONCERN

The directors, having taken account of the Group's net cash resources, available bank facilities and the factors referred to in note 1 to the financial statements and having reviewed the Group's budget and forecasts for the year to 31 May 2003, consider that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Corporate Social Responsibility

→ EMPLOYMENT POLICIES

The directors recognise the importance of the Group's employees to its success and future development and are committed to providing an environment that will attract, motivate and reward high quality employees. The Group continues to invest in training and development and has strong links with local colleges for courses leading to NVQ, BTEC and City & Guilds qualifications, as well as undertaking development in-house. This commitment has been acknowledged by Investors in People (IIP) recognition.

Employees are kept informed of matters affecting them as employees and factors affecting the performance of the Group through employee meetings/briefings and a Company newsletter, "Pacesetter". In the UK, meetings of the Employee Consultation Work Group, an elected forum for the discussion of work related issues, are held with members of the Executive Committee at least six times per year.

The Group welcomes applications for employment from all sectors of the community and is striving to promote equality of opportunity in employment regardless of sex, sexual orientation, disability or ethnic origin. It is the Group's policy that training, career development and promotion opportunities should be available to all employees.

→ HEALTH AND SAFETY

The Group has an established Health and Safety Committee which conducts quarterly review meetings with Group safety representatives regarding health and safety issues relevant to the Group's business. Other safety-related committees also conduct periodic reviews of specific work practices. The Company Safety Officer meets with Tim Fern, Board director with responsibility for health and safety issues, on a regular basis throughout the year.

Site inspections are conducted in the UK, generally on a monthly basis, by safety representatives and this has resulted in several local workplace safety improvements. Generic and detailed risk assessments, chemical assessments and safe systems of work guidance have been made available to employees on the Company's intranet site. The importance of ongoing health and safety awareness training for managers and safety representatives is recognised. As part of this process all safety representatives have had refresher training and 23 managers have successfully completed the IOSH Managing Safely course.

Corporate Governance

continued

The number of UK workplace accidents during the year was 135, of which 4 were reportable to the Health & Safety Executive. Of these accidents, 51 did not involve manufacturing line facilities and no such accidents were reportable. A report concerning health and safety aspects of the Group's business and copies of specific Group safety policy documents can be obtained from the Company Secretary.

→ CHARITABLE AND COMMUNITY SUPPORT

The Group has an established Charitable Donations Committee comprising employees based at the Group's premises in the UK and the USA. This committee considers all requests for charitable and community project assistance within a financial budget and criteria approved by the Board on an annual basis.

The Group's support through the committee is focused on the local geographic area of Pace's premises in Saltaire, Cambridge, Bracknell and Boca Raton, in Florida, as well as charitable and community initiatives of Group employees. Corporate charity policy is to support local charities of benefit to the local area and people living close to each Group site.

During the year 298 requests for support were considered by the committee, 87.3% of such requests satisfying the criteria and receiving financial support amounting to £49,919. The participation of employees of the Group in community and charitable activities outside work hours has been encouraged with the provision of funds to match individual sponsorship raised.

Further details of the charitable and community donations made during the year and criteria for awards made by the Charitable Donations Committee can be obtained from the Company Secretary.

→ ENVIRONMENTAL MANAGEMENT

During the year the Company commissioned its first independent Environmental Report, prepared by consultants, Scott Wilson. The Company has achieved certification to the international management standard ISO 14001 at its Saltaire site.

The Company is a partner in the ENERGY STAR programme established by the United States Environmental Protection Agency which sets low power usage performance criteria for electrical products. The Company is also signatory to the European Code of Conduct on Energy Efficiency of Digital TV Service Systems and is committed to making reasonable efforts to ensure that its STBs are designed to minimise energy consumption.

The Company has developed systems to monitor the proportion (by weight) of its products that are recyclable and procedures to ensure that each product is checked for certain hazardous materials, in each case in anticipation of expected requirements of forthcoming EU regulations. In addition, procedures have been implemented to require that the packaging the Company specifies in the design process is recyclable.

A baseline for energy, water and paper consumption across the Group's three UK sites has been established. This has been carried out with a view to setting objectives, targets and implementing measures for reduction. Using data gathered from the Group's UK sites, together with transport information on flights and road travel, the Company has estimated its direct and indirect greenhouse gas emissions for the period (expressed as units of CO₂ equivalent) and established objectives, targets and measures to reduce its emissions.

The Company has developed supplier assessment and approval procedures to evaluate the environmental performance of its suppliers and sub-contractors. Using the supplier assessment and approval process, the Company intends to influence environmental awareness of its subcontractors and component vendors.

The Company is a member of the Yorkshire Wildlife Trust and during the year participated in the Yorkshire and Humber 4th Regional Index of Environmental Engagement along with 120 of the region's largest companies. This scheme is administered by Business in the Community and ranks companies in terms of their environmental performance. In the 2002 index Pace was ranked at 54 out of 120 (2001 index: 64 out of 87).

A copy of the Group's Environmental Policy Statement and the Environmental Report referred to above can be obtained from the Company Secretary.

→ RELATIONS WITH SHAREHOLDERS

The Board has continued to establish relationships with institutional shareholders and communicates with investors through the Group's web site (www.pace.co.uk). Shareholders are welcome to participate at the Annual General Meeting on 10 September 2002 at which the Board will be introduced and will be available for questions.

Remuneration Report

→ REMUNERATION OF EXECUTIVE DIRECTORS

The policy of the Group is to ensure that the remuneration packages are competitive and designed to attract, retain and motivate executive directors and senior executives of a high calibre and to reward them for performance. The policy seeks to provide rewards and incentives that reflect corporate and individual performance which align with the objectives of the Group.

The main components of the remuneration packages derived from the above policy are set out below.

→ SALARY

Basic salary for each executive director is determined by the Remuneration Committee, taking into account the performance of the individual and information from independent sources on the rates of salary for comparable jobs. In setting salaries, the Committee also takes into account pay and employment conditions in the Group as a whole.

→ PERFORMANCE BONUS

The Company established a non-pensionable performance-related bonus scheme for the executive directors and other key members of management for the year ended 1 June 2002 which was based on successful achievement of corporate and individual objectives. The corporate objectives were linked to the interests of shareholders and the key measure therefore was the profitability of the Group for the full financial year. Achievement of bonus was dependent on the Group's pre-tax profits (before exceptional item and certain goodwill amortisation) exceeding £50 million with the capacity to earn additional bonus increments upon achievement of higher profit targets up to a ceiling of £60 million. In addition, a number of individual personal objectives were set for each director and manager which aligned with the objectives of the Group for the year. Since the minimum corporate objectives were not achieved there were no bonuses awarded to the directors in respect of the year ended 1 June 2002.

→ BENEFITS IN KIND

Each executive director is entitled to benefits such as the provision of a fully expensed company car plus fuel (or cash alternative), private medical insurance, permanent health insurance and life insurance, in line with market practice.

→ PENSION CONTRIBUTIONS

In the year under review, contributions were paid into the executive directors' pension schemes at rates determined by the Board. Contributions have continued to be paid at the rate of 15% of each director's basic salary subject to Inland Revenue limits. The Group does not operate any defined benefit schemes.

→ SERVICE CONTRACTS

Each of the executive directors has a service contract with the Company. Each of these agreements is terminable by the Company on twelve months' prior written notice or by the relevant director on not less than six months' prior written notice.

