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Pace Micro Technology plc

Results for the year ended 29 May 2004

12 July 2004

PACE MICRO TECHNOLOGY PLC

Results for the year ended 29 May 2004

SALIENT POINTS

- Turnover of £239.9m (2003: £166.6m)
- Profit before tax, amortisation of goodwill and exceptional items of £5.9m (2003: loss of £16.2m)
- Full year gross margin of 19.0% (2003: 20.9% before exceptional items)
- Adjusted diluted earnings per share (stated before exceptional items and amortisation of goodwill) of 4.5p (2003: loss per share 6.8p)
- Overheads before exceptional items and amortisation of goodwill reduced to £39.8m (2003: £50.9m)
- Net cash position £20.4m (2003: net cash £13.1m)
- Volume shipments increased to 2.2 million set-top boxes (2003: 1.3 million)
- Good order book cover for H1 2004/05

Commenting on the results, Sir Michael Bett, Chairman, said:

"We are delighted to report a welcome return to profitability, which reflects progressive performance improvements achieved so far by the management team in a new growth phase of the global digital payTV market.

"With a good order book and continued stringent management controls, we are confident of continued progress in the current year."

Preliminary Announcement

In the year ended 29 May 2004 Pace made a welcome return to profitability, following progressive improvements in performance instigated by the management team over the last 18 months.

During the period Pace has been very successful in expanding its revenues, against a background of new momentum in the global digital payTV market caused by reductions in set-top box average selling prices (ASPs). The 2003/04 results represent a marked improvement in the Group's performance, with Pace reshaping its global business and gaining new customers, most importantly in Europe. The Board recognises that net margins need to be improved, which is being addressed by maintaining a rigorous approach to the management of all business costs. The Board believes it is right to maintain its business priority to grow market share whilst addressing these challenges.

Results

Profit before tax, amortisation of goodwill and exceptional items improved to £5.9m (2003: loss £16.2m) on turnover of £239.9m (2003: £166.6m). After taking into account goodwill amortisation of £564k and an exceptional charge of £1.5m, profit before tax was £3.9m (2003: loss £50.1m). Basic earnings per share were 3.7p (2003: loss per share 22.0p). Before goodwill amortisation and exceptional items, adjusted earnings per share were 4.6p (2003: loss per share 6.8p) and adjusted diluted earnings per share were 4.5p (2003: loss per share 6.8p).

Trading review

Pace's core market – digital set-top boxes for payTV operators worldwide – has entered a growth phase and Pace has this year increased its volume shipments by 69% to 2.2 million set-top boxes, up from 1.3 million last year. We are also seeing a significant shift in the geographic spread of the Group's business: sales to non-UK customers have grown by £73m, representing a 3.5 times increase over last year, to 42% of our total revenues, up from 17% of total revenues in 2003.

Overall turnover increased by 44% in the year. The decline in ASPs has made it possible for more digital TV operators to launch and extend their services, thereby generating growth in demand. As a consequence of competition and some component price increases, gross margin for the year declined to 19.0% (2003: 20.9% stated before exceptional items). We have sought to balance the impact of competition on our ASPs through strong overhead management and an increased use of outsourced services, coupled with continued efforts to reduce product cost. We also benefited from the weakness of the US dollar in the second half.

Our Europe and Asia Pacific regions made the most significant contribution to volume growth, growing by factors of seven and three times respectively. In these regions we have won five major new customers: Sky Italia, Viasat in Scandinavia, Premiere and KDG in Germany, and Foxtel in Australia. Sky Italia and Foxtel have quickly become important customers, following successful and high profile service launches. We expect these regions to contribute strongly in the coming year.

The UK, as one of the most advanced and mature digital TV markets, remains important to Pace. Although UK shipments fell 10% to approximately 1 million boxes as Pace has been gradually reducing its efforts in the low margin Freeview market, revenues improved slightly due to changes in product mix. BSkyB has continued the promotion of its Sky+ personal video recorder (PVR) which, combined with ongoing deliveries of the standard Digibox, makes it our largest customer in this region. Our UK cable customers continue to be important to us, although they have moved to dual source supply.

Our US shipments have grown – up three times to 162,000 units – as Pace began to benefit from the demand for high definition television and to establish credibility with individual local networks. High definition TV, which offers US consumers a significant improvement in picture quality, is stimulating competition between cable and satellite operators for digital customers. However, further performance improvements and new product launches are required to move our US operations into profitability. Pace engineers are now well advanced in their work on the Group's first set-top box for networks based on Motorola conditional access technology, which will expand our market opportunity. In addition, we are well into development of our first high definition PVRs, suitable for deployment on all US networks.

