PACE MICRO TECHNOLOGY PLC

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PACE MICRO TECHNOLOGY PLC ANNUAL REPORT & ACCOUNTS 2003

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CONTENTS

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PACE MICRO TECHNOLOGY PLC IS AN ESTABLISHED LEADER IN THE WORLDWIDE MARKET FOR DIGITAL TELEVISION TECHNOLOGY

Pace's success has been achieved through the development of innovative set-top box solutions for operators, broadcasters, telecommunications companies and retail markets.

Pace's key strengths lie in the design and development of set-top box technology that will maximise the opportunity and profitability of digital television markets and service providers. The Group's engineering teams create and develop digital technologies for cable, IPTV (internet protocol television), satellite and terrestrial platforms, exploring concepts from low-cost adapters to high definition television and personal video recorders.

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.

Pace is registered in England and listed on the London Stock Exchange, with offices in the UK, USA, France and Hong Kong.

DIRECTORS, SECRETARY AND ADVISERS

DIRECTORS

all of Victoria Road
Saltaire Shipley
West Yorkshire BD18 3LF

Sir Michael Bett	Non-executive Chairman
John Howard Dyson	Chief Executive
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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Registered Number 1672847

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PRINCIPAL BANKERS

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PO Box 190
Barclays House
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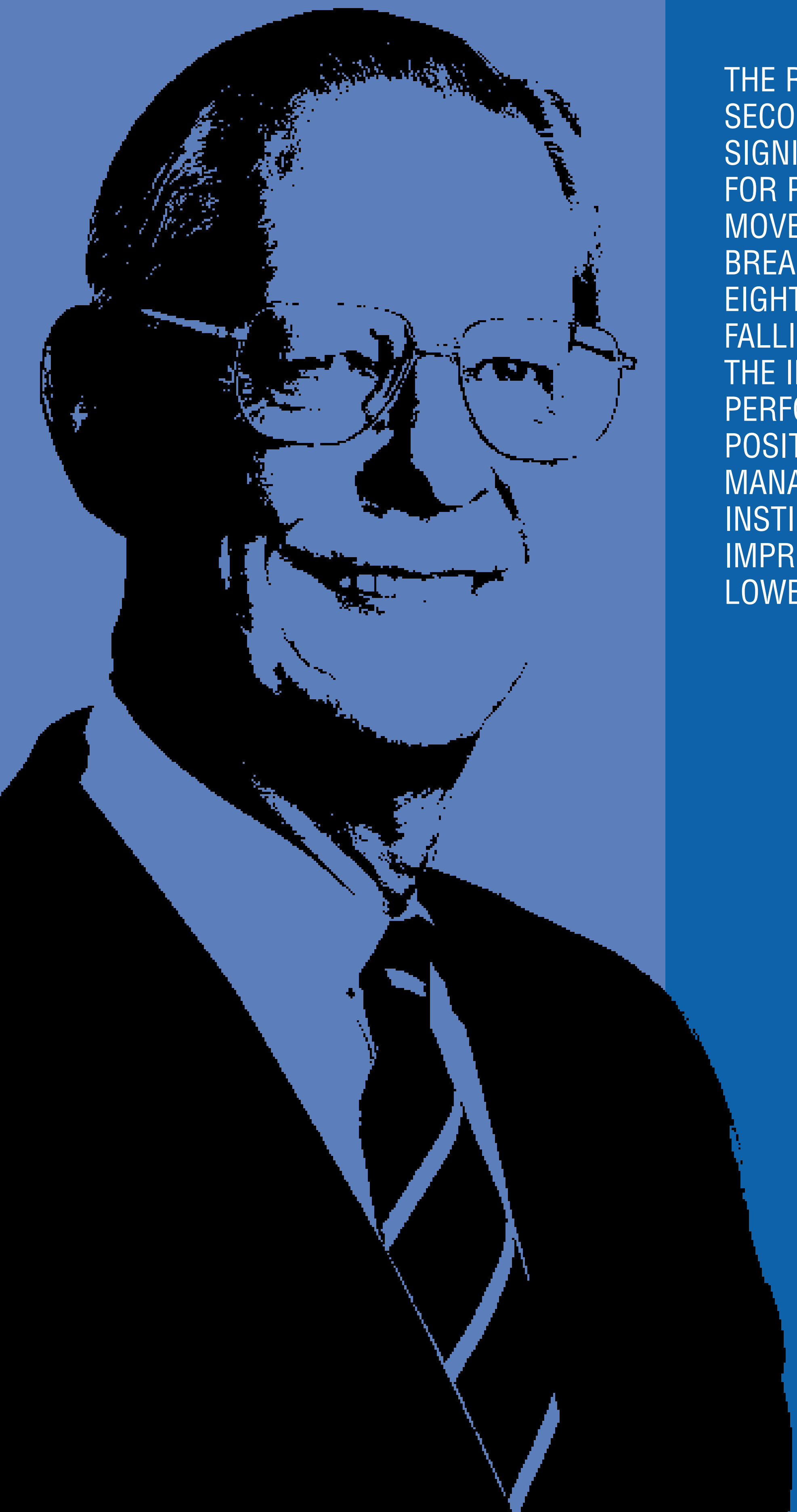
Leeds LS1 2UX

SALIENT POINTS

- Turnover of £166.6m (2002: £351.8m);
- Full year gross margin before exceptional items of 20.9% (2002: 22.7%);
- EBITA loss before exceptional items in H2 reduced to £0.4m (H1 2003: £15.7m);
- Net cash position £13.1m (2002: net borrowings £19.1m);
- Loss before tax, amortisation of goodwill and exceptional items of £16.2m (2002: profit of £13.1m);
- Diluted loss per share before amortisation of goodwill and exceptional items of 6.8p (2002: earnings per share 2.9p);
- Diluted loss per share after amortisation of goodwill and exceptional items of 22.0p (2002: 16.1p);
- No dividend recommended (2002: 1.10p);
- Overhead run rate for the coming year reduced to £40m p.a. (2003: £50.9m);
- New orders from Foxtel, Sky Italia and Viasat.



THE RESULTS IN THE SECOND HALF MARKED A SIGNIFICANT IMPROVEMENT FOR PACE AS THE GROUP MOVED CLOSE TO BREAKEVEN, AFTER EIGHTEEN MONTHS OF FALLING REVENUES. THE IMPROVEMENT IN PERFORMANCE IS THE POSITIVE OUTCOME OF MANAGEMENT'S ACTION TO INSTIGATE RESTRUCTURING, IMPROVE MARGINS AND LOWER COSTS.

CHAIRMAN'S STATEMENT

The year ended 31 May 2003 saw the Group move close to break-even at the EBITA level for the second half, following trading losses in the previous two half year periods. This significant improvement was delivered through improved margins and lower costs, on revenues of £83m in the second half of the year. Net cash was £13.1m (2002: net borrowings of £19.1m).

RESULTS AND DIVIDEND

Loss before tax, amortisation of goodwill and exceptional items was £16.2m (2002: profit £13.1m) on turnover of £167m (2002: £352m). Loss per share was 6.8p (2002: earnings per share of 2.9p).

There was a loss before tax and after amortisation of goodwill and exceptional items of £50.1m (2002: £29.5m).

In the light of the loss and accumulated deficit, the Board has decided not to recommend a dividend for the 2002/03 financial year.

EXCEPTIONAL ITEMS

The Group's total exceptional costs for the year were £32.5m (2002: £40.0m).

A restructuring programme has almost been completed that will see the workforce being reduced to less than 600. The restructuring activity includes negotiations that are expected to result in a management buyout of the VegaStream division, with Pace retaining a 20% stake and the integration of the Internet Protocol Television (IPTV) division into a Pace product line. The changes have resulted in a more efficient and flexible business structure and lower overheads, against exceptional costs of £9.6m to cover redundancies, excess space and asset write-offs.

The Board has reviewed the carrying value of the goodwill that arose on the purchase of Xcom Multimedia Communications and concluded that, in light of the significant decline over the last year in the markets served by Xcom, it should be written down by £21.4m to £10m.

In addition, the Board has decided to make a further £1.5m provision against the Group's loan to the Employee Share Option Plan ("ESOP").

TRADING REVIEW

The challenging markets experienced by digital TV providers had a direct impact on Pace, with the Company's set-top box volumes falling 41% to 1.3m units. Pace's revenues fell 53% as they were further impacted by lower average selling prices.

In the UK, BSkyB continued to add to its subscriber base and the Sky+ PVR increased its penetration. Ntl has taken and installed nearly all of the set-top boxes made in early 2002, while Telewest continued to take boxes in the second half of the year. Pace's share of the free-to-view DTT market naturally reduced as a result of new entrants. This segment is subject to severe competition at the low end of the market.

We expect overall that the UK market will now stabilise at its current level. Pace has a full range of products for the satellite, cable and terrestrial markets in the UK, which should result in the Group retaining the largest market share in this region, but at a lower level than in the past.

In the US, Pace currently supplies Time Warner Cable and Comcast, the US's two largest cable operators, as well as Bright House Networks. In the last reporting year, as Time Warner focused on selling through the Pace standard definition (SD) set-top boxes they had purchased in the previous year, the Group's US revenues fell from £38.2m to £9.9m. The US Government has mandated a move from standard definition broadcasting to high definition broadcasting. Pace has recently launched its high definition box into Time Warner and Bright House Networks.

Outside of the UK and US, Pace shipments reduced sharply, the main factors being lack of finance available to providers, together with a less competitive digital TV marketplace. However, there have been recent new design wins in Europe with Sky Italia and Viasat Broadcasting and at Foxtel in Australia, as well as greater momentum in our existing customers, which together lead us to anticipate much improved volumes in these markets in the coming year.

FINANCIAL REVIEW

Gross margin for the year declined to 20.9% (2002: 22.7%). Performance improved significantly during the year, with a second half margin of 29.1%. This improvement was due to a number of factors, not all of which can be assumed to be recurring at the same level, such as income from a number of one-off engineering projects. However, the growth in deployment of Sky+ is now generating a regular monthly income.

Overheads, net of other income and before amortisation of goodwill, decreased to £50.9m (2002: £66.1m), demonstrating the benefit of the restructuring programme which commenced in the first half of last year. Expenditure on development was £27.1m (2002: £36.9m). Selling, general and other administrative expenses were £23.8m (2002: £29.2m). As noted above, action has already been taken that will reduce overheads further.

Net assets, excluding goodwill, decreased to £34.1m (2002: £65.7m). Within the net current assets of £47.9m (2002: £65.0m), net cash was £13.4m (2002: net borrowings £18.7m). Stocks at the year-end amounted to £16.0m (2002: £46.7m), comprising £8.5m of raw materials and WIP and £7.5m of finished goods. The decrease reflects the sale of Ntl finished goods stock, which stood at £23.7m at 1 June 2002 as well as the near-completion of the full outsourcing of production. The stock turnover rate was 8 times at year-end (2002: 8 times). Debtors of £57.2m (2002: £80.6m) included an amount of £23m that was uninsured. The debt collection period was 12 weeks (2002: 12 weeks).

The improvement in Pace's cash position came from the significant decrease in finished goods stocks as Ntl continued to take delivery of stock in line with an agreed schedule. In addition, the Group received a repayment of £10.1m of Corporation Tax. Pace has £20m in existing committed credit lines.

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 and was able once again to release part of the overall provision. In the last year the level of releases exceeded new provisions by £1.8m. There are still a number of matters outstanding and, 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.

OUTLOOK

The results in the second half marked a significant improvement for Pace as the Group moved close to breakeven, after eighteen months of falling revenues. The improvement in performance is the positive outcome of management's action to instigate restructuring, improve margins and lower costs.

Looking ahead to the coming year Pace has won some new business in Europe and Asia-Pacific and expects to increase its revenues from these regions. The UK will continue to be an important market for Pace, but we may lose some market share due to increased competition at both Ntl and Telewest and the numerous suppliers in the free-to-view market. In the US, we have invested substantial amounts in our operations over the last three years, as it is by far the biggest and most developed television market in the world. The US will continue to incur losses over the next six months or so and offers both upside and risk.