Remuneration Report

continued

→ SHARE OPTION SCHEMES

The Committee believes that share ownership encourages employees to contribute further towards improvements in the Group's performance. To this end, the following share option schemes have previously been established under which employees may obtain ordinary shares:

- A regular savings scheme (the "Sharesave Scheme"), which is open to directors and employees of the Group and under which options, granted at an initial discount of up to 20% against the quoted market price, are normally exercisable on completion of a three-year SAYE contract.
- An All Employee Share Ownership Plan ("AESOP") in terms prescribed by the legislation authorising such schemes. No shares have yet been issued under the AESOP.
- An Inland Revenue Approved Discretionary Scheme (the "Approved Scheme") under which all employees, including full-time directors of the Company or any subsidiary, who do not have and have not had within the previous twelve months a material interest in the Company and are not within two years of retirement, are eligible to participate. Participation is at the discretion of the Board, acting in accordance with the recommendations of the Remuneration Committee. Under the Approved Scheme, options may be granted at the prevailing quoted market price and may usually be exercised between three and ten years from the date of the grant. The aggregate exercise price payable for the shares over which outstanding options may be held by any option holder is restricted to the appropriate legislative limit, which is currently £30,000.
- A Discretionary Unapproved Scheme 1996 ("1996 Unapproved Scheme"), which is similar to the Approved Scheme, although certain rules of the Approved Scheme are not included e.g. the limit of £30,000 mentioned above and the exclusion of employees who have a material interest in the Company. No options have been granted under this scheme since the adoption of the 2000 Unapproved Scheme.
- A Discretionary Unapproved Scheme 2000 ("2000 Unapproved Scheme"), adopted by the Group at the Extraordinary General Meeting of the Company on 17 July 2000, which is open to all employees and full-time directors on the same basis as the 1996 Unapproved Scheme, which it replaced. Under the 2000 Unapproved Scheme options are granted at the prevailing quoted market price and become exercisable ("vest") as to 25% each anniversary after the grant over a four-year period. Under this scheme Basic Options may be granted up to a limit such that unvested options may not exceed four times annual remuneration. For a category of up to 55 key employees there is the ability to award options ("Super Options") above the limit for Basic Options. In the case of up to 40 senior employees, whose contribution is judged to be of key importance, Super Options may be granted up to a limit such that unvested Super Options may not exceed four times annual remuneration; in the case of members of the Executive Committee and up to five other key employees, the relevant limit is eight times annual remuneration; in the case of the Chief Executive Officer, the relevant limit is ten times annual remuneration.

In granting options under the Approved Scheme and the 1996 and 2000 Unapproved Schemes, the Board may include objective performance targets or other conditions as it thinks fit and has included such performance conditions based on growth in earnings per share of 15% above RPI over a three-year period in all grants under the Approved Scheme and 1996 Unapproved Scheme until July 2000. Under the 2000 Unapproved Scheme performance conditions of 6% per annum and 20% per annum compound above RPI have been applied to the grant of Basic Options and Super Options respectively thereunder.

In addition, separate share option schemes have been established for the benefit of the Group's US and French employees within the authority given by shareholders at the Extraordinary General Meeting of the Company held on 17 July 2000. Both such schemes operate within the overall limit on issue of new shares of 10% of the Company's issued share capital applicable to all the Group's employee share schemes. The Pace Americas Sharesave Plan is based on the Sharesave Scheme rules and is designed to satisfy the US Internal Revenue Service requirements for such saving-for-shares plans. The Pace Micro Technology plc French Share Option Scheme 2001 is based on the UK Approved Scheme rules and satisfies the French statutory requirements which provide favourable tax treatment for such schemes.

→ REMUNERATION OF NON-EXECUTIVE DIRECTORS

The Non-executive Directors do not have service contracts and do not participate in any incentive plans. Their fees, which are determined by the Board as a whole, are non-pensionable and within the limits set out in the Articles of Association.

Remuneration Report

continued

→ DIRECTORS' REMUNERATION

Total directors' remuneration for the year ended 1 June 2002 was as follows:

	2002	2001
	£000	£000
Fees	204	154
Salaries and benefits in kind	698	911
Performance-related bonuses	-	708
Pension contributions	80	114
	982	1,887

The remuneration of individual directors for the year to 1 June 2002 is set out in the table below:

	Salaries and fees	Performance bonus	Benefits in kind	Total remuneration		Pension contributions	
	2002	2001	2002	2002	2001	2002	2001
Executive Directors	£000	£000	£000	£000	£000	£000	£000
Malcolm Miller	300	-	24	324	589	38	38
John Dyson	198	-	3	201	353	28	27
Tim Fern	159	-	14	173	156*	14	6*
	657	-	41	698	1,098	80	71
Non-executive Directors							
Robert Fleming**	25	-	-	25	280	-	22
Sir Michael Bett	60	-	-	60	60	-	-
David Hood	25	-	-	25	25	-	-
Marvin Jones	44	-	-	44	44	-	-
Bob Lambourne	25	-	-	25	25	-	-
Mike McTighe*	25	-	-	25	-	-	-
	204	-	-	204	434	-	22
	861	-	41	902	1,532***	80	93***

* Indicates remuneration referable only to period of financial year since date of appointment to the Board.

** A Non-executive Director with effect from 1 June 2001.

*** Figures exclude remuneration of £241,000 paid to former Executive Director Kurt Risdon and pension contributions of £21,000 in respect of Mr Risdon.

→ DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS

The interests of directors holding office at the year-end and those of their immediate families in the ordinary share capital of the Company at 1 June 2002 and at the beginning of the year or date of appointment, if later, are set out below:

	1 June 2002			3 June 2001 or Date of Appointment		
	Shares			Shares		
	Beneficial	Non-Beneficial	Under option	Beneficial	Non-Beneficial	Under option
Sir Michael Bett	43,300	-	-	3,750	-	-
Malcolm Miller	66,603	-	1,870,188	66,603	-	1,070,188
John Dyson	91,586	-	1,009,433	75,603	-	625,416
Mike McTighe	20,000	-	-	-	-	-
Robert Fleming	8,850,990	29,188	-	8,850,990	29,188	-
Marvin Jones	19,825	-	-	5,845	-	-
David Hood	44,457,769	29,188	-	44,457,769	29,188	-
Bob Lambourne	14,500	-	-	14,500	-	-
Tim Fern	1,991	-	678,186	1,991	-	425,000

There were no changes in the directors' interests in the ordinary share capital of the Company between 1 June 2002 and 8 July 2002.

Remuneration Report

continued

→ SHARE OPTIONS

The directors' interests in options over the ordinary shares of 5p each in the Company were as follows:

	At 3 June 2001 or Date of Appointment	Number of options		At 1 June 2002	Option Price	Exercise Period	
		Granted	Exercised			From	To
Malcolm Miller							
Approved Scheme	-	8,000	-	8,000	375.0p	24.07.04	23.07.11
1996 Unapproved Scheme	330,189	-	-	330,189	53.0p	17.11.00	16.11.04
1996 Unapproved Scheme	340,000	-	-	340,000	200.0p	07.07.02	06.07.09
2000 Unapproved Scheme	37,317	-	-	37,317	857.5p	17.07.01	16.07.10
2000 Unapproved Scheme	-	348,268	-	348,268	375.0p	24.07.02	23.07.11
2000 Super Options	362,682	-	-	362,682	857.5p	17.07.01	16.07.10
2000 Super Options	-	443,732	-	443,732	375.0p	24.07.02	23.07.11
John Dyson							
Approved Scheme	-	8,000	-	8,000	375.0p	24.07.04	23.07.11
1996 Unapproved Scheme	259,434	-	-	259,434	53.0p	17.11.00	16.11.04
1996 Unapproved Scheme	150,000	-	-	150,000	200.0p	07.07.02	06.07.09
2000 Unapproved Scheme	69,970	-	-	69,970	857.5p	17.07.01	16.07.10
2000 Unapproved Scheme	-	146,134	-	146,134	375.0p	24.07.02	23.07.11
2000 Super Options	130,029	-	-	130,029	857.5p	17.07.01	16.07.10
2000 Super Options	-	245,866	-	245,866	375.0p	24.07.02	23.07.11
Sharesave Scheme	15,983	-	15,983	-	61.0p	01.10.01	31.03.02
Tim Fern							
Approved Scheme	3,498	-	-	3,498	857.5p	17.07.03	16.07.10
1996 Unapproved Scheme	150,000	-	-	150,000	70.0p	28.04.01	27.04.05
1996 Unapproved Scheme	100,000	-	-	100,000	64.0p	23.09.01	22.09.08
1996 Unapproved Scheme	75,000	-	-	75,000	200.0p	07.07.02	06.07.09
2000 Unapproved Scheme	60,190	-	-	60,190	857.5p	17.07.01	16.07.10
2000 Unapproved Scheme	-	77,042	-	77,042	375.0p	24.07.02	23.07.11
2000 Super Options	36,312	-	-	36,312	857.5p	17.07.01	16.07.10
2000 Super Options	-	172,958	-	172,958	375.0p	24.07.02	23.07.11
Sharesave Scheme	-	3,186	-	3,186	304.0p	01.10.04	31.03.05