We have continued to utilise Solectron's manufacturing facilities in Romania and China and have now started to outsource engineering projects to Tata Elxsi in India. These, together with ongoing improvements to our engineering performance, are enabling us to manage significantly more projects, without a commensurate increase in cost.

Financial review

We have cut overheads, with non-engineering expenditure (excluding goodwill amortisation) down from £23.8m in 2003 to £18.5m and engineering development down, due to the improvements mentioned in the previous paragraph, to £21.3m (2003: £27.1m). As a percentage of revenue, total overheads excluding exceptional items and goodwill amortisation, fell to 16.6% (2003: 30.5%).

The taxation credit for the year resulted mainly from agreement with the UK Inland Revenue in respect of certain prior year issues.

The Group continued its policy of providing for all current claims relating to the alleged use of the intellectual property of others and was able, as in previous years, to release part of the overall provision. In the year ended 29 May 2004, the level of releases exceeded new provisions by £0.6m (2003: £1.8m).

Net assets at 29 May 2004, excluding goodwill, increased to £42.5m (2003: £34.1m). Net current assets were £54.1m (2003: £47.9m). Net cash balances at the year end were £20.4m (2003: £13.1m).

Stocks at the year-end amounted to £10.0m (2003: £16.0m), comprising £5.4m of raw materials and work in progress and £4.6m of finished goods. The stock turnover rate was over 19 times based on year-end stock levels (2003: 8 times). Debtors of £64.7m (2003: £57.2m) included insured balances of £38.5m (2003: £34.2m). The trade debt collection period was 11 weeks (2003: 12 weeks).

Pace's improved cash position came from the reduction in the levels of stock held and improvement in the working capital position overall, offset by the final earn-out payment of £4.4m made in respect of a prior year acquisition.

As previously announced, the Company is a party to a reference to the Financial Services and Markets Tribunal. The Company is unfortunately prohibited under the Financial Services and Markets Act 2000 from providing any further information regarding this reference until the matter is resolved. The Board considers it appropriate to make an exceptional charge of £1.5m for costs, including legal fees, associated with this reference.

Outlook

In the UK digital TV is now in 53% of households and over two-thirds of these households have payTV. We expect growth in penetration to continue, but at a slower rate. Pace has good relationships with all of the UK's digital payTV operators and has led the introduction of higher specification products such as PVR. However, with steady unit sales and declining ASPs, we expect to see an overall reduction in UK revenues in 2004/05.

By contrast, Continental Europe and Asia Pacific represent our biggest opportunities for growth in the next year and beyond, as more payTV operators go digital and others progress to higher specification PVR platforms.

In the US, we continue to focus our efforts on building our relationships with Comcast and Time Warner, as well as developing increasingly good relationships with other important operators. Next year, revenues will increase, albeit working from a relatively low starting point, and we aim to grow our market share, especially in the second half of the financial year.

We enter the year with good order cover. However, the market remains extremely competitive, some component prices are increasing and the continuing volatility in the US Dollar exchange rate provide an additional element of unpredictability and pressure on gross margins. To mitigate these factors, management is concentrating on tight control of costs as well as the successful introduction of new PVR and high definition products. Pace has established a strong position in these technologies. Overall, for the 2004/05 financial year, we expect to see further improvements in our performance, with revenues ahead and volumes significantly ahead of last year.

Sir Michael Bett
Chairman

12 July 2004

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 29 MAY 2004

		2004			2003		
	Note	Before exceptional items £000	Exceptional items (note 3) £000	Total £000	Before exceptional items £000	Exceptional items (note 3) £000	Total £000
Turnover	2	239,949	-	239,949	166,597	-	166,597
Cost of sales		(194,425)	-	(194,425)	(131,794)	(2,542)	(134,336)
Gross profit		45,524	-	45,524	34,803	(2,542)	32,261
Other operating income and charges		(40,350)	(1,500)	(41,850)	(52,257)	(29,981)	(82,238)
Operating profit/(loss)		5,174	(1,500)	3,674	(17,454)	(32,523)	(49,977)
Net interest receivable/(payable) and similar charges		206	-	206	(100)	-	(100)
Profit/(loss) on ordinary activities before taxation		5,380	(1,500)	3,880	(17,554)	(32,523)	(50,077)
Tax credit on profit/(loss) on ordinary activities	4	4,186	-	4,186	1,340	706	2,046
Retained profit/(loss) for the financial year		9,566	(1,500)	8,066	(16,214)	(31,817)	(48,031)
Basic earnings/(loss) per ordinary share	5			3.7p			(22.0)p
Diluted earnings/(loss) per ordinary share	5			3.6p			(22.0)p