Pace has built good customer relationships, developed innovative products and continues to invest in new technologies. Future growth will be driven by the ability of digital TV providers to develop their respective businesses and make profits from the move to digital. The Group's improved financial position, combined with new orders in May 2003, gives rise to cautious optimism.

Sir Michael Bett
Chairman

14 July 2003

THERE IS NOW A GREATER SENSE OF STABILITY IN OUR MARKETS AFTER THE DIFFICULTIES THAT HAVE CHARACTERISED DIGITAL TELEVISION MARKETS OVER THE LAST 18 MONTHS.

CHIEF EXECUTIVE'S STATEMENT

In the last year Pace has demonstrated its ability to react, respond and develop within the constantly evolving global digital television market. What we see today is a Group still focused on delivering the best in digital television services, but driven by a stronger impetus to be more profitable.

As expected, market conditions have been tough and this is reflected in our revenues and profitability. However, tough markets are now standard for most industries and in the last year we have developed our business to succeed in this environment, rather than react to its difficulties.

Pace has responded with new product concepts, a more flexible organisational structure and a strong approach to cost-management. We are already seeing the benefits; moving close to operational break even in the second half of 2002/03, winning a good share of the significant new broadcaster business that has been available in Europe and Asia-Pacific and leading important technology developments in the US.

GLOBAL MARKETS

There is now a greater sense of stability in our markets after the difficulties that have characterised digital television markets over the last 18 months. In 2002 the global market shrank by over 16% on 2001[1], but looking ahead, industry researchers believe the market is growing again, although not as dramatically as in the late 1990s and early 2000s.

Pace, through the unmatched breadth of our set-top box technologies, is a strong contender. The results of our Customer Satisfaction Survey are driving further improvements to our operations, particularly in respect of whole-life cost of ownership, that will enhance our opportunity to win new business and develop existing customer relationships.

UK

The UK is one of the world's most successful digital television markets with almost 44%[2] of households converted.

This market was influenced by the successful relaunch of digital terrestrial services under the Freeview banner. Freeview, a joint venture between the BBC, BSkyB and Crown Castle, has kept digital TV in the headlines and delivered a new customer group into the digital fold: those for whom payTV is not important.

Compared to payTV, the Freeview 'technology barrier' is relatively low and has attracted a large number of set-top box suppliers in the basic adapter category. However, Pace has led Freeview from the front. We were first to market with our Freeview adapter, the DTVA and have now launched 'Twins', the first Freeview personal video recorder (PVR). The Twin Digital TV Recorder has been well received, winning important industry awards and accolades.

The UK Government reaffirmed its commitment to a complete digital switch by 2010 and Freeview, alongside the payTV platforms, has an important role to play. Pace is contributing to Digital Switch through product innovation and active participation in the Government's Digital TV Action Plan. However, the excitement surrounding Digital Switch should not overshadow our achievements in the payTV sector, as this is where our skills can create more differentiation and longer-term profitability.

I am particularly pleased with our progress over the last 12 months at BSkyB. We are the only company to have provided three products for BSkyB's Sky digital platform: the Digibox, Minibox and Sky+ PVR.

[1] The Digital Bomb II, May 2002 and the Digital Bomb III, May 2003 reports from Enders Analysis
[2] 43.9% of UK households, at 31 March 2003, ITC Multichannel Quarterly published 24 June 2003

The commercial terms under which we supply Sky+ saw some important changes. In July 2002 Pace agreed to supply Sky+ at below cost for a limited period, in return for a fixed share of the monthly subscription on each box installed. In February 2003 the agreement concluded as planned, with a return to our usual terms of business. We started shipping our second generation Sky+ PVR in April. Although PVR was a difficult concept for consumers not acquainted with digital TV to grasp at first, awareness and installations are now growing. Around the world PVR users have demonstrated their enthusiasm through extremely low churn rates.

In UK cable, Ntl and Telewest are continuing with their respective restructuring programmes. Both companies have purchased set-top boxes, but in lower volumes than previous years. Pace secured new business with Ntl Ireland, which ordered Pace's new DC400 cable set-top box, combining the latest developments in product design with tailored functionality. Moreover, the product is built using the same silicon and software as other models in Pace's cable range so there are no differences in overall speed, performance and interoperability.

NORTH AMERICA

The US cable market, where over eight million set-top boxes were shipped in 2002, holds significant potential for Pace and we continue to invest in the opportunity it presents. Importantly Time Warner Cable and Bright House Networks have now deployed both our standard definition and high definition products – the DC510 and DC550.

Time Warner Cable, our most significant US customer to date, has been installing the 250,000 boxes purchased in the previous financial year. Time Warner comprises 34 operating divisions: seventeen are now using our DC510, with several divisions purchasing mostly Pace boxes during this period.

We were also pleased to begin shipments to Comcast, North America's largest cable operator, who purchased 43,000 DC510 boxes for their Scientific-Atlanta® systems. This is the first time Comcast has bought set-top boxes from an alternative supplier.

OUR ACHIEVEMENTS WITH THE DC510 AT BOTH TIME WARNER AND COMCAST ARE NOW GIVING US CONFIDENCE AS WE CONCENTRATE ON OUR NEXT TWO US PRODUCT LAUNCHES.

The move into product deployment has enabled us to demonstrate not just the strength of our product, but our long-term commitment to US customers. A vital aspect of our commitment is service and support. Our achievements with the DC510 at both Time Warner and Comcast are now giving us confidence as we concentrate on our next two US product launches.

The first launch will be the ramp up of Pace's DC550, created to meet the growing demand for high definition television (HDTV). HDTV results in significantly better picture quality, which US cable operators are keen to deliver in their competition with satellite for the most lucrative TV homes. Our DC550 HD set-top box was approved for deployment after successful field trials in May and its impressive feature set has put Pace in a strong competitive position.

The second launch will be a high definition set-top box with integrated high-speed DOCSIS modem for Comcast, the DC755 HD, due at the beginning of 2004. Comcast, like many US operators, has multiple networks that use either the Scientific-Atlanta or Motorola-owned conditional access (CA) systems. All Pace products to date have been for Scientific-Atlanta networks. The DC755 HD incorporates the Motorola DigiCipher CA system, which is used on 65% of US networks. Pace is the first supplier to successfully complete DigiCipher validation testing and is the only company able to supply set-top boxes for both 'types' of US cable network.

Pace has challenged the US 'status quo' in set-top box development and supply. We have continued this trend with a new product concept, the Digital Cable Adapter (DCA). Most US operators are keen to switch their entire networks to digital to maximise their bandwidth for higher revenue services such as video-on-demand and HDTV. However, the cost of transferring 'analogue happy' subscribers is currently holding operators back, an issue our low-cost and easy to install DCA confronts. Initial response from the cable industry has been of interest for the longer term.

CONTINENTAL EUROPE AND ASIA-PACIFIC

Pace has gained significant new business in these regions for shipment in our 2003/04 financial year. The first win was with Foxtel in Australia. Foxtel is Australia's leading subscription television provider and will use Pace products to launch its new cable service and extend its existing digital satellite operation.

Secondly we won new business with Viasat Broadcasting, the pay and free-to-air satellite TV division of international media group, the Modern Times Group. Viasat is the largest commercial TV operator in Northern Europe, covering Sweden, Norway, Denmark and Finland.

Finally we reached an agreement with Sky Italia to provide set-top boxes for their service launch in summer 2003. Sky Italia is the new Italian satellite operator owned by News Corporation and Telecom Italia and formed following a merger between Telepiù and Stream.

The continental European and Asia-Pacific markets generally have made slower moves to digital than other markets we operate in, reflecting ongoing issues regarding investment, consolidation, regulation and consumer enthusiasm for premium payTV.

Notwithstanding these issues Pace did ship product into Europe and the Middle East, including Scandinavia, Spain and Russia. In the Asia-Pacific region we made further shipments into India, China and New Zealand.

There are signs of a stronger momentum towards digital in these regions and looking ahead we are keeping a close watch on countries such as Spain, Germany and France as well as cable and IPTV markets in the Far East. In Germany for example, DTT has been launched successfully in Berlin and cable has been given a new lease of life following the sale of Deutsche Telekom's cable network.

OTHER MARKETS

Pace's Internet Protocol Television (IPTV) and VegaStream divisions both operate in new, but potentially lucrative markets.

The IPTV division develops set-top boxes for telecoms and broadband IP operators. This market has made slow progress although Pace has won business in the Far East. A variety of factors have held back growth, most noticeably potential customers' ability to invest in new service launches. To address these issues we launched our new IP400 product range. The IP400 products are cost-effective and support new streaming protocols such as MPEG4 and Windows Media 9 to optimise bandwidth and content availability.

VegaStream develops Voice over Internet Protocol (VoIP) gateways for the small and medium enterprise (SME) and service provider CPE (customer premises equipment) markets. Progress reflected a dramatic slowdown in service provider spending on network development and the depressed state of mainstream enterprise customers. Nevertheless VegaStream has won business with some major network equipment providers and enterprise solution providers. As the business approaches profitability more investment is required and I believe the proposed management buyout, in which Pace retains a share, will be the best route to achieve this.

PACE TECHNOLOGIES

Pace is proud of its ability to innovate ahead of the competition creating products that incorporate the latest in electronic and visual design.

An innovative digital television product is not always defined as the most powerful or sophisticated available, but rather the best product for the needs of the market at any given time. For example in the last year, Pace has led the response to an industry demand for lower-cost products through platforms such as the DTVA, 410 series and DC400. At the same time our engineers are continually improving deployed customer platforms to make them faster and more cost-effective.

Our engineering teams have taken this concept further with the development of a new 'common platform' onto which a cable, satellite or terrestrial front-end and operator specific software and applications can be added. The approach is highly cost-effective and also enhances reliability and speed to market as the final product is based on core elements already proven in deployment. Common platform was an important aspect of our Foxtel and Viasat contract wins and is a good example of how we are refocusing our core business with products, functions and features that deliver revenue today.

As the new Pace products are amongst some of the smallest models in the industry, we have been able to experiment with new and eye-catching cosmetic designs. The 'look' is important to an increasing number of broadcasters and operators who want customers to purchase rather than rent their set-top box.

Our customers are also moving their focus to the overall cost of set-top box ownership and must be confident their platform is reliable, easy to install and maintain. To aid this process we have continued to invest in new equipment and support teams to ensure our customers can maximise the investment they have made in Pace technology.

Pace products are amongst the most energy-efficient available today. For example our latest Digibox is the only one to use less than 9 watts of power in standby, saving 5 watts over earlier Pace boxes. As a result of our work on power efficiency, across the base of Pace set-top boxes deployed in the UK, energy savings equivalent to 250,000 tonnes of CO_2 emissions have been made. Pace engineers are actively involved in the latest update to the European Code of Conduct on Energy Efficiency of Digital TV. The Code recognises that reductions in standby power consumption will make a major difference and Pace designs have been held up as an industry example. Pace leads in the US too, with all our products being Energy Star compliant. Energy Star is the US Environmental Protection Agency's energy efficiency programme.

To further improve engineering efficiency, Pace will make greater use of outsourcing companies to develop the basic set-top box software. The outsourcing companies employed to date have exceptionally high quality standards (SEI Level 5) and release our in-house teams to concentrate on new product designs and architectures to drive product roadmaps forwards.

OUR ENGINEERING TEAMS HAVE TAKEN THIS CONCEPT FURTHER WITH THE DEVELOPMENT OF A NEW ‘COMMON PLATFORM’ ONTO WHICH A CABLE, SATELLITE OR TERRESTRIAL FRONT-END AND OPERATOR SPECIFIC SOFTWARE AND APPLICATIONS CAN BE ADDED.

FINANCIAL REVIEW

INTANGIBLE FIXED ASSETS

The intangible fixed assets net of amortisation, which arose from the purchase of Xcom, were £10.0m (2002: £35.8m). Following the annual impairment review, the Board concluded that it would be appropriate to recognise an impairment of £21.4m to the carrying value of the goodwill attributable to Xcom. This reflects the current economic climate and the continued integration of the Xcom business into the rest of the Group.