On 8 October 2001 John Dyson exercised an option over 15,983 shares under the Sharesave Scheme, when the share price was 220p and retained such shares.

The mid-market share price on 31 May 2002 (the last dealing day before year end) was 89p. The lowest and highest closing mid-market prices during the year were 69p and 490p respectively.

Remuneration Report

continued

→ EMPLOYEE TRUSTS

The Company has established the Pace Micro Technology plc Employee Benefits Trust, which is capable of acquiring shares in the Company in the market and using them for the purposes of satisfying new share options granted under the Company's Share Option Schemes. During the year the Trust acquired 640,000 shares in the Company at a cost of £1.7million.

During the year 1,776,200 options under the Company's share option schemes were exercised and were satisfied by shares transferred by the Trust.

The Company has established the Pace QUEST (Qualifying Employee Share Trust), which is capable of acquiring shares in the Company either through purchase in the market or allotment and using any such shares for the purposes of satisfying options under the Company's Sharesave Scheme. No shares were acquired by the QUEST during the year:

During the year 601,735 options under the Company's Sharesave Scheme were exercised and were satisfied by shares transferred by the QUEST.

By order of the Board

Anthony J Dixon

Company Secretary

8 July 2002

Statement of Directors' Responsibilities

→ STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the Independent Auditors' Report set out on page 38, is made for the purpose of clarifying the respective responsibilities of the directors and auditors.

The directors are required by company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures which are disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is not appropriate to presume that the Group will continue in business.

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

Independent Auditors' Report to the Members of Pace Micro Technology plc

We have audited the financial statements on pages 39 to 59.

→ RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for preparing the Annual Report. As described on page 37, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on page 28 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

→ BASIS OF AUDIT OPINION

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

Uncertainty arising from market conditions

In forming our opinion we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the uncertainty relating to the valuation of stocks arising from the reorganisation currently being undertaken by NTL Incorporated, and the directors' consideration of the appropriateness of the going concern basis of preparation of the financial statements. In view of the significance of these matters, we consider that note 1 should be drawn to your attention but our opinion is not qualified in these respects.

→ OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 1 June 2002 and of the loss of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

Chartered Accountants

Registered Auditor

Leeds

8 July 2002

Consolidated Profit and Loss Account

→ FOR THE YEAR ENDED 1 JUNE 2002

	Note	2002			2001 Restated		
		Before exceptional items £000	Exceptional items (note 5) £000	Total £000	Before exceptional item £000	Exceptional item (note 5) £000	Total £000
Turnover	2	351,794	-	351,794	523,641	-	523,641
Cost of sales		(271,832)	-	(271,832)	(418,453)	(4,529)	(422,982)
Gross profit		79,962	-	79,962	105,188	(4,529)	100,659
Other operating income and charges	4	(68,817)	(39,952)	(108,769)	(62,698)	-	(62,698)
Operating profit/(loss)		11,145	(39,952)	(28,807)	42,490	(4,529)	37,961
Net interest (payable)/receivable	6	(718)	-	(718)	107	-	107
Profit/(loss) on ordinary activities before taxation		10,427	(39,952)	(29,525)	42,597	(4,529)	38,068
Tax on profit/(loss) on ordinary activities	9	(6,796)	1,479	(5,317)	(14,429)	821	(13,608)
Profit/(loss) on ordinary activities after taxation		3,631	(38,473)	(34,842)	28,168	(3,708)	24,460
Dividends	10	(2,386)	-	(2,386)	(2,269)	-	(2,269)
Retained profit/(loss) for the financial year	26	1,245	(38,473)	(37,228)	25,899	(3,708)	22,191
Basic (loss)/earnings per ordinary share	11			(16.1)p			11.5p
Diluted (loss)/earnings per ordinary share	11			(16.1)p			11.1p
Dividends per ordinary share	10			1.10p			1.05p

→ RESULTS BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEMS

		£000	Restated £000
Operating profit		13,862	44,182
Profit on ordinary activities before taxation		13,144	44,289
Adjusted basic earnings per ordinary share	11	2.9p	14.0p
Adjusted diluted earnings per ordinary share	11	2.9p	13.5p

The accompanying accounting policies and notes form an integral part of these financial statements.

In both the current and preceding year the Group had no material discontinued operations.

Consolidated Balance Sheet

→ AT 1 JUNE 2002

	Note	2002		2001 Restated	
		£000	£000	£000	£000
Fixed assets					
Intangible	13		35,822		59,097
Tangible	13		15,285		16,842
Investments	14		4,033		21,537
			55,140		97,476
Current assets					
Stocks	15	46,719		39,693	
Debtors	16	80,626		89,746	
Cash at bank and in hand	30	-		28,373	
		127,345		157,812	
Creditors: amounts falling due within one year	17	(62,301)		(81,194)	
Net current assets			65,044		76,618
Total assets less current liabilities			120,184		174,094
Creditors: amounts falling due after more than one year	18		(332)		(629)
Provisions for liabilities and charges	21		(18,293)		(23,336)
Net assets			101,559		150,129
Capital and reserves					
Called up equity share capital	22		11,312		11,288
Share premium account	23		35,426		35,085
Shares to be issued	24		10,000		21,871
Merger reserve	25		17,209		36,827
Profit and loss account	26		27,612		45,058
Total equity shareholders' funds			101,559		150,129

These financial statements were approved by the Board of Directors on 8 July 2002 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman

John Dyson - Finance Director

Company Balance Sheet

→ AT 1 JUNE 2002

	Note	2002		2001 Restated	
		£000	£000	£000	£000
Fixed assets					
Tangible	13		11,649		14,379
Investments	14		56,520		88,765
			68,169		103,144
Current assets					
Stocks	15	39,407		35,467	
Debtors	16	79,427		89,355	
Cash at bank and in hand		-		28,221	
		118,834		153,043	
Creditors: amounts falling due within one year	17	(54,515)		(75,773)	
Net current assets			64,319		77,270
Total assets less current liabilities			132,488		180,414
Provisions for liabilities and charges	21		(15,899)		(21,335)
Net assets			116,589		159,079
Capital and reserves					
Called up equity share capital	22		11,312		11,288
Share premium account	23		35,426		35,085
Shares to be issued	24		10,000		21,871
Merger reserve	25		17,209		36,827
Profit and loss account	26		42,642		54,008
Total equity shareholders' funds			116,589		159,079

These financial statements were approved by the Board of Directors on 8 July 2002 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman

John Dyson - Finance Director

Consolidated Cash Flow Statement

→ FOR THE YEAR ENDED 1 JUNE 2002

	Note	2002 £000	2001 £000
Net cash (outflow)/inflow from operating activities	28	(18,910)	34,731
Returns on investments and servicing of finance	29	(201)	(19)
Taxation		(8,149)	(9,220)
Capital expenditure and financial investment	29	(8,984)	(22,618)
Acquisitions		(8,303)	(1,504)
Equity dividends paid		(2,375)	(2,020)
Cash outflow before financing		(46,922)	(650)
Financing	29	(143)	1,742
(Decrease)/increase in cash in the year		(47,065)	1,092

→ RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET (DEBT)/FUNDS

	Note	2002 £000	2001 £000
(Decrease)/increase in cash in the year		(47,065)	1,092
Cash flow from decrease in debt		507	83
Movement in net (debt)/funds in the year		(46,558)	1,175
Net funds at start of year		27,484	26,309
Net (debt)/funds at end of year	30	(19,074)	27,484

Consolidated Statement of Total Recognised Gains and Losses and Reconciliation of Movements in Shareholders' Funds

→ FOR THE YEAR ENDED 1 JUNE 2002

→ CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2002	2001 Restated
	£000	£000
(Loss)/profit for the year	(34,842)	24,460
Currency translation differences on foreign currency net investments	164	(40)
Total recognised (losses)/gains relating to the year	(34,678)	24,420
Prior year adjustment (as explained in note 12)	2,284	-
Total gains and losses recognised since the last annual report	(32,394)	24,420

→ RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2002	2001 Restated
	£000	£000
(Loss)/profit for the year	(34,842)	24,460
Dividends	(2,386)	(2,269)
Retained (loss)/profit for the year	(37,228)	22,191
Other recognised gains and losses relating to the year	164	(40)
Issue of ordinary share capital	365	19,207
Movement in shares to be issued	(11,871)	17,278
Net (reduction in)/addition to equity shareholders' funds	(48,570)	58,636
Equity shareholders' funds at start of year (originally £147,845,000 before prior year adjustment of £2,284,000)	150,129	91,493
Equity shareholders' funds at end of year	101,559	150,129

Notes

1 ACCOUNTING POLICIES

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements, except for the treatment of taxation referred to below. The provisions of FRS 19 (Deferred Tax) have been adopted during the year and the impact of the adoption of FRS 19 is set out in note 12.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention.

Carrying value of stocks

As of 1 June 2002, the Group held stocks at a cost value of £46.7m, including an amount of £23.7 million which had been produced for its significant UK cable customer, NTL Group Ltd ("ntl"). The Group has an agreement (announced 22 May 2002) to deliver 300,000 boxes over a 13 month period ending in May 2003.

The US parent of ntl, NTL Incorporated, filed voluntary petitions for a "prearranged" Plan of Reorganisation under Chapter 11 of the US Bankruptcy Code on 8 May 2002. Subject to US Bankruptcy Court approval, the re-organisation plan is expected to be considered for approval by NTL Incorporated stakeholders, with a stated target to approve the re-organisation plan and complete the Chapter 11 bankruptcy process during the third quarter of 2002.

The directors have carefully considered the Group's ability to realise value for the stocks held for ntl having regard to relevant factors including the progress of the proposed re-organisation referred to above, the public statements relevant to the ntl UK operating companies, and the recent course of trading between ntl and the Group.

As a result of these considerations the directors have concluded that it is appropriate to carry the stocks produced for ntl at cost. The financial statements do not therefore include any adjustments to the carrying value of those stocks that would result from the Group's inability to realise anticipated value, which might be the case if a suitable reorganisation plan of ntl's US parent is not approved.

Going concern

Global markets, particularly the technology sector, are experiencing a high degree of volatility.

The worldwide market for home gateways (set-top boxes) is not growing as quickly as previously expected and there is turbulence in the broadcasting industry. Slowing demand and lower selling prices are features of current and anticipated market conditions. New trading arrangements are constantly becoming necessary.

These factors have increased the sensitivity of the judgements required to prepare the financial statements.

The Group has a two year banking facility, based on specific covenants.

The Board has built all of these factors into their working capital forecasts and has modelled various business scenarios. Based on these, the Board has concluded, whilst recognising there is some uncertainty, that the Group has appropriate existing banking arrangements and that, in the event it should need to, it will be able to take action to maintain such facilities.

The Board has therefore concluded it is appropriate to confirm the going concern basis of preparation of the financial statements.

Basis of consolidation

The Group financial statements consolidate those of the Company and of its subsidiary undertakings (note 14) drawn up to 1 June 2002. Unless otherwise stated, the acquisition method of accounting has been adopted. Profits or losses on intra-group transactions are eliminated in full. Under this method the results of the subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Financial year end

The annual financial statements are drawn up to the Saturday nearest to 31 May. The current year's financial statements are for the 52 weeks ended 1 June 2002 and the previous year's financial statements are for the 52 weeks ended 2 June 2001.

Depreciation

Depreciation is calculated to write down the cost less estimated residual value of all tangible fixed assets by equal annual instalments over their expected useful lives. The periods generally applicable are:

Long leasehold properties	Period of lease
Short leasehold properties	Period of lease
Plant and machinery	1 - 10 years
Motor vehicles	4 years

Notes

continued

1 ACCOUNTING POLICIES (continued)**Research and development**

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Deferred taxation

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date except as otherwise required by FRS 19.

Goodwill

Purchased goodwill (both positive and negative) arising on consolidation in respect of acquisitions before 31 May 1998, when FRS 10 *Goodwill and Intangible Assets* was adopted, was written off to reserves in the year of acquisition. When a subsequent disposal occurs any related goodwill previously written off to reserves is written back through the profit or loss account as part of the profit or loss on disposal.

Purchased goodwill (representing the excess of the fair value of the consideration given and associated costs over the fair value of the separable net assets acquired) arising on consolidation in respect of acquisitions since 31 May 1998 is capitalised. Positive goodwill is amortised to nil by equal annual instalments over its estimated useful life, normally 20 years.

On the subsequent disposal or termination of a business acquired since 31 May 1998, the profit and loss on disposal or termination is calculated after charging the unamortised amount of any related goodwill.

In the Company's financial statements, investments in subsidiary undertakings are stated at cost (less any impairment in value).

Accounting for employee share schemes

Interests in own shares held by the Pace Micro Technology plc Employee Benefits Trust are disclosed as a fixed asset investment at cost, less any impairment in value in accordance with UITF No.13 (Accounting for ESOP Trusts). The Company has taken advantage of the exemption available under UITF No.17 revised 2000 (Accounting for Employee Share Schemes) in respect of the 20% discount against the quoted market price for the Sharesave Schemes and equivalent overseas schemes.

Asset impairment

Intangible and tangible fixed assets are tested for impairment when an event that might affect asset values has occurred. An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or by the discounted future earnings from operating the assets.

Foreign currencies

Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at the balance sheet date.

Exchange differences of a trading nature are dealt with in the profit and loss account. Exchange differences on the restatement of the net investment in overseas subsidiaries and the difference between the profit and loss account translated at the average rate and the closing rate are recorded as movements on reserves.

Financial instruments are used to reduce certain exposures to fluctuations in foreign exchange rates. If the instrument is used to hedge a trading exposure then any gain or loss is dealt with in the profit and loss account. Any gain or loss on an instrument used to hedge an exposure on the net investment in overseas subsidiaries is recorded as a movement on reserves.

Pension contributions

The pension costs charged to the profit and loss account represent the amount of the contributions payable to various defined contribution schemes during the year.