RESULTS BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEMS

	Note	2004 £000	2003 £000
Operating profit/(loss)		5,738	(16,053)
Profit/(loss) on ordinary activities before taxation		5,944	(16,153)
Adjusted basic earnings/(loss) per share	5	4.6p	(6.8)p
Adjusted diluted basic earnings/(loss) per share	5	4.5p	(6.8)p

CONSOLIDATED BALANCE SHEET
AT 29 MAY 2004

	Note	2004	2003
		£000	£000
Fixed assets			
Intangible		9,436	10,000
Tangible		7,010	10,269
Investments	6	2,436	2,515
		18,882	22,784
Current assets			
Stocks		10,006	15,967
Debtors	7	64,724	57,201
- due within one year		*60,912*	*49,317*
- due after one year		*3,812*	*7,884*
Cash at bank and in hand		20,705	13,410
		95,435	86,578
Creditors: amounts falling due within one year		(41,378)	(38,638)
Net current assets		54,057	47,940
Total assets less current liabilities		72,939	70,724
Creditors: amounts falling due after more than one year		(246)	(288)
Provisions for liabilities and charges	8	(20,748)	(26,331)
Net assets		51,945	44,105
Capital and reserves			
Called up equity share capital		11,339	11,312
Share premium account		35,647	35,427
Profit and loss account		4,959	(2,634)
Total equity shareholders' funds		51,945	44,105

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 29 MAY 2004

	Note	2004 £000	2003 £000
Net cash inflow from operating activities	9	14,165	32,093
Returns on investments and servicing of finance		136	(496)
Taxation		391	9,082
Capital expenditure and financial investment		(2,665)	(2,001)
Acquisitions and disposals		(4,936)	(5,000)
Equity dividends paid		-	(1,528)
Cash inflow before financing		7,091	32,150
Financing		204	(48)
Increase in cash in the year		7,295	32,102

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

	2004 £000	2003 £000
Increase in cash in the year	7,295	32,102
Cash flow from decrease in debt	34	49
Movement in net funds in the year	7,329	32,151
Net funds/(debt) at start of year	13,077	(19,074)
Net funds at end of year	20,406	13,077

ANALYSIS OF CHANGES IN NET FUNDS

	At 1 June 2003 £000	Cash Flow £000	At 29 May 2004 £000
Cash at bank and in hand	13,410	7,295	20,705
Debt due within one year	(45)	(8)	(53)
Debt due after one year	(288)	42	(246)
	13,077	7,329	20,406

NOTES

1 Basis of preparation

The annual financial statements are drawn up to the Saturday nearest to 31 May. The current year's financial statements are for the 52-week period ended 29 May 2004 and the previous year's financial statements are for the 52-week period ended 31 May 2003. The annual financial statements for the next period will be for a 53-week period ending 4 June 2005.

The financial information set out herein does not constitute the Group's financial statements for the years ended 29 May 2004 and 31 May 2003 but is derived from those financial statements. The financial statements for the year ended 31 May 2003 have been delivered to the Registrar of Companies, and those for the year ended 29 May 2004 will be delivered following the Annual General Meeting. The auditors have reported on those financial statements; their reports were unqualified and did not contain statements under section 237 (2) or (3) of the Companies Act.

Financial position and market conditions

The performance of the Group has improved in the year, with both a significant increase in turnover and an increased geographical diversity of that turnover, coupled with a return to profit.

The Group ended the year with net cash balances of £20.4m, up from £13.1m at the end of the previous year and has recently negotiated new uncommitted banking facilities in an amount of £20m, which are available until 30 September 2005.

Notwithstanding the above, the Board recognises that there remains continued risk in the digital broadcasting industry, with some customers incurring losses as they implement their business plans and other customers reviewing the timing and nature of their business plans. Lower selling prices continue to be a feature of this market.

The Board has built these circumstances into their working capital forecasts and has modelled various business scenarios. Based on these, the Board has concluded it is appropriate to confirm the going concern basis of preparation for the financial statements.