INVESTMENTS

The investments of £2.5m (2002: £4.0m) represent the amount owed to Pace by the Group's Employee Benefits Trust. The sum is in respect of past loans made to the Trust to buy Pace shares in the market to meet obligations for the provision of shares on the exercise of staff share options. Following the decline in Pace's share price and the issue of new options at exercise prices reflecting the share price decline, it was appropriate to take a further provision of £1.5m against the outstanding loan.

NET TANGIBLE FIXED ASSETS

The net balance of £10.3m (2002: £15.3m) primarily represents plant and machinery associated with manufacturing, test and engineering development. The fall to £2.0m in investment for last year reflects the move to outsourced manufacturing.

STOCKS

Stocks have decreased to £16.0m (2002: £46.7m) primarily due to a significant reduction in finished goods which now stand at £7.5m (2002: £30.9m). A significant proportion of the decrease in finished goods is due to Ntl sales, for which only a minor balance is now held (2002: £23.7m). Raw materials have declined to £8.5m (2002: £15.8m) due to the reduction in turnover and outsourced manufacturing.

DEBTORS

Debtors have fallen to £57.2m (2002: £80.6m) as a result of the fall in turnover. Pace has tried in the past to insure the substantial majority of its debtor balances, but cover on some customers has not been possible due to insurance market conditions. At the year-end £23m (2002: £4m) of the balance was uninsured, of which £16.0m relates to Ntl. Recent experience suggests that such insurance may be difficult to obtain in the future.

CASH

The net cash balance of £13.1m (2002: borrowings of £19.1m) was due to the reduction in finished goods stocks and a Corporation Tax refund of £10.1m, offset by earn-out payments of £5.0m to the former shareholders of Xcom. The Group has a total of £20m in available committed credit facilities that are adequate for our current needs.

CREDITORS

Creditors have fallen to £38.6m (2002: £43.6m) which is largely a feature of reduced turnover. However, the reduction has been partly offset by the outstanding Xcom earn-out payments of approximately £4.3m included in Other Creditors.

PROVISIONS

Provisions have increased to £26.3m (2002: £18.3m). The change includes a provision against the £10.1m Corporation Tax refund received whilst finalisation of the tax computations is awaited and an onerous contracts provision of £3.7m primarily due to vacant property commitments. Such increases have been partially offset by the utilisation of a provision of £2.5m to cover part of the Xcom earn-out and refinements in the levels of royalty provisions.

FOREIGN EXCHANGE

The majority of the Group's production costs are designated in US Dollars. In the last year the Group has earned sufficient Dollars from its US sales, supplemented with spot purchases, to meet its short-term needs. The need to implement a more formal programme of forward cover will continue to be reviewed closely in the light of future requirements. There were no open derivative contracts at the year-end.

PACE CAN DELIVER CUSTOMERS THE BEST SET-TOP BOX SOLUTION WHATEVER THEIR BUSINESS NEED OR BROADCAST PLATFORM.

MANUFACTURING AND OPERATIONS

Pace's manufacturing strategy is a vital element of our ability to compete on the world stage ensuring we deliver the 'best in class' products at the lowest cost of ownership. In the last year we completed our transfer to Solectron Corporation who now manufacture the majority of our set-top boxes.

As one of Solectron's customers we benefit from their global buying power, production flexibility and specialist manufacturing expertise, all of which will benefit our customers.

Solectron's Pace production is currently concentrated in Timisoara, Romania, but other sites are under review as we consider product cost and how to target markets with excessive import duties. For example we are now working to establish a new facility in China to manufacture products for our US and Asia-Pacific customers.

PEOPLE

The Group ended the year with 644 people, a reduction of 301. To reposition the Group for long-term profitability we have reviewed the number of people needed to achieve our business objectives. This has not been a simple exercise in headcount reduction, but rather a more radical review of how Pace operates and the organisation we need to succeed in today's marketplace.

We are in the final stages of consultation to reduce the number of people based at our EMEA/APAC head office in Grenoble, France. In addition, when the management buyout of VegaStream is completed, the total headcount of the Pace Group will fall below 600.

Two directors also resigned from the Board in the last year, Malcolm Miller as Chief Executive and Tim Fern as Chief Technology Officer, with myself, John Dyson, being appointed to the role of Chief Executive. The positions previously filled by Tim Fern and myself as Finance Director have not been replaced with Board level appointments, but the roles are currently being filled by internally appointed staff on the Executive Committee.

Change is unsettling for staff and I would like to take this opportunity to thank all who work at Pace for their commitment and focus during this difficult period.

THE FUTURE

Pace is now in a better financial position than a year ago. Knowing they could count on the long-term survival of Pace was a prime concern of our customers, as they trust the Group with the future of their networks.

In the coming year we shall place more emphasis on the cost of ownership of our products. To achieve this goal we have introduced a programme of continuous improvement, involving all of Pace's employees, which will address such matters as reducing field failure rates to the best in class for our market. These elements combined with renewed market growth, our new business wins and ongoing strong customer relationships are placing the Company in a better position for long-term growth.

Inevitably there are dependencies for success, most importantly the financial strength and confidence of our major operator customers. However, to deliver on our growth opportunity in the next 12 months, we will redouble our efforts on expanding business in the US and Europe, whilst at the same time maintaining our strong UK performance. All of this is underpinned by Pace's global technology leadership, through which Pace can deliver customers the best set-top box solution whatever their business need or broadcast platform.

John Dyson
Chief Executive

14 July 2003

PRODUCT REVIEW

Pace Micro Technology is the world's largest dedicated developer of digital set-top box technology. The Company designs set-top boxes for cable, IPTV (internet protocol television), satellite and terrestrial platforms for broadcaster, operator and retail customers worldwide.

Pace's digital set-top boxes have now been installed in over 10.6 million homes. This achievement includes an impressive list of industry firsts, most importantly designing the world's first MPEG2, DVB set-top boxes for commercial deployment on cable, satellite and terrestrial platforms. Further accomplishments include development of the first set-top boxes with integrated DOCSIS, EuroDOCSIS and DAVIC cable modems, the first MPEG4 IPTV set-top box and the first European iDTV module.

To aid development, Pace is a member of many major standards bodies and is in constant dialogue with strategic partners in the world of digital technology. For example, Pace has unrivalled experience in conditional access and middleware integration. It is this expertise that makes Pace an ideal partner for the launch and long-term development of any digital television service.

Digital technology is constantly evolving and Pace is always working on new and innovative solutions that will exploit the full potential of digital television. The Company's latest solutions range from low-cost adapters to widen the reach of digital television services to personal video recorders and high definition set-top boxes.

Pace is at the forefront of developments in digital television and through the Company's technical leadership and understanding of market conditions, has created a world-leading range of digital set-top boxes.

CABLE

In 2002 Pace was ranked as the largest cable supplier in Europe and third largest in the world by Strategy Analytics and Cahners In-Stat Group.

Pace has worked with major operators in Europe and the US, helping them to exploit the full potential of their cable networks from essential multichannel TV to advanced interactive services such as video-on-demand, e-commerce and high-speed data.

DC600

A third generation set-top box with built in DOCSIS or DAVIC modem for high-speed two-way cable networks. Currently being used by Ntl and Telewest in the UK.

DC400

A cost-effective scalable set-top box that can be used as standalone product or as a second box with the DC600. Deployed by Ntl Ireland.

DC510

Pace's standard definition set-top box for US cable operators using Scientific-Atlanta's PowerKey® conditional access. Shipped to Time Warner Cable, Comcast and Bright House Networks.

PACE MICRO TECHNOLOGY IS THE WORLD'S LARGEST DEDICATED DEVELOPER OF DIGITAL SET-TOP BOX TECHNOLOGY.

DC550HD
An advanced set-top box solution for the delivery of high definition content on networks utilising Scientific-Atlanta's conditional access technology in the US. Pace's HD box is highly flexible and cost-effective and incorporates several industry firsts. Shipped to Time Warner Cable and Bright House Networks.

DC755HD
Currently in development for Comcast, this box will be the first second-source box for US networks using the DigiCipher CA.

IPTV

Internet Protocol Television makes it possible to deliver multichannel television and multimedia services over existing DSL infrastructures owned by telcos and broadband IP operators.

Pace is one of the leading players in this new market and has developed a range of set-top box products that address many of the critical factors holding back deployment including investment issues, bandwidth utilisation and future proofing.

DSL4000
Pace's most widely deployed IPTV set-top box, which has an ethernet connection and can support a wide range of high-speed interactive services, including video-on-demand, web browsing and home shopping.

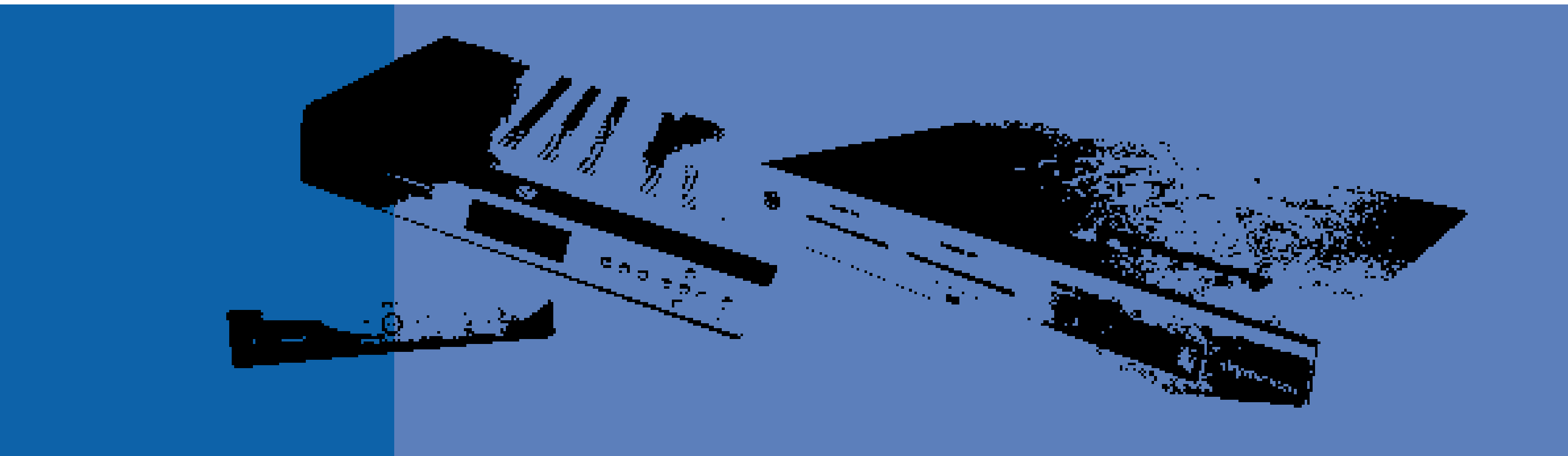
IP400 SERIES
The latest addition to Pace's IP range features an open-architecture design and incorporates the latest in low bit-rate streaming protocols, including MPEG4 and Windows Media 9. The new low bit-rate codecs use less bandwidth, expanding the potential for IP-based services.

SATELLITE

Since launching the first digital satellite service in 1995, Pace has enabled major global satellite broadcasters to launch on time and stay ahead of competition by delivering cost-effective yet advanced digital set-top boxes supporting enhanced features and services.

DS400 SKY DIGIBOX
Designed for BSkyB's UK digital satellite services the Pace Digibox, now in its sixth generation, enables Sky digital viewers to access multichannel programming, interactive services and navigate Sky's on-screen electronic programme guide. This Digibox is smaller and more compact than previous Pace Digiboxes and has been designed to meet the European Commission's Code of Conduct[1] on stand-by power consumption.

[1] European Commission's Code of Conduct For Energy Efficiency of Digital TV Services Systems. From 2003, the Code of Conduct requires high-specification set-top boxes to consume no more than 9 watts of power when in standby mode.



TDS400 SKY+

A set-top box that combines the benefits of Sky digital with advanced PVR functionality. Using Sky+ viewers can pause live TV, record one digital satellite programme while watching another, record episodes of favourite series and experience digital-quality fast forward and rewind.