Leased assets

Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet and depreciated over their expected useful lives. The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to the profit and loss account over the period of the lease.

All other leases are regarded as operating leases and the payments made under them are charged to the profit and loss account on a straight line basis over the lease term.

Notes

continued

2 TURNOVER

Turnover represents the invoiced value of goods sold and services provided in the year, stated exclusive of value added tax. The geographical analysis of turnover which arises from the principal activities is as follows:

Turnover by destination	2002 £000	2001 £000
United Kingdom	255,844	443,975
Continental Europe	40,205	35,250
Far East and Australasia	11,072	17,368
North America	38,216	2,653
Rest of the World	6,457	24,395
	351,794	523,641

By origin	Turnover		(Loss)/profit before taxation		Net assets/(liabilities)	
	2002 £000	2001 £000	2002 £000	2001 £000	2002 £000	2001 Restated £000
United Kingdom	310,397	512,901	(35,480)	37,059	94,760	148,310
Continental Europe	40,674	10,740	5,238	1,557	6,358	1,059
Far East and Australasia	510	-	375	31	672	1,373
Rest of the World	213	-	342	(579)	(231)	(613)
	351,794	523,641	(29,525)	38,068	101,559	150,129

The Group's principal activities are the development, design and distribution of digital receivers and receiver decoders, which provide a gateway for the reception of digital television and the reception/transmission of interactive services, telephony and high speed data. The Group also provides support services and software applications to its gateway customers. Each of these services may be delivered over satellite, cable, terrestrial and DSL transmission systems.

3 LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION IS STATED AFTER CHARGING/(CREDITING)

	2002 £000	2001 £000
Group auditors' and their associates' remuneration		
- audit services	220	125
- non audit services	153	87
Company auditors' and their associates' remuneration		
- audit services	205	110
- non audit services	148	24
Amortisation of goodwill	2,717	1,692
Depreciation of tangible fixed assets		
- owned	9,010	9,631
- held under finance leases and hire purchase contracts	3	149
Other operating lease rentals		
- land and buildings	2,942	1,929
- plant and machinery	148	300
- motor vehicles	294	214
Profit on disposal of tangible fixed assets	(5)	(86)
Exceptional loss on disposal of fixed assets (see note 5)	1,526	-

4 OTHER OPERATING INCOME AND CHARGES (before exceptional items)

	2002 £000	2001 £000
Development expenditure	36,857	33,720
Administrative expenses	7,529	8,216
Distribution costs	494	851
Other charges	23,937	19,911
	68,817	62,698

Notes

continued

5 EXCEPTIONAL ITEMS

	2002 £000	2001 £000
Restructuring costs	4,931	4,529
Impairment of own shares held in ESOP and QUEST	17,515	-
Impairment of goodwill	17,506	-
	39,952	4,529

The restructuring costs relate to the costs of redundancies, asset write downs and office closures associated with the strategic repositioning of the business.

A provision has been made against the carrying value of the shares held by the Pace Micro Technology plc Employee Benefits Trust and QUEST.

Following an impairment review a provision has been made against the remaining carrying value of goodwill attributable to the Group's investment in VegaStream Limited.

The exceptional item in 2001 arises from the decision to cease in-house manufacturing.

6 NET INTEREST (PAYABLE)/RECEIVABLE

	2002 £000	2001 £000
Finance charges in respect of finance leases and similar hire purchase contracts	-	(3)
Other interest payable	(1,400)	-
Interest payable and other similar charges	(1,400)	(3)
Interest receivable	682	110
	(718)	107

7 REMUNERATION OF THE DIRECTORS

The remuneration, share options and pension entitlements of the directors are disclosed in the Report of the Directors on pages 32 to 36.

8 STAFF NUMBERS AND COSTS

The average number of employees were:	2002	2001
Research and development	683	541
Administration	124	266
Sales and marketing	87	80
Manufacturing and operations	202	524
	1,096	1,411
Staff costs:	£000	£000
Wages and salaries	35,703	37,723
Social security costs	3,359	3,613
Other pension costs	1,314	892
Redundancy	2,996	2,491
	43,372	44,719

Notes

continued

9 TAX ON (LOSS)/PROFIT ON ORDINARY ACTIVITIES

The tax charge is based on the (loss)/profit for the year and comprises:	2002	2001
	£000	Restated £000
Current tax:		
UK corporation tax on (losses)/profits of the period	-	13,529
Overseas tax	3,411	458
Total current tax	3,411	13,987
Deferred tax:		
Origination and reversal of timing differences	1,906	(379)
Tax on (loss)/profit on ordinary activities	5,317	13,608
	2002	2001
	£000	Restated £000
(Loss)/profit on ordinary activities before tax	(29,525)	38,068
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax (30%)	(8,858)	11,420
Effects of:		
Expenses not deductible for tax purposes and amortisation of goodwill	6,693	2,683
Fixed asset timing differences	239	1,106
Short term timing differences	(231)	(1,485)
Tax losses carried forward	4,759	-
Overseas tax not at 30%	809	263
Current tax charge for period	3,411	13,987

The tax credit in respect of the exceptional items included within the above tax charge, amounts to £1,479,000 (2001: £821,000).

10 DIVIDENDS

	2002	2001
	£000	£000
Interim dividend of 0.40p per ordinary share paid 8 April 2002 (2001 : 0.35p)	894	789
Proposed final dividend of 0.70p per ordinary share payable 25 October 2002 (2001 : 0.70p)	1,584	1,581
Dividends waived by Pace Micro Technology plc Employee Benefits Trust and QUEST	(92)	(101)
Total dividends	2,386	2,269

The proposed final dividend will be paid to shareholders on the register at the close of business on 20 September 2002.

11 (LOSS)/EARNINGS PER ORDINARY SHARE

Basic (loss)/earnings per ordinary share have been calculated by reference to the (loss)/profit for the year before and after the amortisation of goodwill and exceptional items and after taxation, on the weighted average number of ordinary shares of 5p in issue during the year. The earnings before amortisation of goodwill and exceptional items was £6,348,000 (2001 as restated: £29,860,000) and the loss after amortisation of goodwill and exceptional items was £(34,842,000) (2001 as restated: profit of £24,460,000). The average number of qualifying ordinary shares in issue during the year was 216,902,805 (2001: 213,128,019).

Diluted (loss)/earnings per ordinary share may vary from basic earnings per ordinary share due to the effect of the notional exercise of outstanding share options. In the current period, due to the Group having made a loss (being after amortisation of goodwill and exceptional items) from its continuing operations, in accordance with the requirements of FRS 14, the diluted earnings per share amounts as measured based on both before and after amortisation of goodwill and exceptional items are the same as the basic earnings per share amounts.

In financial year 2001 the 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 number of qualifying ordinary shares used in that calculation was 221,114,030.

Notes

continued

12 PRIOR YEAR ADJUSTMENT

The policy for deferred tax has been changed during the period in order to comply with FRS19 (Deferred Tax). In prior years, the policy adopted was one of partial provisioning. The comparative figures in the financial statements have been restated to reflect the new policy, as shown below:

	2001 £000
Profit and Loss Account	
Deferred Tax	2,652
Decrease in profit for the period	2,652
Balance Sheet	
Debtors	2,284
Increase in net assets	2,284

The change in accounting policy has had no material effect on the profits reported for the period to 1 June 2002.