2 Turnover

The geographical analysis of turnover by destination is as follows:

	2004 £000	2003 £000
United Kingdom	138,275	137,494
Continental Europe	56,812	9,806
Asia Pacific	19,986	9,060
North America	22,252	9,911
Rest of the World	2,624	326
	239,949	166,597

3 Exceptional items

	2004 £000	2003 £000
Cost regarding reference to Financial Services and Markets Tribunal	1,500	-
Restructuring costs	-	5,900
Onerous contracts	-	3,671
Impairment of own shares held in ESOP and QUEST	-	1,500
Impairment of goodwill in Xcom Multimedia Communications SAS	-	21,452
	1,500	32,523

The Company is a party to a reference to the Financial Services and Markets Tribunal. The Board considers it appropriate to make an exceptional charge for costs, including legal fees, associated with this reference. The Company is currently in discussion with insurers in respect of potential recoveries of legal costs, which recoveries have not been included in the charge.

All the above items are operating exceptional items.

4 Tax credit on profit/(loss) on ordinary activities

	2004	2003
	£000	£000
The tax credit is based on the profit/(loss) for the year and represents:		
Current tax:		
United Kingdom corporation tax at 30% (2003: 30%)	-	-
Overseas tax	44	(300)
Adjustment in respect of prior year	8,214	-
	8,258	(300)
Deferred tax		
Origination and reversal of timing differences	(4,072)	2,346
	4,186	2,046

The tax credit in respect of the exceptional items included within the above tax credit amounts to £Nil (2003: £706,000).

5 Basic and diluted earnings/(loss) per share

	2004	2003
	pence	pence
Basic earnings/(loss) per share before amortisation of goodwill and exceptional items	4.6	(6.8)
Effect of amortisation of goodwill	(0.2)	(0.6)
Effect of exceptional items	(0.7)	(14.6)
Basic earnings/(loss) per share	3.7	(22.0)

The calculation of basic earnings per share is based on profit for the year of £8,066,000 (2003: loss £48,031,000) divided by the weighted average number of ordinary shares in issue of 218,497,203 (2003: 218,184,770). Adjusted earnings per share before amortisation of goodwill and exceptional items is disclosed to indicate the underlying profitability of the Group and is based on profit of £10,130,000 (2003: loss £14,813,000).

	2004	2003
	£000	£000
Earnings/(loss) before amortisation of goodwill and exceptional items	10,130	(14,813)
Effect of amortisation of goodwill	(564)	(1,401)
Effect of exceptional items	(1,500)	(31,817)
Profit/(loss) for the year	8,066	(48,031)

	2004	2003
Number of shares	million	million
Weighted average number of ordinary shares in issue during the year	218.5	218.2
Dilutive effect of options outstanding	6.8	2.0
Diluted weighted average number of ordinary shares in issue during the year	225.3	220.2

Diluted earnings/(loss) per ordinary share varies from basic earnings per ordinary share due to the effect of the notional exercise of outstanding share options. In the 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 earnings per share amounts as measured based on both before and after amortisation of goodwill and exceptional items are the same as the basic earnings per share amounts.

6 Investments

An amount of £2,436,000 (2003: £2,515,000) is held by the Pace Micro Technology Employee Benefits Trust and the QUEST in respect of own shares purchased to satisfy options granted to employees.

7 Debtors

Debtors include a deferred tax asset of £3,812,000 (2003: £7,884,000) all of which is due after more than one year.

8 Provisions for liabilities and charges

	Royalties under negotiation (see below) £000	Onerous contracts £000	Warranties £000	Corporation tax £000	Total £000
At 1 June 2003	10,491	3,671	2,082	10,087	26,331
Net (credit)/charge for the year	(619)	-	8,614	(4,727)	3,268
Utilised	(2,008)	(1,843)	(5,000)	-	(8,851)
At 29 May 2004	7,864	1,828	5,696	5,360	20,748

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 Board has 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 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 Board considers 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 in 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.

9 Net cash inflow from operating activities

	2004 £000	2003 £000
Operating profit/(loss)	3,674	(49,977)
Exceptional items not directly affecting cash flow	-	32,523
Amortisation of goodwill	564	1,401
Depreciation	5,317	6,303
Loss on sale of tangible fixed assets	317	595
Decrease in stocks	5,961	30,752
(Increase)/decrease in debtors	(11,540)	25,759
Increase/(decrease) in creditors	10,728	(15,714)
(Decrease)/increase in provisions for liabilities and charges	(856)	451
Net cash inflow from operating activities	14,165	32,093

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