DS200 SKY MINIBOX

Developed as a 'second box' for Sky digital to connect extra televisions in the home to their service.

DSR 600

A DVB-compliant set-top box for the reception of News Corporation and other digital satellite services worldwide. Currently being shipped to Sky New Zealand.

TERRESTRIAL

Pace has led the way in both pay and free-to-air digital terrestrial products.

Digital terrestrial can widen the reach of digital television as services are delivered through existing TV aerials, a vital consideration for any country considering a complete switch to digital.

The UK, with its Freeview service, is the most important market to date and using this experience Pace is developing digital terrestrial products for a number of European countries.

DT200 – DIGITAL TELEVISION ADAPTER (DTVA)

A low-cost adapter to switch standard analogue terrestrial televisions to digital. The DTVA is easy to install and has led the UK retail market for digital terrestrial products as the first Freeview adapter.

TDT460 – TWIN DIGITAL TV RECORDER

A digital terrestrial PVR and another Pace first in the UK market. ‘Twins’ incorporates a hard disk drive to record Freeview content at digital broadcast quality and enable other PVR services including live TV pause, watch one record another and high-speed fast-forward and rewind and slow motion play-back.

MULTIPLE PLATFORM

A range of Pace products can be configured to work on cable, satellite and terrestrial platforms. The concept has been developed further in the last year, resulting in the creation of Pace’s new ‘common platform’.

DTVA AND 410 SERIES

Both of these products are available in cable, satellite and terrestrial versions. They are MPEG2 DVB compliant, can use multiple CAs and come with an eight-day EPG in a choice of European and Far Eastern languages.

TDS450 – TWIN SATELLITE RECEIVER

This product builds on the DTVA and 410 series by incorporating twin decoders. As a result viewers can watch two separate programmes on separate televisions or record one programme on a VCR whilst watching another. An additional product version incorporates a hard disk drive for PVR services.

DX210 AND DX420 SERIES – THE COMMON PLATFORM

Pace engineers have created a common hardware platform onto which separate cable and satellite front-ends and operator specific software and applications are added. The approach is highly cost-effective and enhances reliability and speed to market as the final product is based on core elements already proven in deployment.

VOIP GATEWAYS

The gateways developed by VegaStream, use Voice over Internet Protocol (VoIP) to re-route telephone conversations over data networks.

VEGA 50

The Vega 50 is used by enterprise end-users or by service providers to connect enterprise users to their network. This product enables up to eight simultaneous telephone conversations using analogue or digital connections and is targeted at business voice communications for smaller sites.

VEGA 100

This product enables up to 60 simultaneous telephone conversations and is targeted at business voice communications in larger companies. The Vega 100 can be deployed by enterprise end-users or by service providers to connect enterprise users to their network.

For more detailed technical specifications on Pace's set-top box products, visit **www.pace.co.uk.**

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.

DigiCipher – the CA system owned by Motorola Inc.

DOCSIS (Data over Cable Service Interface) – 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 content.

Decoder – the unit in a set-top box used to decrypt an encrypted television transmission.

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

EPG (Electronic Programme Guide) – an application running on a set-top box, which allows a user to select services and obtain additional information about the programmes running on those services, either now or in the future.

Free-to-view – non-subscription television services i.e. television programming that can be accessed without CA.

HDTV (high definition television) – a high-resolution television display technology, currently being introduced in the US. It provides very high picture quality, using 720 or 1080 lines of resolution compared to the 525 lines in US standard definition television.

Internet Protocol - the method or protocol by which data is sent from one computer to another on the Internet. Each computer (known as a host) on the Internet has at least one IP address that uniquely identifies it from all other computers on the Internet. The same principle applies to set-top boxes that use IP to transport television and interactive services over telecoms or cable networks.

MPEG2 – an international standard that enables the conversion of moving pictures into a highly compressed stream of digital data for transmission.

MPEG4 – a more advanced version of MPEG2 with greater compression capabilities. As result a higher quantity of television programming and interactive services can be delivered over the same network at the same quality. Also known as a low bit-rate streaming protocol.

Middleware – a layer of software or interface in the set-top box that allows applications such as interactive news and digital teletext to operate on all of the approved set-top boxes that may be running on a specific digital television network.

PowerKey conditional access – the CA system owned by Scientific-Atlanta Inc. Scientific-Atlanta and PowerKey are registered trademarks of Scientific-Atlanta.

PVR (Personal Video Recorder) – a set-top box that includes a hard disk drive to provide digital quality recording, fast-forward and rewind and new features such as the ability to pause live TV.

VoIP (Voice over Internet Protocol) – is the method by which voice is digitised 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 31 together with the audited financial statements for the year ended 31 May 2003. Both the current and prior period were of 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 31 May 2003 is set out on page 43. The loss before tax, amortisation of goodwill and exceptional items was £16.2 million (2002: profit of £13.1 million). After amortisation of goodwill and exceptional items there was a loss of £50.1 million (2002: loss of £29.5 million).

No interim dividend was paid during the year and the directors are not recommending the payment of a final dividend (2002: total dividend 1.10p per share).

SHARE CAPITAL

Changes in the Company's share capital during the year ended 31 May 2003 are set out in note 21 to the financial statements.

SIGNIFICANT SHAREHOLDINGS

The Company has been notified in accordance with Sections 198 to 208 of the Companies Act 1985 of the following significant shareholdings as at 13 July 2003:

	Number of shares	**% of issued share capital**
David Hood and related family trusts	44,486,957	19.7
Fidelity Investment Management Limited and related companies	29,873,225	13.2
Robert Fleming and related family trusts	8,880,178	3.9
Legal & General Investment Management Limited	7,955,451	3.5
Pace Micro Technology plc Employee Benefits Trust	7,373,104	3.3

REPORT OF THE DIRECTORS CONTINUED

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 68, joined the Board in February 2000 and was appointed Chairman on 31 March 2000. He is also Non-executive Chairman of Compel Group plc, and a Non-executive Director 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.

John Dyson
John, aged 55, was appointed Chief Executive on 1 May 2003, after assuming the role of Acting Chief Executive in January 2003. Prior to this he was Finance Director, joining the Company in November 1997. He is also a Non-executive Director of XP 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.

Robert Fleming
Rob, aged 46, 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 and became a Non-executive Director of the Company in May 2001. He is the Chief Executive of The Franklyn Group Ltd, a nursing home group.

Neil Gaydon
Neil, aged 43, 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 55, 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 65, 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 51, was appointed as a Non-executive Director in June 1996 and in February 2000 was appointed Senior Independent Director. He has held a number of public company directorships, most recently as an Executive Director of RMC Group plc and, prior to that, as an executive director of Hepworth PLC.

Michael McTighe
Mike, aged 49, was appointed a Non-executive Director on 3 June 2001. He has held a number of directorships, and is currently Chairman of Corvil Networks Ltd, Chairman of Radiant Networks plc, Chairman of Red M Communications Ltd, Chairman of Via Networks, Inc, a non executive director of Enition SA, a director of London Metal Exchange Holdings Ltd, and a non-executive director of Alliance & Leicester plc. Mike also advises a number of private equity partnerships. Previously he was Chairman & CEO of Carrier1 International SA, and before that Executive Director & Chief Executive, Global Operations of Cable & Wireless plc. Prior to these experiences, Mike spent 5 years with Philips of the Netherlands, 5 years with Motorola, and 10 years with GE.

During the year the following persons also held office as directors:

Malcolm Miller: retired 1 January 2003
Tim Fern: retired 28 February 2003

Sir Michael Bett and John Dyson will retire by rotation at the Annual General Meeting of the Company and will offer themselves for re-election. Details of the executive directors' service contracts are disclosed on page 34.

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 42 days (2002: 41 days) and for the Company were 41 days (2002: 41 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 £27.1million (2002: £36.9million) during the year.

DONATIONS

During the year the Group donated £34,900 (2002: £49,919) to charitable causes. No political donations were made. Further details of the charitable and community-related activities of the Group are given on page 30.

CORPORATE GOVERNANCE

The Combined Code issued by the UK Listing Authority under the Finacial Services Authority as the competent authority for listing in the United Kingdom establishes Principles of Good Governance. 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.

BOARD COMMITTEES

The Group is controlled through the Board of Directors, which comprises two 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 page 26. The Chairman, Sir Michael Bett, is mainly responsible for the running of the Board. The responsibilities of the Chief Executive, John Dyson, 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. 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. All directors, in accordance with the Combined Code, submit themselves for re-election at least once every three years.

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.

REPORT OF THE DIRECTORS CONTINUED

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 is chaired by Bob Lambourne. 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 John Dyson as Chief Executive. The Committee generally meets twice monthly and ensures that the strategy, plans and policies previously agreed or delegated by the Board are implemented.

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

Francis Brochon	President of Pace Europe
Anthony Dixon	Director of Legal Services
Callum Gordon	Director of Engineering
Graham North	Regional Director UK Sales
Steve Owens	Director of Commercial Operations
Maggie Pedder	Director of Personnel
John Spottiswood	Director of Manufacturing and Supply Chain
Damien Wilkinson	Group Financial Controller

- The **Remuneration Committee** is comprised of non-executive directors David Hood, Marvin Jones, Bob Lambourne and Mike McTighe 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 three times during the year.
- The **Nominations Committee** comprises non-executive directors Rob Fleming, David Hood, Marvin Jones, Bob Lambourne and Mike McTighe, together with John Dyson, and is chaired by Sir Michael Bett. Its purpose is to consider and make recommendations to the Board regarding the appointment of new directors.

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 Directors to shareholders is set out on pages 32 to 40 and includes the remuneration policy of the Company and details of directors' incentive payments and the related performance criteria.

ACCOUNTABILITY AND AUDIT

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 41 and the responsibilities of the auditors are described on page 42.

REPORT OF THE DIRECTORS CONTINUED

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 the auditors and from the management relating to the interim and annual accounts and the control systems in use throughout the Group.

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 employees.

- **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 a risk assessment review of the Group's business has been conducted 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, twice-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 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 regularly.

  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.

- **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: 2000 and it is the intention to extend this to include the Boca Raton site in Florida.

- **Monitoring systems**
  Monitoring of the internal control systems is carried out by internal audit staff on a periodic 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.

REPORT OF THE DIRECTORS CONTINUED

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 2004, 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 a range of internal and external initiatives to promote employee development. 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. In the event that an employee becomes disabled, the Group makes reasonable adjustments where any aspect of premises or working practices puts such a disabled employee at a substantial disadvantage compared with a non-disabled employee.

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 Health and Safety Officer has reported to the Board regarding health and safety matters at least twice during the year.

Site inspections and individual ergonomic risk assessments have been conducted in the UK by safety representatives and this has resulted in several local workplace health and safety improvements. Generic and detailed risk assessments, chemical assessments and safe systems of work guidance are maintained for the benefit of 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 safety representatives have had refresher training and during the year a further nine managers have successfully completed the IOSH Managing Safely course.

The number of UK workplace accidents during the year was eighteen, none of which were reportable to the Health & Safety Executive. 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. The 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 geographical area of Pace's premises in Saltaire, Bracknell, Grenoble 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 162 requests for support were considered by the committee, 124 of these satisfying the criteria and receiving financial support amounting to £34,900. 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.

REPORT OF THE DIRECTORS CONTINUED

ENVIRONMENTAL MANAGEMENT

During the year the Company commissioned its second independent Environmental Report, prepared by consultants, Scott Wilson. The Company has achieved certification to the international management standard ISO 14001 at its Saltaire site and the Group Enviromental Policy has been applied to all Pace sites worldwide.

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 a 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 these products 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.

Objectives and targets for minimising energy, water and paper consumption across the Group's three UK sites have been established. 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 CO_2 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. Influenced by this Group initiative, the percentage of ISO14001 accredited component vendors utilised has increased to 38%.