13 FIXED ASSETS

	Intangible goodwill £000	Long leasehold buildings £000	Short leasehold land and buildings £000	Plant and machinery £000	Motor vehicles £000	Tangible fixed assets Total £000
Group						
Cost						
At 2 June 2001	61,089	507	5,924	47,809	351	54,591
Exchange adjustments	-	25	(7)	(17)	(1)	-
Additions	-	51	605	8,672	-	9,328
Disposals	-	-	(1,445)	(14,313)	(149)	(15,907)
Adjustments (note 24)	(3,052)	-	-	-	-	-
At 1 June 2002	58,037	583	5,077	42,151	201	48,012
Amortisation/depreciation						
At 2 June 2001	1,992	-	3,649	33,900	200	37,749
Exchange adjustments	-	-	(1)	(3)	-	(4)
Provided in the year	2,717	26	694	8,251	42	9,013
Impairment (note 5)	17,506	-	-	-	-	-
Disposals	-	-	(1,272)	(12,659)	(100)	(14,031)
At 1 June 2002	22,215	26	3,070	29,489	142	32,727
Net book amount at 1 June 2002	35,822	557	2,007	12,662	59	15,285
Net book amount at 2 June 2001	59,097	507	2,275	13,909	151	16,842
Company						
Cost						
At 2 June 2001		-	5,588	45,882	301	51,771
Additions		-	526	6,230	-	6,756
Disposals		-	(1,444)	(14,155)	(110)	(15,709)
At 1 June 2002		-	4,670	37,957	191	42,818
Depreciation						
At 2 June 2001		-	3,619	33,585	188	37,392
Provided in the year		-	616	7,135	40	7,791
Disposals		-	(1,272)	(12,649)	(93)	(14,014)
At 1 June 2002		-	2,963	28,071	135	31,169
Net book amount at 1 June 2002		-	1,707	9,886	56	11,649
Net book amount at 2 June 2001		-	1,969	12,297	113	14,379

Notes

continued

13 FIXED ASSETS (continued)

The figures stated on the previous page include assets held under finance leases and similar hire purchase contracts as follows:

	Group and Company Motor vehicles £000
Net book amount at 1 June 2002	–
Net book amount at 2 June 2001	3
Depreciation provided during the year	3

14 FIXED ASSET INVESTMENTS

Group	Own	Investments	Total
	shares	other than	
	£000	loans	£000
Cost at 2 June 2001	21,537	45	21,582
Additions	1,735	–	1,735
Disposal on exercise of share options	(1,724)	–	(1,724)
Cost at 1 June 2002	21,548	45	21,593
Provision at 1 June 2002	(17,515)	(45)	(17,560)
Net book value at 1 June 2002	4,033	–	4,033
Net book value at 2 June 2001	21,537	–	21,537

Company	Own	Shares	Intra-	Investments	Total
	shares	in group	group	other than	
	£000	undertakings	loans	loans	£000
Cost at 2 June 2001	21,537	6,174	61,054	45	88,810
Additions	1,735	–	4,891	–	6,626
Disposal on exercise of share options	(1,724)	–	–	–	(1,724)
Cost at 1 June 2002	21,548	6,174	65,945	45	93,712
Provision at 1 June 2002	(17,515)	–	(19,632)	(45)	(37,192)
Net book value at 1 June 2002	4,033	6,174	46,313	–	56,520
Net book value at 2 June 2001	21,537	6,174	61,054	–	88,765

Investments in own shares comprise £4,033,000 (2001: £21,537,000) in respect of 8,064,623 (2001: 9,815,058) of the Company's own shares held by the Pace Micro Technology plc Employee Benefits Trust and the QUEST. The amounts will be recovered from employees on the exercise of options.

A provision was made within the year in respect of the carrying value of shares held in the Pace Micro Technology plc Employee Benefits Trust and QUEST (see note 5).

Following a review of the carrying value of the investment in VegaStream Limited, a provision has been made against the carrying value of intra group loans relating to the subsidiary.

Notes

continued

14 FIXED ASSET INVESTMENTS (continued)

The Pace Micro Technology plc Employee Benefits Trust has granted options to employees (including directors options) over these ordinary shares of 5p each as follows:

Number of ordinary shares subject to option	Exercise period	Price per share pence
1,792,536	24 September 2001 to 23 September 2008	64.0
1,115,919	26 January 2002 to 25 January 2009	84.5
1,135,000	7 July 2002 to 6 July 2009	200.0
40,000	20 March 2003 to 19 March 2010	945.0
511,375	17 July 2001 to 16 July 2010	857.5
1,567,790	29 January 2002 to 28 January 2011	610.0
2,462,000	24 July 2002 to 23 July 2011	375.0
8,624,620		

The QUEST has acquired shares in the Company either through purchase in the Market or by allotment for the purpose of satisfying the following Sharesave Schemes:

Number of ordinary shares subject to option	Exercise period	Price per share pence
328,731	1 April 2002 to 30 September 2002	84.0
157,674	1 October 2002 to 31 March 2003	178.0
14,309	1 April 2003 to 30 September 2003	664.0
3,741	1 October 2003 to 31 March 2004	721.0
19,781	1 April 2004 to 30 September 2004	550.0
288,982	1 October 2004 to 31 March 2005	304.0
397,306	1 April 2005 to 30 September 2005	269.0
1,210,524		

At 1 June 2002 the Company had a beneficial interest in the equity of the following principal undertakings:

	Percentage holding	Country of incorporation	Country of operation	Class of share capital held
Pace Distribution GmbH	100%	Germany	Germany	Ordinary
Pace Scandinavia A/S (in liquidation)	100%	Denmark	Denmark	Ordinary
Pace Digital Italia srl (in liquidation)	100%	Italy	Italy	Ordinary
Pace Micro Technology (HK) Limited	100%	Hong Kong	Hong Kong	Ordinary
Pace Micro Technology (Thailand) Limited*	100%	Thailand	Thailand	Ordinary
Pace Micro Technology (Australia) Pty Limited	100%	Australia	Australia	Ordinary
Pace Micro Technology (SA) (PTY) Limited (in liquidation)	100%	South Africa	South Africa	Ordinary
Pace Micro Technology (Support Services) Limited***	100%	UK	USA	Ordinary
Pace Micro Technology Europe SARL	100%	France	France	Ordinary
Pace Micro Technology (Asia Pacific) Limited*	100%	Hong Kong	Hong Kong	Ordinary
VegaStream Limited ***	100%	UK	UK	Ordinary
Xcom Multimedia Communications SAS ***	100%	France	France	Ordinary
Xcom Asia Company Limited**	100%	Hong Kong	Hong Kong	Ordinary
SCI Les 9 Tilleuls**	100%	France	France	Ordinary
EUURL New Com Immobilier**	100%	France	France	Ordinary
Cxsat SAS**	49%	France	France	Ordinary
Pace Distribution (Overseas) Limited	100%	UK	UK	Ordinary/Preference
Pace Advanced Consumer Electronics Limited	100%	UK	UK	Ordinary
VegaStream Inc****	100%	USA	USA	Ordinary

* Denotes company owned by Pace Micro Technology (HK) Limited

** Denotes company owned by Xcom Multimedia Communications SAS

*** Denotes company owned by Pace Distribution (Overseas) Limited

**** Denotes company owned by VegaStream Limited

Each of the subsidiary undertakings listed above have been consolidated in the Group's financial statements.

Certain of the above subsidiaries have been placed voluntarily into liquidation as part of the Group's restructuring exercise.