During the year the Company set environmental targets and achieved the following outcomes:

Object	**2002**	**2003 Target**	**2003**
CO_2 emission (tonnes)	4,170	3,600	3,000
Electricity (KWh)	4.7 million	4.5 million	3.5 million
Gas (KWh)	2.1 million	2.0 million	2.1 million
Water (m^3/employee)	20.6	19.6	24.7

The Company is a member of the Yorkshire Wildlife Trust and during the year participated in the Yorkshire and Humber 5th Regional Index of Environmental Engagement. This scheme is administered by Business in the Community and ranks companies in terms of their environmental performance. In the 2003 index Pace was ranked at 23 out of 142 (2002 index: 54 out of 120).

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

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.

RELATIONS WITH SHAREHOLDERS

The Board has continued to establish and maintain 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 9 September 2003 at which the Board will be available for questions.

ANNUAL GENERAL MEETING

The Annual General Meeting of the Company will be held on 9 September 2003 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.

By order of the Board

Anthony J Dixon
Company Secretary

14 July 2003

REMUNERATION REPORT

The directors present their report to shareholders on pages 32 to 40 regarding remuneration matters in respect of the year ended 31 May 2003.

REMUNERATION COMMITTEE

The Remuneration Committee (the "Committee") is responsible for setting the individual remuneration of the executive directors and other members of the Executive Committee within the framework of the remuneration policy described below, which is set by the Board.

Directors who were members of the Remuneration Committee at any time during the period relevant to the year ending 31 May 2003 were Sir Michael Bett, who acted as Chairman of the Committee, David Hood, Marvin Jones, Bob Lambourne and Mike McTighe. For guidance, the Committee makes use of surveys of executive pay and knowledge of market rates. The Committee was assisted in its consideration of remuneration matters by Maggie Pedder, Director of Personnel of the Group. Maggie Pedder was not appointed by the Committee.

REMUNERATION POLICY

The Board believes that it is necessary to ensure that the remuneration packages of the executive directors remain competitive in order to attract, retain and motivate executive directors and senior managers of a high calibre and to reward them for performance. The policy is for a significant proportion of total remuneration of executive directors' total remuneration to be capable of being earned from variable, performance-based incentives, through annual bonuses and share options. The objective of this policy is to provide rewards and incentives that reflect corporate and individual performance and align management's objectives directly with those of the Group.

The Board's policy in relation to non-executive directors continues to be to pay fees which are competitive with the fees paid by comparable quoted companies. Non-executive directors' fees are determined by the Board as a whole within the limits set out in the Company's Articles of Association. Non-executive directors are not eligible for performance bonuses or pension contributions and do not participate in the share option schemes.

The main components of senior executive remuneration derived from the Remuneration Policy, including performance related elements, are set out below. The Company does not currently expect its policy on directors' remuneration for subsequent financial years to change significantly.

SALARY

Basic salary for each executive director is determined by the Committee, taking into account the performance of the individual and information from independent sources on the rates of salary for comparable jobs. In setting senior executives' 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 31 May 2003 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 the bonus was dependent on the Group's pre-tax profits (before exceptional items and certain goodwill amortisation) exceeding £3.9 million with the capacity to earn additional bonus increments upon achievement of higher profit targets up to a ceiling of £15 million. In addition, a number of individual personal objectives were set for each director and manager which were 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 31 May 2003. A similarly-structured performance-related bonus scheme for the executive directors and other key senior executives is in effect in respect of the current financial year but with new pre-tax profit targets set in June 2003. In each year the maximum bonus achievable by the executive directors in the event that all corporate and individual targets are met is 100% of basic salary.

REMUNERATION REPORT CONTINUED

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. Neil Gaydon, who is based in the USA is, in addition, entitled to a non-pensionable overseas living allowance, payment of rental on a family home in the USA, educational and associated expenses in respect of his children and international private medical insurance.

PENSION CONTRIBUTIONS

In the year ended 31 May 2003, contributions were paid into the executive directors' pension schemes at rates determined by the Board. Contributions have continued to be paid during the current year 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.

SHARE OPTION SCHEMES

The Board 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, including executive directors, 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 Committee. Under the Approved Scheme, options are granted at the prevailing quoted market price and may usually be exercised between three and ten years from the date of the grant.
- 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 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, the relevant limit is ten times annual remuneration.

REMUNERATION REPORT CONTINUED

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 ("EPS") of 15% above the Retail Prices Index ("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. The Remuneration Committee believes that EPS is the most appropriate measure of the Group's underlying financial performance. In order to assess whether the performance conditions have been met, the Committee will utilise the EPS derived from the audited financial statements of the Company.

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.

SERVICE CONTRACTS

Company policy is that in normal circumstances executive directors' notice periods should not exceed one year. 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. At the option of the Company each agreement may be terminated forthwith subject to the Company paying to the director a sum equivalent to 12 months' salary and pension contributions. The Remuneration Committee considers that compensation payments on termination of employment should depend on individual circumstances. It is the Company's policy to honour its obligations with regard to directors' service agreements and where the employment of a director is terminated in accordance with the aforementioned contractual process the Company will pay the sum specified in the relevant service agreement as payable.

The service agreement of John Dyson was entered into on 10 October 1997 and subsequently amended on 1 January 2003 and 2 May 2003. The service agreement of Neil Gaydon was entered into on 28 November 2001 and subsequently amended on 21 December 2001 and 14 January 2003. The service agreement of Malcolm Miller was entered into on 15 September 1997 and terminated on 1 January 2003. The service agreement of Tim Fern was entered into on 1 June 1998 and terminated on 28 February 2003. Save for the notice periods referred to in the above paragraph, these contracts have no unexpired term.

The Company maintains directors' and officers' liability insurance in respect of senior employees including the directors.

REMUNERATION REPORT CONTINUED

The auditors are required to report on the information disclosed on pages 35 to 38.

DIRECTORS' REMUNERATION

Total directors' remuneration in respect of qualifying services for the year ended 31 May 2003 was as follows:

	2003 £000	2002 £000
Fees	**204**	204
Salaries, benefits in kind and termination payments	**1,016**	698
Performance-related bonuses	**–**	–
Pension contributions	**77**	80
	1,297	982

The remuneration of individual directors in respect of qualifying services for the year to 31 May 2003 is set out in the table below:

	Salaries and fees	Termination payment	Benefits in kind	Total remuneration		Pension contributions	
				2003	2002	2003	2002
Executive Directors	£000	£000	£000	£000	£000	£000	£000
John Dyson	**249**	**–**	**3**	**252**	201	**28**	28
Neil Gaydon*	**152**	**–**	**94**	**246**	–	**15**	–
Tim Fern*	**130**	**181**	**1**	**312**	173	**12**	14
Malcolm Miller*	**182**	**–**	**23**	**205**	324	**22**	38
	713	**181**	**121**	**1,015**	698	**77**	80
Non-executive Directors							
Sir Michael Bett	**60**	**–**	**1**	**61**	60	**–**	–
Robert Fleming	**25**	**–**	**–**	**25**	25	**–**	–
David Hood	**25**	**–**	**–**	**25**	25	**–**	–
Marvin Jones	**44**	**–**	**–**	**44**	44	**–**	–
Bob Lambourne	**25**	**–**	**–**	**25**	25	**–**	–
Mike McTighe	**25**	**–**	**–**	**25**	25	**–**	–
	917	**181**	**122**	**1,220**	902	**77**	80

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

A summary of the benefits in kind provided to the executive directors is contained on page 33.

REMUNERATION REPORT CONTINUED

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 31 May 2003 and at the beginning of the year or date of appointment, if later, are set out below:

	31 May 2003 Shares			2 June 2002 or Date of Appointment Shares		
	Beneficial	**Non Beneficial**	**Under option**	Beneficial	Non Beneficial	Under option
Sir Michael Bett	**343,300**	**–**	**–**	43,300	–	–
John Dyson	**191,586**	**–**	**1,488,881**	91,586	–	1,009,433
Mike McTighe	**20,000**	**–**	**–**	20,000	–	–
Robert Fleming	**8,850,990**	**29,188**	**–**	8,850,990	29,188	–
Neil Gaydon	**7,462**	**–**	**824,946**	7,462	–	311,829
Marvin Jones	**156,824**	**–**	**–**	19,825	–	–
David Hood	**44,457,769**	**29,188**	**–**	44,457,769	29,188	–
Bob Lambourne	**14,500**	**–**	**–**	14,500	–	–

There were no changes in the directors' interests in the ordinary share capital of the Company between 31 May 2003 and 13 July 2003.

REMUNERATION REPORT CONTINUED

SHARE OPTIONS

Details of the options over the ordinary shares of 5p each in the Company held by the directors who held office during the year were as follows:

	Number of options						
	At 2 June 2002 or Date of Appointment	**Granted**	**Expired**	**At 31 May 2003 or Date of Cessation**	Exercise Price	Exercise Period From	To
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**	–	**52,478***	**17,492**	857.5p	17.07.01	16.07.10
2000 Unapproved Scheme	**146,134**	–	**146,134***	–	375.0p	24.07.02	23.07.11
2000 Unapproved Scheme	–	**500,000**	–	**500,000**	20.0p	21.01.04	20.01.13
2000 Unapproved Scheme	–	**500,000**	–	**500,000**	37.0p	02.05.04	01.05.13
2000 Super Options	**130,029**	–	**97,522***	**32,507**	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	–	**14,000**	–	**14,000**	18.0p	01.10.05	31.03.06
Sharesave Scheme	–	**7,448**	–	**7,448**	14.5p	01.04.06	30.09.06
Neil Gaydon							
Approved Scheme	**3,498**	–	–	**3,498**	857.5p	17.07.03	16.07.10
1996 Unapproved Scheme	**75,000**	–	–	**75,000**	64.0p	24.09.01	23.09.08
1996 Unapproved Scheme	**75,000**	–	–	**75,000**	200.0p	07.07.02	06.07.09
2000 Unapproved Scheme	**93,252**	–	–	**93,252**	375.0p	24.07.02	23.07.11
2000 Unapproved Scheme	–	**7,023**	–	**7,023**	20.0p	21.01.04	20.01.13
2000 Super Option	**56,748**	–	–	**56,748**	375.0p	24.07.02	23.07.11
2000 Super Option	–	**492,977**	–	**492,977**	20.0p	21.01.04	20.01.13
Sharesave Scheme	**6,919**	–	**6,919**	–	84.0p	01.04.02	30.09.02
Sharesave Scheme	**1,412**	–	**1,412**	–	269.0p	01.04.05	30.09.05
Sharesave Scheme	–	**14,000**	–	**14,000**	18.0p	01.10.05	31.03.06
Sharesave Scheme	–	**7,448**	–	**7,448**	14.5p	01.04.06	30.09.06
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

*Options surrendered for no consideration on 9 October 2002

REMUNERATION REPORT CONTINUED

	Number of options						
	At 2 June 2002 or Date of Appointment	Granted	Expired	At 31 May 2003 or Date of Cessation	Exercise Price	Exercise Period From	To
Tim Fern							
Approved Scheme	**3,498**	–	–	**3,498**	857.5p	17.07.03	28.02.04
1996 Unapproved Scheme	**150,000**	–	–	**150,000**	70.0p	28.04.01	28.02.04
1996 Unapproved Scheme	**100,000**	–	–	**100,000**	64.0p	24.09.01	28.02.04
1996 Unapproved Scheme	**75,000**	–	–	**75,000**	200.0p	07.07.02	28.02.04
2000 Unapproved Scheme	**60,190**	–	**45,143**	**15,047**	857.5p	17.07.01	28.02.04
2000 Unapproved Scheme	**77,042**	–	**77,042**	–	375.0p	24.07.02	23.07.11
2000 Unapproved Scheme	–	**500,000**	**500,000**	–	20.0p	21.01.04	20.01.13
2000 Super Option	**36,312**	–	**27,234**	**9,078**	857.5p	17.07.01	28.02.04
2000 Super Option	**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
Sharesave Scheme	–	**14,000**	–	**14,000**	18.0p	01.03.03	31.08.03

No options were exercised by any of the directors during the year. In the previous financial year, John Dyson exercised an option over 15,983 shares under the Sharesave Scheme at the exercise price of 61.0p when the share price was 220p and retained such shares.

The mid-market price of shares in the Company on 30 May 2003 (the last dealing day before the financial year end) was 62.25p. The lowest and highest closing mid-market prices of shares in the Company during the year were 14p and 89p respectively.