Notes

continued

15 STOCKS

	Group		Company	
	2002	2001	2002	2001
	£000	£000	£000	£000
Raw materials and consumable stores	15,813	34,452	9,230	31,036
Work in progress	-	1,250	-	981
Finished goods	30,906	3,991	30,177	3,450
	46,719	39,693	39,407	35,467

16 DEBTORS

	Group		Company	
	2002	2001	2002	2001
	£000	Restated £000	£000	Restated £000
Amounts falling due within one year:				
Trade debtors	69,956	78,546	61,854	72,722
Amounts owed by subsidiary undertakings	-	-	11,056	6,858
Other debtors	3,821	2,137	346	957
Deferred tax	-	1,030	-	1,030
Prepayments and accrued income	1,311	1,619	633	1,374
	75,088	83,332	73,889	82,941
Amounts falling due after more than one year:				
Deferred tax	5,538	6,414	5,538	6,414
	80,626	89,746	79,427	89,355

Deferred tax assets have been recognised to the extent they are regarded as recoverable, in accordance with FRS 19. An amount of £7.7m (2001 as restated: £0.9m) has not been recognised as a deferred tax asset.

17 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2002	2001	2002	2001
	£000	£000	£000	£000
Bank loans and overdrafts (note 19)	18,742	257	16,607	-
Trade creditors	24,079	48,313	14,572	42,664
Amounts owed to subsidiary undertakings	-	-	9,041	3,124
Corporation tax	4,432	9,170	1,906	8,578
Social security and other taxes	1,062	1,458	795	1,226
Other creditors	1,788	3,280	1,619	2,683
Accruals	10,675	15,206	8,452	13,988
Deferred income	-	1,995	-	1,995
Amounts due under finance leases and similar				
Hire purchase contracts (note 19)	-	3	-	3
Proposed dividend	1,523	1,512	1,523	1,512
	62,301	81,194	54,515	75,773

18 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group	
	2002	2001
	£000	£000
Bank loans (note 19)	332	629
	332	629

Notes

continued

19 BORROWINGS

Borrowings consist mainly of bank loans, overdrafts and finance leases:

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Within one year	18,742	260	16,607	3
After one and within two years	50	169	-	-
After two and within five years	152	252	-	-
After five years	130	208	-	-
	<u>19,074</u>	<u>889</u>	<u>16,607</u>	<u>3</u>

The banking facilities of £40 million (2001: £32 million) are available until June 2004. The facility is secured by a fixed and floating charge over the assets of Pace Micro Technology plc and certain of its subsidiaries.

A revolving facility to a maximum of £50 million (2001: £50 million) on the sale of insured trade debtors, is available until July 2002.

20 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Short term debtors and creditors that meet the definition of a financial asset or liability respectively have been excluded from all FRS 13 analysis, other than the currency risk exposures, as permitted by the Standard.

(a) Interest rate risk profile of financial assets

Currency	Floating rate	Interest free	Total
	£000	£000	£000
At 1 June 2002:			
Sterling	-	123	123
US Dollar	2,271	-	2,271
Euro	121	-	121
Other	68	1	69
	<u>2,460</u>	<u>124</u>	<u>2,584</u>
At 2 June 2001:			
Sterling	35,245	8	35,253

The interest rate on Sterling, US Dollar, Euro and other floating rate financial assets is linked to the relevant bank base rate.

(b) Interest rate risk profile of financial liabilities

Currency	Floating rate	Interest free	Total
	£000	£000	£000
At 1 June 2002:			
Sterling	18,898	-	18,898
Euro	2,263	-	2,263
Other	497	-	497
	<u>21,658</u>	<u>-</u>	<u>21,658</u>
At 2 June 2001:			
Sterling	3	-	3
US Dollar	6,170	-	6,170
Euro	1,274	-	1,274
Other	322	-	322
	<u>7,769</u>	<u>-</u>	<u>7,769</u>

The interest rate on Sterling, US Dollar, Euro and other floating rate financial liabilities is linked to the relevant bank base rate.

Notes

continued

20 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (continued)

(c) Currency exposures

The table below shows the Group's currency exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group which are not denominated in the operating or functional currency of the operating unit involved.

Functional currency of group operation	Net foreign currency monetary assets/(liabilities)			
	US Dollar £000	Euro £000	Other £000	Total £000
At 1 June 2002:				
Sterling	10,509	(4,499)	(1,944)	4,066
Euro	4,099	-	350	4,449
Total	14,608	(4,499)	(1,594)	8,515
At 2 June 2001:				
Sterling	(10,854)	(6,810)	(2,404)	(20,068)
Euro	3,334	-	(2)	3,332
Other	-	-	1,652	1,652
Total	(7,520)	(6,810)	(754)	(15,084)

(d) Gains and losses on hedges

During the year, the Group continued to experience a US Dollar shortage as a consequence of its purchases not being fully offset by sales. However sales denominated in US Dollars will partly provide a natural hedge against US Dollar purchases. When required the Group enters into foreign currency hedge contracts to eliminate certain currency exposures that arise on sales and purchase contracts denominated in foreign currencies.

	Sell Currency	Buy Currency	Value	Average Rate	Maturity
At 1 June 2002:	Sterling	US Dollar	\$5m	1.4250	June 2002
At 2 June 2001:	Sterling	US Dollar	\$50m	1.4487	June 2001 to July 2001

The unrealised loss on the above contracts amount to £60,000 (2001: gain of £690,000) of which a loss £60,000 (2001: gain of £198,000) has been matched against monetary assets and liabilities denominated in the respective currencies and recognised in the profit and loss account.

(e) Fair value

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities. The fair values are estimated by discounting the future cash flows to net present values using the prevailing market rates.

	2002 Book value £000	2002 Fair value £000	2001 Book value £000	2001 Fair value £000
Primary financial instruments held or issued to finance the Group's operations:				
Finance lease and similar hire purchase contracts	-	-	(3)	(3)
Cash and other liquid funds	-	-	28,373	28,373
Bank loans and overdrafts	(19,074)	(19,074)	(886)	(886)
Derivative financial instruments held to hedge the currency exposure:				
Foreign exchange hedge contracts	(60)	(60)	198	690

Notes

continued

21 PROVISIONS FOR LIABILITIES AND CHARGES

	Royalties under negotiation (note 32) £000	Onerous contracts £000	Warranties £000	Contingent consideration cash £000	Total £000
Group					
At 2 June 2001	17,430	524	3,382	2,000	23,336
Net (credit)/charge for the year	(321)	692	6,525	500	7,396
Utilised	(4,516)	(878)	(7,045)	-	(12,439)
At 1 June 2002	12,593	338	2,862	2,500	18,293
Company					
At 2 June 2001	15,689	524	3,122	2,000	21,335
Net (credit)/charge for the year	(974)	692	6,785	500	7,003
Utilised	(4,516)	(878)	(7,045)	-	(12,439)
At 1 June 2002	10,199	338	2,862	2,500	15,899

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

22 SHARE CAPITAL

	2002		2001	
	Number	£000	Number	£000
Authorised				
Ordinary shares of 5p each	300,000,000	15,000	300,000,000	15,000
Allotted, called up and fully paid				
Ordinary shares of 5p each	226,245,162	11,312	225,766,656	11,288

During the year, the Company allotted Ordinary shares as follows:

	Number	Option price per share (p)	Nominal value £000	Consideration £000
Employee share option schemes	10,161	190.0	1	19
	93,000	42.5	5	40
	250,000	82.0	12	205
	85,345	64.0	4	55
	30,000	84.5	1	26
	10,000	200.0	1	20
	478,506		24	365

Notes

continued

22 SHARE CAPITAL (continued)

The Company has granted options which are subsisting (including directors' options and options granted prior to listing of the Company) in respect of the following presently unissued ordinary shares of 5p each.

Number of ordinary shares subject to option	Exercise period	Price per share pence
45,348	27 June 1997 to 26 June 2003	172.0
111,266	25 June 1999 to 24 June 2006	190.0
29,284	25 June 1999 to 24 June 2003	172.0
35,000	19 August 2000 to 18 August 2007	42.5
35,000	19 August 2000 to 18 August 2004	42.5
589,623	17 November 2000 to 16 November 2004	53.0
300,000	28 April 2001 to 27 April 2005	70.0
1,175,000	7 July 2002 to 6 July 2009	200.0
1,466,000	11 January 2003 to 10 January 2010	599.5
254,292	17 July 2003 to 16 July 2010	857.5
1,450,384	17 July 2001 to 16 July 2010	857.5
15,000	21 August 2001 to 20 August 2010	835.0
62,751	29 January 2004 to 28 January 2011	610.0
928,363	29 January 2002 to 28 January 2011	610.0
6,141	1 June 2004 to 31 May 2011	488.5
143,859	1 June 2002 to 31 May 2011	488.5
28,067	7 February 2003 to 8 May 2003	278.0
350,000	24 July 2005 to 23 July 2011	375.0
1,879,069	24 July 2002 to 23 July 2011	375.0
548,224	24 July 2003 to 23 July 2011	375.0
210,861	18 January 2003 to 17 January 2012	357.0
75,639	18 January 2005 to 17 January 2012	357.0
5,000	18 January 2006 to 17 January 2012	357.0
9,744,171		

The Pace Micro Technology plc Employee Benefits Trust has granted options over existing shares and the QUEST has acquired shares to satisfy certain Sharesave options. Details of these additional options are shown in note 14.

23 SHARE PREMIUM ACCOUNT

	£000
Group and Company	
At 2 June 2001	35,085
Premium on allotments	341
At 1 June 2002	35,426

The shares allotted during the year are listed in note 22.

24 SHARES TO BE ISSUED

	£000
Group and Company	
At 2 June 2001	21,871
Adjustments	(11,871)
At 1 June 2002	10,000

During the year, a settlement of £8,819,000 has been made in respect of contingent share consideration. A further adjustment of £3,052,000 has been made to reflect reductions in the amount of contingent consideration payable in respect of previous acquisitions. The levels of goodwill arising on these acquisitions has been adjusted accordingly.

Notes

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25 MERGER RESERVE

	£000
Group and Company	
At 2 June 2001	36,827
Transfer to profit and loss account reserve	(19,618)
At 1 June 2002	17,209

The transfer to the profit and loss account reserve has been made following an impairment of intra-group loan balances established on group reorganisation. The amount transferred of £19,618,000 arose on the acquisition of VegaStream Limited.

26 PROFIT AND LOSS ACCOUNT

	£000
Group	
At 2 June 2001	42,774
Prior year adjustment on adoption of FRS19	2,284
As restated	45,058
Retained loss for the year	(37,228)
Movement in merger reserve (see note 25)	19,618
Exchange differences	164
At 1 June 2002	27,612

	£000
Company	
At 2 June 2001	51,724
Prior year adjustment on adoption of FRS19	2,284
As restated	54,008
Retained loss for the year	(30,984)
Movement in merger reserve (see note 25)	19,618
At 1 June 2002	42,642

The cumulative total of goodwill written off against Group profit and loss reserves, in respect of acquisitions prior to 1 June 1998 when FRS10 (Goodwill and Intangible Assets) was adopted, amounts to £360,000 (2001: £360,000).

27 PROFIT FOR THE YEAR

The parent Company has taken advantage of Section 230 of the Companies Act 1985 and has not included its own profit and loss account in these financial statements. The Group (loss)/profit includes a parent Company loss before dividends of £28,598,000 (2001: restated profit of £39,396,000).

28 RECONCILIATION OF OPERATING (LOSS)/PROFIT TO NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES

	2002 £000	2001 £000
Operating (loss)/profit	(28,807)	37,961
Exceptional items	39,952	4,529
Operating profit before exceptional items	11,145	42,490
Goodwill amortisation	2,717	1,692
Depreciation	9,013	9,780
Profit on disposal of tangible fixed assets	(5)	(86)
(Increase) in stocks	(7,146)	(15,446)
Decrease/(increase) in debtors	6,758	(12,511)
(Decrease)/increase in creditors	(35,849)	7,375
(Decrease)/increase in provisions for liabilities and charges	(5,543)	1,437
Net cash (outflow)/inflow from operating activities	(18,910)	34,731

Notes

continued

29 ANALYSIS OF CASH FLOWS FOR HEADINGS NETTED IN THE CASH FLOW STATEMENT

	2002 £000	2001 £000
Returns on investments and servicing of finance		
Interest received	982	130
Interest paid	(1,183)	(146)
Finance lease and asset loan interest paid	-	(3)
Net cash outflow for returns on investments and servicing of finance	(201)	(19)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(9,328)	(12,302)
Acquisition of own shares for Pace Micro Technology plc Employee Benefits Trust and QUEST	(1,735)	(11,094)
Sale of tangible fixed assets	355	201
Exercise of employee share options	1,724	577
Net cash outflow for capital expenditure and financial investment	(8,984)	(22,618)
Financing		
Issue of ordinary share capital	365	1,866
Capital element of finance lease rental payments	(3)	(83)
Repayment of subsidiary asset loans	(505)	(41)
Net cash (outflow)/inflow from financing	(143)	1,742

30 ANALYSIS OF CHANGE IN NET FUNDS/(DEBT)

	At 2 June 2001 £000	Cash flow £000	At 1 June 2002 £000
Cash at bank and in hand	28,373	(28,373)	-
Overdrafts	-	(18,692)	(18,692)
	28,373	(47,065)	(18,692)
Debt due within one year	(257)	207	(50)
Debt due after one year	(629)	297	(332)
Finance Leases	(3)	3	-
	27,484	(46,558)	(19,074)

31 CAPITAL COMMITMENTS

	Group and Company 2002 £000	2001 £000
Contracted but not provided for	1,736	1,791

32 CONTINGENT LIABILITY

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

Notes

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33 PENSIONS

The Company contributes to several defined contribution Group Personal Pension Plans, which all executive directors and employees are entitled to join. At 1 June 2002 contributions of £Nil (2001: £Nil) were outstanding.

34 LEASING COMMITMENTS

The following annual lease commitments are due within one year in respect of leases expiring:

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Land and buildings				
Within one year	-	45	-	-
Between two and five years	359	371	311	324
In five years or more	1,972	2,086	1,638	1,502
	<hr/>	<hr/>	<hr/>	<hr/>
	2,331	2,502	1,949	1,826
Other				
Between two and five years	207	354	207	354
	<hr/>	<hr/>	<hr/>	<hr/>
	2,538	2,856	2,156	2,180

35 RELATED PARTY TRANSACTIONS

The Company purchases travel services at commercial rates, on an ad hoc basis from Multiflight Limited. The amount purchased during the year ended 1 June 2002 was £Nil (2001: £24,593) of which £Nil (2001: £Nil) was outstanding at the year end. Multiflight Limited is a company which is controlled by David Hood, a Non-executive Director of Pace Micro Technology plc.

Five Year Record

	2002	2001*	2000*	1999*	1998*
	£000	£000	£000	£000	£000
Turnover	351,794	523,641	377,621	182,836	184,034
(Loss)/profit before tax	(29,525)	38,068	23,972	15,096	(12,120)
Profit/(loss) before exceptional items and tax	10,427	42,597	27,272	15,096	(12,120)
(Loss)/profit after tax	(34,842)	24,460	19,453	9,622	(9,521)
Diluted (LPS)/EPS	(16.1)p	11.1p	8.9p	4.5p	(4.4)p
Diluted EPS before exceptional items and goodwill amortisation	2.9p	13.5p	10.0p	4.5p	(4.4)p
Net assets excluding goodwill	65,737	91,032	67,817	43,813	35,623

*The comparatives for financial years 1998 through to 2001 have been restated to reflect the impact of adoption of FRS19 (Deferred Tax) during the current period.



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