Information concerning the performance conditions attached to the above options is contained on page 34.

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. No shares were acquired by the Trust during the year.

During the year no options under the Company's Share Option Schemes were exercised and satisfied by shares transferred by the Trust.

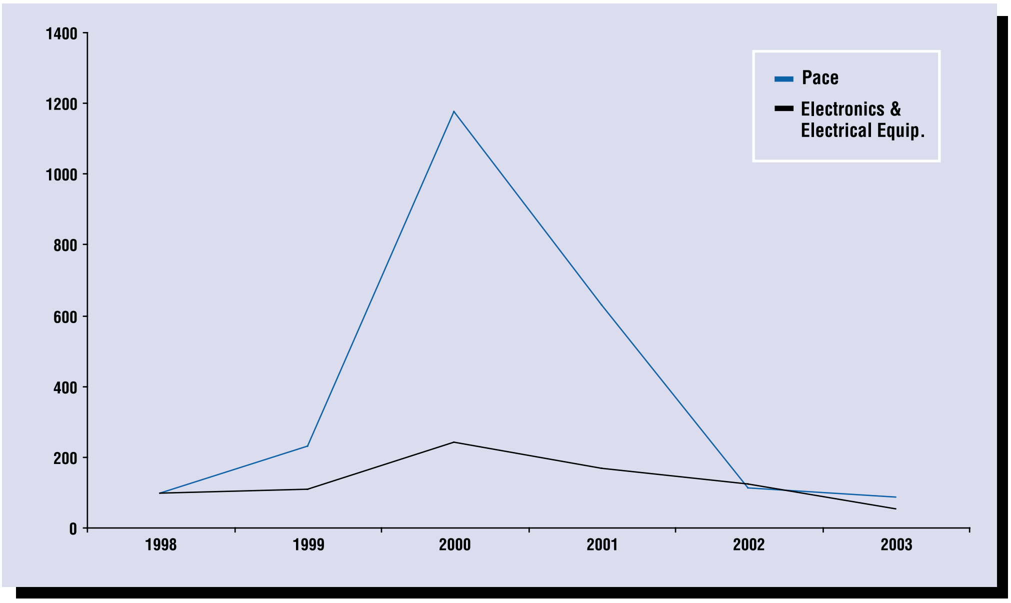
The Company has established the Pace QUEST (Qualifying Employee Share Trust), which is capable of acquiring shares in the Company either through purchases in the market or allotment and using any such shares for the purposes of satisfying options under the Company's Sharesave Scheme. No shares were acquired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

During the year 22,792 options under the Company's Sharesave Scheme were exercised and were satisfied by shares transferred by the QUEST.

REMUNERATION REPORT CONTINUED

PERFORMANCE GRAPH

Set out below is a performance graph showing the total shareholder return of the Company for the five financial years of the Company ending 31 May 2003 compared to the total shareholder return of the FTSE Electronics and Electrical Equipment sector index which is considered by the Board as an appropriate benchmark index against which to compare the Company's performance having regard to the principal activities of the Group.



By order of the Board

Anthony J Dixon
Company Secretary

14 July 2003

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the Independent Auditors' Report set out on page 42, 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; and
- to 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 43 to 63. We have also audited the information in the directors' remuneration report on pages 35 to 38 that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 41, 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 whether the financial statements and the part of the directors' remuneration report to be audited have been 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 regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on pages 27 to 29 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 the unaudited part of the directors' remuneration report, 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 and the part of the directors' remuneration report to be audited. 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 and the part of the directors' remuneration report to be audited 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 and the part of the directors' remuneration report to be audited.

Uncertainty arising from market conditions

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 to the financial statements concerning the uncertainty arising from market conditions and the directors' consideration of the appropriateness of the going concern basis of preparation of the financial statements. In view of the significance of this matter, we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

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 31 May 2003 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds

14 July 2003

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 MAY 2003

	Note	**2003** Before exceptional items	**2003** Exceptional items (note 5)	**2003** Total	2002 Before exceptional items	2002 Exceptional items (note 5)	2002 Total
		£000	**£000**	**£000**	£000	£000	£000
Turnover	2	**166,597**	**–**	**166,597**	351,794	–	351,794
Cost of sales		**(131,794)**	**(2,542)**	**(134,336)**	(271,832)	–	(271,832)
Gross profit		**34,803**	**(2,542)**	**32,261**	79,962	–	79,962
Other operating income and charges	4	**(52,257)**	**(29,981)**	**(82,238)**	(68,817)	(39,952)	(108,769)
Operating (loss)/profit		**(17,454)**	**(32,523)**	**(49,977)**	11,145	(39,952)	(28,807)
Net interest payable and similar charges	6	**(100)**	**–**	**(100)**	(718)	–	(718)
(Loss)/profit on ordinary activities before taxation	3	**(17,554)**	**(32,523)**	**(50,077)**	10,427	(39,952)	(29,525)
Tax credit/(charge) on (loss)/profit on ordinary activities	9	**1,340**	**706**	**2,046**	(6,796)	1,479	(5,317)
(Loss)/profit on ordinary activities after taxation		**(16,214)**	**(31,817)**	**(48,031)**	3,631	(38,473)	(34,842)
Dividends	10	**–**	**–**	**–**	(2,386)	–	(2,386)
Retained (loss)/profit for the financial year	25	**(16,214)**	**(31,817)**	**(48,031)**	1,245	(38,473)	(37,228)
Basic loss per ordinary share	11			**(22.0)p**			(16.1)p
Diluted loss per ordinary share	11			**(22.0)p**			(16.1)p
Dividend per ordinary share	10			**–**			1.10p

RESULTS BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEMS

	Note	**£000**	£000
Operating (loss)/profit		**(16,053)**	13,862
(Loss)/profit on ordinary activities before taxation		**(16,153)**	13,144
Adjusted basic (loss)/earnings per ordinary share	11	**(6.8)p**	2.9p
Adjusted diluted (loss)/earnings per ordinary share	11	**(6.8)p**	2.9p

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 31 MAY 2003

	Note	2003	2003	2002	2002
		£000	**£000**	£000	£000
Fixed assets					
Intangible	12		**10,000**		35,822
Tangible	12		**10,269**		15,285
Investments	13		**2,515**		4,033
			22,784		55,140
Current assets					
Stocks	14	**15,967**		46,719	
Debtors	15	**57,201**		80,626	
– due within one year		***49,317***		*75,088*	
– due after more than one year		***7,884***		*5,538*	
Cash at bank and in hand		**13,410**		–	
		86,578		127,345	
Creditors: amounts falling due within one year	16	**(38,638)**		(62,301)	
Net current assets			**47,940**		65,044
Total assets less current liabilities			**70,724**		120,184
Creditors: amounts falling due after more than one year	17		**(288)**		(332)
Provisions for liabilities and charges	20		**(26,331)**		(18,293)
Net assets			**44,105**		101,559
Capital and reserves					
Called up equity share capital	21		**11,312**		11,312
Share premium account	22		**35,427**		35,426
Shares to be issued	23		**–**		10,000
Merger reserve	24		**–**		17,209
Profit and loss account	25		**(2,634)**		27,612
Total equity shareholders' funds			**44,105**		101,559

These financial statements were approved by the Board of Directors on 14 July 2003 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman
John Dyson - Chief Executive

COMPANY BALANCE SHEET

AT 31 MAY 2003

	Note	2003		2002	
		£000	**£000**	£000	£000
Fixed assets					
Tangible	12		**7,536**		11,649
Investments	13		**20,496**		56,520
			28,032		68,169
Current assets					
Stocks	14	**6,695**		39,407	
Debtors	15	**50,703**		79,427	
– due within one year		***42,819***		*73,889*	
– due after more than one year		***7,884***		*5,538*	
Cash at bank and in hand		**13,364**		–	
		70,762		118,834	
Creditors: amounts falling due within one year	16	**(30,924)**		(54,515)	
Net current assets			**39,838**		64,319
Total assets less current liabilities			**67,870**		132,488
Provisions for liabilities and charges	20		**(23,364)**		(15,899)
Net assets			**44,506**		116,589
Capital and reserves					
Called up equity share capital	21		**11,312**		11,312
Share premium account	22		**35,427**		35,426
Shares to be issued	23		**–**		10,000
Merger reserve	24		**–**		17,209
Profit and loss account	25		**(2,233)**		42,642
Total equity shareholders' funds			**44,506**		116,589

These financial statements were approved by the Board of Directors on 14 July 2003 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman
John Dyson - Chief Executive

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 MAY 2003

	Note	**2003**	2002
		£000	£000
Net cash inflow/(outflow) from operating activities	27	**32,093**	(18,910)
Returns on investments and servicing of finance	28	**(496)**	(201)
Taxation		**9,082**	(8,149)
Capital expenditure and financial investment	28	**(2,001)**	(8,984)
Acquisitions	28	**(5,000)**	(8,303)
Equity dividends paid		**(1,528)**	(2,375)
Cash inflow/(outflow) before financing		**32,150**	(46,922)
Financing	28	**(48)**	(143)
Increase/(decrease) in cash in the year		**32,102**	(47,065)

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

	Note	**2003**	2002
		£000	£000
Increase/(decrease) in cash in the year		**32,102**	(47,065)
Cash flow from decrease in debt		**49**	507
Movement in net funds/(debt) in the year		**32,151**	(46,558)
Net (debt)/funds at start of year		**(19,074)**	27,484
Net funds/(debt) at end of year	29	**13,077**	(19,074)

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES AND RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

FOR THE YEAR ENDED 31 MAY 2003

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2003	2002
	£000	£000
Loss for the year	**(48,031)**	(34,842)
Currency translation differences on foreign currency net investments	**576**	164
Total recognised losses relating to the year	**(47,455)**	(34,678)
Prior year adjustment	**–**	2,284
Total recognised losses since the last annual report	**(47,455)**	(32,394)

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2003	2002
	£000	£000
Loss for the year	**(48,031)**	(34,842)
Dividends	**–**	(2,386)
Retained loss for the year	**(48,031)**	(37,228)
Other recognised gains and losses relating to the year	**576**	164
Issue of ordinary share capital	**1**	365
Movement in shares to be issued	**(10,000)**	(11,871)
Net reduction in equity shareholders' funds	**(57,454)**	(48,570)
Equity shareholders' funds at start of year	**101,559**	150,129
Equity shareholders' funds at end of year	**44,105**	101,559

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.

BASIS OF PREPARATION

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

UNCERTAINTY ARISING FROM MARKET CONDITIONS

Global markets, particularly the technology sector, are continuing to experience a high degree of volatility.

The worldwide market for set-top boxes declined in the past 18 months. Whilst there is some evidence of improved stability over the last six months, there remains continued risk in the digital broadcasting industry. Lower selling prices are a feature of current and anticipated market conditions.

The Group has a two year banking facility, of which over twelve months remain, in the amount of £20m.

The Board has built these circumstances 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 maintain such facilities.

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

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 31 May 2003 and the previous year's financial statements are for the 52 weeks ended 1 June 2002.

BASIS OF CONSOLIDATION

The Group financial statements consolidate those of the Company and of its subsidiary undertakings (note 13) drawn up to 31 May 2003. 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.

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

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 tems 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 and 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).

NOTES CONTINUED

1 ACCOUNTING POLICIES CONTINUED

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 Scheme 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.

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	**2003**	2002
	£000	£000
United Kingdom	**137,494**	255,844
Continental Europe	**9,806**	40,205
Far East and Australasia	**9,060**	11,072
North America	**9,911**	38,216
Rest of the World	**326**	6,457
	166,597	351,794

By origin	**Turnover**		**(Loss)/profit before taxation**		**Net assets/(liabilities)**	
	2003	2002	**2003**	2002	**2003**	2002
	£000	£000	**£000**	£000	**£000**	£000
United Kingdom	**154,775**	310,397	**(46,709)**	(35,480)	**38,493**	94,760
Continental Europe	**9,871**	40,674	**(3,523)**	5,238	**4,263**	6,358
Far East and Australasia	**1,620**	510	**(216)**	375	**704**	672
Rest of the World	**331**	213	**371**	342	**645**	(231)
	166,597	351,794	**(50,077)**	(29,525)	**44,105**	101,559

NOTES CONTINUED

2 TURNOVER CONTINUED

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)

	2003	2002
	£000	£000
Group auditors' and their associates' remuneration		
- audit services	**200**	220
- taxation services	**39**	33
- other services	**89**	120
Company auditors' and their associates' remuneration		
- audit services	**187**	205
Amortisation of goodwill	**1,401**	2,717
Depreciation of tangible fixed assets		
- owned	**6,303**	9,010
- held under finance leases and hire purchase contracts	**–**	3
Other operating lease rentals		
- land and buildings	**2,440**	2,942
- land and buildings (exceptional charge - see note 5)	**1,958**	–
- plant and machinery	**–**	148
- motor vehicles	**373**	294
Loss/(profit) on disposal of tangible fixed assets	**67**	(5)
Exceptional loss on disposal of fixed assets (see note 5)	**528**	1,526

4 OTHER OPERATING INCOME AND CHARGES (before exceptional items)

	2003	2002
	£000	£000
Research and development expenditure	**27,079**	36,857
Administrative expenses	**6,460**	7,529
Distribution costs	**–**	494
Other charges	**18,718**	23,937
	52,257	68,817

NOTES CONTINUED

5 EXCEPTIONAL ITEMS

	2003 £000	2002 £000
Restructuring costs	**5,900**	4,931
Onerous contracts	**3,671**	–
Impairment of own shares held in ESOP and QUEST	**1,500**	17,515
Impairment of goodwill	**21,452**	17,506
	32,523	39,952

In both years the restructuring costs relate to redundancies, fixed asset and inventory write downs and office closures associated with the rationalisation of the business.

The onerous contracts represent commitments in respect of the future costs associated with vacant properties leased by the company and raw material purchases arising from the decision to reorganise the IPTV division.

Provisions have been made in both years against the carrying value of shares held in the Pace Micro Technology plc Employee Benefits Trust and QUEST.

Following an impairment review a provision has been made against the carrying value of goodwill attributable to the Group's investment in Xcom Multimedia Communications SAS. In the prior period the impairment related to a full provision against the goodwill attributable to the investment in VegaStream Limited (see also note 12).

6 NET INTEREST PAYABLE AND SIMILAR CHARGES

	2003 £000	2002 £000
Bank interest payable and other similar charges	**(919)**	(1,400)
Bank interest receivable	**819**	682
	(100)	(718)

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 40.

8 STAFF NUMBERS AND COSTS

The average number of employees were:	2003 No.	2002 No.
Research and development	**511**	683
Administration	**102**	124
Sales and marketing	**60**	87
Manufacturing and operations	**89**	202
	762	1,096

Staff costs:	£000	£000
Wages and salaries	**26,771**	35,703
Social security costs	**3,021**	3,359
Other pension costs	**1,111**	1,314
Redundancy	**2,157**	2,996
	33,060	43,372

NOTES CONTINUED

9 TAX CREDIT/(CHARGE) ON (LOSS)/PROFIT ON ORDINARY ACTIVITIES

The tax credit/(charge) is based on the (loss)/profit for the year and comprises:	**2003**	2002
	£000	£000
Current tax:		
UK corporation tax on (losses)/profits of the period	**–**	–
Overseas tax	**(300)**	(3,411)
Total current tax charge	**(300)**	(3,411)
Deferred tax:		
Origination and reversal of timing differences (note 15)	**2,346**	(1,906)
Tax credit/(charge) on (loss)/profit on ordinary activities	**2,046**	(5,317)

Reconciliation of total current tax charge:	**2003**	2002
	£000	£000
Loss on ordinary activities before tax	**(50,077)**	(29,525)
Loss on ordinary activities multiplied by standard rate of corporation tax (30%)	**(15,023)**	(8,858)
Effects of:		
Expenses not deductible for tax purposes and amortisation of goodwill	**7,107**	6,693
Deferred tax movements (current year):		
Accelerated capital allowances	**237**	239
Other timing differences	**–**	(231)
Trading losses recognised	**1,500**	–
Tax losses carried forward	**7,226**	4,759
Research and development tax credit	**(822)**	–
Overseas tax not at 30%	**75**	809
Current tax charge for period	**300**	3,411

The tax credit in respect of the exceptional items included within the above tax charge amounts to £706,000 (2002: £1,479,000).

10 DIVIDENDS

	2003	2002
	£000	£000
Interim dividend of nil per ordinary share (2002 : 0.40p)	**–**	894
Proposed final dividend of nil per ordinary share (2002 : 0.70p)	**–**	1,584
Dividends waived by Pace Micro Technology plc Employee Benefits Trust and QUEST	**–**	(92)
Total dividends	**–**	2,386

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 loss before amortisation of goodwill and exceptional items was £14,813,000 (2002: earnings of £6,348,000) and the loss after amortisation of goodwill and exceptional items was £48,031,000 (2002: loss of £34,842,000). The average number of qualifying ordinary shares in issue during the year was 218,184,770 (2002: 216,902,805).

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

NOTES CONTINUED

12 FIXED ASSETS

Group	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
Cost						
At 2 June 2002	58,037	583	5,077	42,151	201	48,012
Exchange adjustments	–	52	(46)	(216)	–	(210)
Additions	–	16	34	2,260	–	2,310
Disposals	–	–	(369)	(3,721)	(142)	(4,232)
Adjustments (note 23)	(2,969)	–	–	–	–	–
At 31 May 2003	55,068	651	4,696	40,474	59	45,880
Amortisation/depreciation						
At 2 June 2002	22,215	26	3,070	29,489	142	32,727
Exchange adjustments	–	3	(12)	(62)	–	(71)
Provided in the year	1,401	67	602	5,612	22	6,303
Impairment (note 5 and below)	21,452	–	–	–	–	–
Disposals	–	–	(233)	(3,010)	(105)	(3,348)
At 31 May 2003	45,068	96	3,427	32,029	59	35,611
Net book amount at 31 May 2003	**10,000**	**555**	**1,269**	**8,445**	**–**	**10,269**
Net book amount at 1 June 2002	35,822	557	2,007	12,662	59	15,285
Company						
Cost						
At 2 June 2002		–	4,670	37,957	191	42,818
Additions		–	34	1,835	–	1,869
Disposals		–	(369)	(3,310)	(134)	(3,813)
At 31 May 2003		–	4,335	36,482	57	40,874
Depreciation						
At 2 June 2002		–	2,963	28,071	135	31,169
Provided in the year		–	528	4,798	21	5,347
Disposals		–	(233)	(2,846)	(99)	(3,178)
At 31 May 2003		–	3,258	30,023	57	33,338
Net book amount at 31 May 2003		**–**	**1,077**	**6,459**	**–**	**7,536**
Net book amount at 1 June 2002		–	1,707	9,886	56	11,649

The Group has carried out a review to determine whether there has been an impairment of its goodwill. The carrying values of goodwill have been compared to their recoverable amounts, represented by their value in use to the Group.

In accordance with FRS11, the value in use of each of the Group's income generating units has been determined with reference to the Group's budgets and forecasts (covering the next 2 year period), which have been approved by the Board, using a growth rate of 3% for the three years beyond this period, a nil growth rate thereafter and a discount rate of 14%.

The resulting charge of £21.5m relates to the carrying value of the Group's investment in Xcom Multimedia Communications SAS ("Xcom"), and reflects both the continuing uncertainty in the European and Asian markets together with the continued integration of Xcom into the business of the Group.

NOTES CONTINUED

13 FIXED ASSET INVESTMENTS

Group	Own shares £000	Investments other than loans £000	Total £000
Cost at 2 June 2002	21,548	45	21,593
Disposal on exercise of share options	(18)	–	(18)
Cost at 31 May 2003	21,530	45	21,575
Provision at 2 June 2002	(17,515)	(45)	(17,560)
Movement in period	(1,500)	–	(1,500)
Provision at 31 May 2003	(19,015)	(45)	(19,060)
Net book value at 31 May 2003	**2,515**	**–**	**2,515**
Net book value at 1 June 2002	4,033	–	4,033

Company	Own shares £000	Shares in group undertakings £000	Intra-group loans £000	Investments other than loans £000	Total £000
Cost at 2 June 2002	21,548	6,174	65,945	45	93,712
Disposal on exercise of share options	(18)	–	–	–	(18)
Cost at 31 May 2003	21,530	6,174	65,945	45	93,694
Provision at 2 June 2002	(17,515)	–	(19,632)	(45)	(37,192)
Movement in period	(1,500)	–	(34,506)	–	(36,006)
Provision at 31 May 2003	(19,015)	–	(54,138)	(45)	(73,198)
Net book value at 31 May 2003	**2,515**	**6,174**	**11,807**	**–**	**20,496**
Net book value at 1 June 2002	4,033	6,174	46,313	–	56,520

Investments in own shares comprise £2,515,000 (2002: £4,033,000) in respect of 8,041,831 (2002: 8,064,623) 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 Xcom Multimedia Communications SAS, a provision has been made against the carrying value of intra-group loans relating to the subsidiary.

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	Normal exercise period	Price per share pence
1,557,536	24 September 2001 to 23 September 2008	64.0
1,025,919	26 January 2002 to 25 January 2009	84.5
962,500	7 July 2002 to 6 July 2009	200.0
3,174	20 March 2003 to 19 March 2010	945.0
231,519	17 July 2001 to 16 July 2010	857.5
1,072,553	29 January 2002 to 28 January 2011	610.0
471,000	24 July 2002 to 23 July 2011	375.0
1,000,000	21 January 2004 to 20 January 2013	20.0
500,000	2 May 2004 to 1 May 2013	37.0
6,824,201		

NOTES CONTINUED

13 FIXED ASSET INVESTMENTS CONTINUED

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	Normal exercise period	Price per share pence
653	1 October 2002 to 31 March 2003	178.0
4,836	1 April 2003 to 30 September 2003	664.0
1,233	1 October 2003 to 31 March 2004	721.0
1,865	1 April 2004 to 30 September 2004	550.0
15,225	1 October 2004 to 31 March 2005	304.0
15,815	1 April 2005 to 30 September 2005	269.0
3,421,000	1 October 2005 to 31 March 2006	18.0
1,906,682	1 April 2006 to 30 September 2006	14.5
5,367,309		

At 31 May 2003 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
EURL New Com Immobilier**	100%	France	France	Ordinary
Pace Advanced Consumer Electronics Limited	100%	UK	UK	Ordinary
Pace Asia Limited**	100%	Hong Kong	Hong Kong	Ordinary
Pace Digital Italia srl (in liquidation)	100%	Italy	Italy	Ordinary
Pace Distribution GmbH	100%	Germany	Germany	Ordinary
Pace Distribution (Overseas) Limited	100%	UK	UK	Ordinary/Preference
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
SCI Les 9 Tilleuls**	100%	France	France	Ordinary
VegaStream Inc****	100%	USA	USA	Ordinary
VegaStream Limited ***	100%	UK	UK	Ordinary
Xcom Multimedia Communications SAS ***	100%	France	France	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 has been consolidated in the Group's financial statements.
Certain of the above subsidiaries have been placed voluntarily into liquidation as part of a previous restructuring exercise.

14 STOCKS

	Group		Company	
	2003 £000	2002 £000	**2003 £000**	2002 £000
Raw materials and consumable stores	**8,521**	15,813	**1,771**	9,230
Finished goods	**7,446**	30,906	**4,924**	30,177
	15,967	46,719	**6,695**	39,407

NOTES CONTINUED

15 DEBTORS

	Group		Company	
	2003	2002	**2003**	2002
	£000	£000	**£000**	£000
Amounts falling due within one year:				
Trade debtors	**46,750**	69,956	**41,102**	61,854
Amounts owed by subsidiary undertakings	**–**	–	**7**	11,056
Other debtors	**1,138**	3,821	**748**	346
Prepayments and accrued income	**1,429**	1,311	**962**	633
	49,317	75,088	**42,819**	73,889
Amounts falling due after more than one year:				
Deferred tax	**7,884**	5,538	**7,884**	5,538
	57,201	80,626	**50,703**	79,427

Deferred tax assets have been recognised to the extent they are regarded as recoverable, in accordance with FRS 19. The following table outlines the recognised and unrecognised deferred tax assets.

	Recognised asset		Unrecognised asset	
	2003	2002	**2003**	2002
	£000	£000	**£000**	£000
Group and company				
Accelerated capital allowances	**1,657**	811	**–**	–
Trading losses (see note below)	**4,667**	3,167	**14,590**	7,743
Other timing differences	**1,560**	1,560	**–**	–
	7,884	5,538	**14,590**	7,743

As at 31st May 2003 the Company had unrecognised deferred tax assets in respect of trading losses of £10,818,000 (2002: £5,255,000).

16 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2003	2002	**2003**	2002
	£000	£000	**£000**	£000
Bank loans and overdrafts (note 18)	**45**	18,742	**–**	16,607
Trade creditors	**20,114**	24,079	**15,820**	14,572
Amounts owed to subsidiary undertakings	**–**	–	**–**	9,041
Corporation tax	**3,727**	4,432	**1,911**	1,906
Social security and other taxes	**3,505**	1,062	**4,304**	795
Other creditors	**6,305**	1,788	**4,910**	1,619
Accruals	**4,942**	10,675	**3,979**	8,452
Proposed dividend	**–**	1,523	**–**	1,523
	38,638	62,301	**30,924**	54,515

17 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group	
	2003	2002
	£000	£000
Bank loans (note 18)	**288**	332

NOTES CONTINUED

18 BORROWINGS

Borrowings consist mainly of bank loans and overdrafts:

	Group		Company	
	2003 £000	2002 £000	**2003 £000**	2002 £000
Within one year	**45**	18,742	**–**	16,607
After one and within two years	**6**	50	**–**	–
After two and within five years	**152**	152	**–**	–
After five years	**130**	130	**–**	–
	333	19,074	**–**	16,607

The banking facilities of £20 million (2002: £40 million) are available until 31 July 2004. The facility is secured by a fixed and floating charge over the assets of Pace Micro Technology plc and certain of its subsidiaries.

19 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 £000**	**Interest free £000**	**Total £000**
At 31 May 2003:			
Sterling	12,812	134	12,946
US Dollar	582	–	582
Other	134	–	134
Total	13,528	134	13,662
At 1 June 2002:			
Sterling	–	123	123
US Dollar	2,271	–	2,271
Euro	121	–	121
Other	68	1	69
	2,460	124	2,584

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 £000**	**Interest free £000**	**Total £000**
At 31 May 2003:			
Euro	252	–	252
	252	–	252
At 1 June 2002:			
Sterling	18,898	–	18,898
Euro	2,263	–	2,263
Other	497	–	497
	21,658	–	21,658

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

NOTES CONTINUED

19 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.

	Net foreign currency monetary assets/(liabilities)			
Functional currency of group operation	**US Dollar £000**	**Euro £000**	**Other £000**	**Total £000**
At 31 May 2003:				
Sterling	(5,992)	(1,090)	(27)	(7,109)
Euro	(801)	–	180	(621)
Total	(6,793)	(1,090)	153	(7,730)
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

(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 31 May 2003:	–	–	–	–	–
At 1 June 2002:	Sterling	US Dollar	$5m	1.4250	June 2002

The unrealised loss on the above contracts in the prior year amounted to £60,000 of which £60,000 was 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.

	2003 Book value £000	**2003 Fair value £000**	2002 Book value £000	2002 Fair value £000
Primary financial instruments held or issued to finance the Group's operations:				
Cash and other liquid funds	**13,410**	**13,410**	–	–
Bank loans and overdrafts	**(333)**	**(333)**	(19,074)	(19,074)
Derivative financial instruments held to hedge the currency exposure:				
Foreign exchange hedge contracts	**–**	**–**	(60)	(60)

NOTES CONTINUED

20 PROVISIONS FOR LIABILITIES AND CHARGES

	Royalties under negotiation	Onerous contracts	Warranties	Corporation tax	Contingent consideration cash	Total
	£000	£000	£000	£000	£000	£000
Group						
At 2 June 2002	12,593	338	2,862	–	2,500	18,293
Net (credit)/charge for the year	(1,752)	3,671	5,083	10,087	–	17,089
Utilised	(350)	(338)	(5,863)	–	(2,500)	(9,051)
At 31 May 2003	10,491	3,671	2,082	10,087	–	26,331
Company						
At 2 June 2002	10,199	338	2,862	–	2,500	15,899
Net (credit)/charge for the year	(2,325)	3,671	5,083	10,087	–	16,516
Utilised	(350)	(338)	(5,863)	–	(2,500)	(9,051)
At 31 May 2003	7,524	3,671	2,082	10,087	–	23,364

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.

The directors consider that to disclose the amounts unused following the negotiation of royalty claims during the year would be seriously prejudicial to other royalty claims currently under negotiation, in litigation or dispute. Accordingly the directors have aggregated amounts released unused with additional provisions made in order to arrive at the net credit for the year shown above.

21 SHARE CAPITAL

	2003		2002	
	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	**226,249,327**	**11,312**	226,245,162	11,312

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	4,165	18.0	–	1

NOTES CONTINUED

21 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	Normal exercise period	Price per share pence
45,348	27 June 1997 to 26 June 2003	172.0
96,737	25 June 1999 to 24 June 2006	190.0
23,470	25 June 1999 to 24 June 2003	172.0
35,000	19 August 2000 to 18 August 2007	42.5
30,000	19 August 2000 to 18 August 2004	42.5
259,434	17 November 2000 to 16 November 2004	53.0
300,000	28 April 2001 to 27 April 2005	70.0
735,000	7 July 2002 to 6 July 2009	200.0
1,211,099	11 January 2003 to 10 January 2010	599.5
228,428	17 July 2003 to 16 July 2010	857.5
368,475	17 July 2001 to 16 July 2010	857.5
9,375	21 August 2001 to 20 August 2010	835.0
52,883	29 January 2004 to 28 January 2011	610.0
308,310	29 January 2002 to 28 January 2011	610.0
6,141	1 June 2004 to 31 May 2011	488.5
35,964	1 June 2002 to 31 May 2011	488.5
334,000	24 July 2005 to 23 July 2011	375.0
1,212,953	24 July 2002 to 23 July 2011	375.0
479,118	24 July 2004 to 23 July 2011	375.0
87,987	18 January 2003 to 17 January 2012	357.0
69,013	18 January 2005 to 17 January 2012	357.0
3,000	18 January 2006 to 17 January 2012	357.0
1,879,684	22 October 2003 to 21 October 2012	15.75
711,520	22 October 2005 to 21 October 2012	15.75
170,000	22 October 2006 to 21 October 2012	15.75
162,760	16 February 2004 to 16 May 2004	16.0
8,855,699		

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 13.

22 SHARE PREMIUM ACCOUNT

Group and Company	£000
At 2 June 2002	35,426
Premium on allotments	1
At 31 May 2003	35,427

The shares allotted during the year are listed in note 21.

23 SHARES TO BE ISSUED

Group and Company	£000
At 2 June 2002	10,000
Adjustments	(2,969)
Transfer to other creditors	(7,031)
At 31 May 2003	–

The adjustments reflect the agreement of the final element of earn out payments due on previous acquisitions. Such amounts are now payable in cash rather than shares and the net remaining amount due of £4.3m is included within Other Creditors.

NOTES CONTINUED

24 MERGER RESERVE

	£000
Group and Company	
At 2 June 2002	17,209
Transfer to profit and loss account reserve	(17,209)
At 31 May 2003	–

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 £17,209,000 arose on the acquisition of Xcom Multimedia Communications SAS.

25 PROFIT AND LOSS ACCOUNT

	£000
Group	
At 2 June 2002	27,612
Retained loss for the year	(48,031)
Movement in merger reserve (see note 24)	17,209
Exchange differences	576
At 31 May 2003	(2,634)

	£000
Company	
At 2 June 2002	42,642
Retained loss for the year	(62,084)
Movement in merger reserve (see note 24)	17,209
At 31 May 2003	(2,233)

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 (2002: £360,000).

26 LOSS 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 includes a parent Company loss before dividends of £62,084,000 (2002: loss of £28,598,000).

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

	2003 £000	2002 £000
Operating loss	**(49,977)**	(28,807)
Exceptional items	**32,523**	39,952
Operating (loss)/profit before exceptional items	**(17,454)**	11,145
Goodwill amortisation	**1,401**	2,717
Depreciation	**6,303**	9,013
Loss/(profit) on disposal of tangible fixed assets	**595**	(5)
Decrease/(increase) in stocks	**30,752**	(7,146)
Decrease in debtors	**25,759**	6,758
Decrease in creditors	**(15,714)**	(35,849)
Increase/(decrease) in provisions for liabilities and charges	**451**	(5,543)
Net cash inflow/(outflow) from operating activities	**32,093**	(18,910)

NOTES CONTINUED

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

	2003	2002
	£000	£000
Returns on investments and servicing of finance		
Interest received	**831**	982
Interest paid	**(1,327)**	(1,183)
Net cash outflow for returns on investments and servicing of finance	**(496)**	(201)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(2,310)**	(9,328)
Acquisition of own shares for Pace Micro Technology plc Employee Benefits Trust and QUEST	**–**	(1,735)
Sale of tangible fixed assets	**291**	355
Exercise of employee share options	**18**	1,724
Net cash outflow for capital expenditure and financial investment	**(2,001)**	(8,984)
Acquistions		
Settlement of deferred consideration in respect of previous acquisitions	**(5,000)**	(8,303)
Financing		
Issue of ordinary share capital	**1**	365
Capital element of finance lease rental payments	**–**	(3)
Repayment of subsidiary asset loans	**(49)**	(505)
Net cash outflow from financing	**(48)**	(143)

29 ANALYSIS OF CHANGE IN NET FUNDS/(DEBT)

	At 2 June 2002	Cash flow	**At 31 May 2003**
	£000	£000	**£000**
Cash at bank and in hand	–	13,410	**13,410**
Overdrafts	(18,692)	18,692	**–**
	(18,692)	32,102	**13,410**
Debt due within one year	(50)	5	**(45)**
Debt due after one year	(332)	44	**(288)**
	(19,074)	32,151	**13,077**

30 CAPITAL COMMITMENTS

	Group and Company	
	2003	2002
	£000	£000
Contracted but not provided for	**1,222**	1,736

NOTES CONTINUED

31 PENSIONS

The Company contributes to several defined contribution Group Personal Pension Plans, which all executive directors and employees are entitled to join. At 31 May 2003 contributions of £Nil (2002: £Nil) were outstanding.

32 LEASING COMMITMENTS

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

	Group		Company	
	2003	2002	**2003**	2002
	£000	£000	**£000**	£000
Land and buildings				
Within one year	**48**	–	**–**	–
Between two and five years	**–**	359	**–**	311
In five years or more	**1,972**	1,972	**1,638**	1,638
	2,020	2,331	**1,638**	1,949
Other				
Between two and five years	**151**	207	**135**	207
	2,171	2,538	**1,773**	2,156

FIVE YEAR RECORD

	2003	2002	2001*	2000*	1999*
	£000	£000	£000	£000	£000
Turnover	**166,597**	351,794	523,641	377,621	182,836
(Loss)/profit before tax	**(50,077)**	(29,525)	38,068	23,972	15,096
(Loss)/profit before exceptional items and tax	**(17,554)**	10,427	42,597	27,272	15,096
(Loss)/profit after tax	**(48,031)**	(34,842)	24,460	19,453	9,622
Diluted (LPS)/EPS	**(22.0)p**	(16.1)p	11.1p	8.9p	4.5p
Diluted (LPS)/EPS before exceptional items and goodwill amortisation	**(6.8)p**	2.9p	13.5p	10.0p	4.5p
Net assets excluding goodwill	**34,105**	65,737	91,032	67,817	43,813

* The comparatives for financial years 1999 through to 2001 have been restated to reflect the impact of adoption of FRS19 (Deferred Tax) in the previous period.

NOTES