Pace Micro Technology plc

Interim Report 2006

17 January 2006

Pace Micro Technology plc

for the 26 weeks ended 3 December 2005

SALIENT POINTS

- Shipments of 1.1 million set-top boxes (2004: 2.1 million);
- Revenue of £78.9m (2004: £150.5m);
- Loss before tax and restructuring costs of £8.9m (2004: profit £4.7m);
- Diluted loss per share of 4.6p (2004: earnings per share of 4.3p);
- Net cash position £13.6m (4 June 2005: £26.4m).

All figures, including comparatives, are presented under IFRS.

Pace Micro Technology's Chairman, Sir Michael Bett, commented:

"Over the last six months Pace has won further new supply contracts with important digital TV operators around the world, continuing the momentum that is seeing Pace gain an increasing role in the payTV market in the developed world. Revenues are expected to improve significantly during the second half through shipments to the US as well as Premiere in Germany, UPC in The Netherlands, Foxtel in Australia and Sky New Zealand. This growth will be offset somewhat as in the UK we expect units and revenues to continue to decline in the short-term.

"The Board remains confident that Pace is well positioned for a solid performance in the next financial year due to its growing customer base, demand for new technologies such as high definition, MPEG-4 and multiroom and from shipments into the US that are expected to be flowing strongly by then. Although short-term issues may impact immediate expectations, the Board continues to be enthusiastic about the Group's position and is confident in the ability of Pace's employees to progress our business."

Chairman's Statement

Over the last six months Pace has won further new supply contracts with important digital TV operators around the world, continuing the momentum that is seeing Pace gain an increasing role in the payTV market in the developed world. Shipments on these contracts are expected to commence in the remainder of the financial year.

As announced on 16 December 2005, some short-term setbacks in new product introduction and some shipment delays due to industry-wide component shortages impacted the Group's performance. Turnover for the half year to 3 December 2005 was substantially reduced at £78.9m (2004: £150.5m), with a loss before tax and restructuring costs of £8.9m (2004: profit £4.7m). Basic earnings per share amounted to loss per share of 4.6p (2004: earnings per share 4.4p). Diluted earnings per share amounted to a loss of 4.6p (2004: earnings per share 4.3p).

An interim dividend is not declared (2004:nil).

Trading review

UK and EMEA

In the UK, which is a maturing market, shipments decreased to 0.4 million boxes (2004: 0.5m). BSkyB remained an important customer as its Sky+ PVR service continues to grow and there were ongoing shipments into UK cable.

In continental Europe, Pace has worked with Premiere, Kabel Deutschland (KDG), Viasat and Sky Italia. Shipments were lower at 0.5m (2004: 1.5m), the reduction mainly due to the high level of boxes delivered to Sky Italia last year as part of its service launch. In Germany, Pace has continued to ship basic digital set-top boxes to KDG and Premiere.

Additionally for Premiere, Pace has recently launched a standard definition PVR and became the first supplier to deliver a certified set-top box for its high definition service. This set-top box is Europe's first to utilise the latest MPEG-4 compression technology, which enables more high definition channels to be delivered within existing available bandwidth.

Pace has commenced PVR shipments to Sky Italia and to Viasat in Scandinavia. It is developing its first set-top box for delivery to UPC (part of Liberty Global Inc) in The Netherlands following a contract win in June 2005.

North America

In the US, Pace is now close to seeing a return on the investment made by the Group in this market over the last six years. This follows major contract wins with Comcast in May 2005 and DIRECTV in July 2005. Currently Pace is in the final development stages before delivery of the first products on both of these important contracts.

Pace's shipments to North America during the period increased slightly to 99,000 units (2004: 75,000) and includes shipments to Rogers Cable and Videotron, Canadian cable operators.

Asia Pacific

In Asia Pacific, Pace continued to work with Foxtel in Australia and Sky New Zealand. Pace shipped PVRs for the Foxtel IQ service on both satellite and cable platforms and commenced shipments of the new Sky New Zealand PVR in December. New business was won with Galaxy Satellite Broadcasting in Hong Kong, Pace's first move into the Chinese market.

Engineering and Operations

The contracts Pace is currently working on reflect the important strategic moves taken by the Group over the last eighteen months to expand its worldwide customer base and shift the balance of shipments towards more advanced products for major payTV operators. The Pace engineering team is meeting a number of challenges in bringing this complex range of new products to market as quickly as possible commensurate with having a reliable product. That this work is both complex and needs first class engineering skills represents one of the major barriers to entry to our market.

The management team has continued to drive initiatives to improve efficiency, cost-effectiveness and focus. In the last six months Pace has made further improvements to its engineering development process that will enable the Group to take greater advantage of outsourced engineering and manufacturing. This work will help improve margins from current levels and deliver next generation products.

The industry is presently constrained by a shortage of components. This affected the shipments we expected to make in November. Although that shortfall has been substantially made up, component availability remains as an issue in the short-term.

Future technologies

Pace continues to take a long-term view of its market. To ensure it is at the forefront of creating innovative new solutions for the digital home, Pace is increasing investment in its technology programme. Products and technologies currently under development include high definition, multiroom, home networking, mobile, a solution to improve satellite signal distribution around apartment and similar buildings, bandwidth enhancements for cable operators, software to enable Open Cable in the US and devices that allow content to be delivered via broadband in the home. These investments are expected to result in growth and higher margin products in the coming years.

Financial review

The Board has previously discussed the impact of International Financial Reporting Standards (IFRS) and the figures and information contained in this Interim Report have, for the first time, been prepared using IFRS as set out in the accounting policies. Comparative figures for 2004 and 2005 have also been adjusted and the full impact of IFRS changes is outlined in an appendix to this document.

As previously announced on 16 December 2005, the principal difference between IFRS and UK GAAP for Pace is the IAS38 requirement to capitalise development expenditure and amortise that expenditure over the economic life of a product. Due to the product delays outlined above and the additional engineering resource required to bring these products to market, the Board now expects a net increase of over £7m in the amount of capitalised development expenditure over the year, of which £5.5m has occurred in the first half.

Overheads (excluding restructuring costs on an IFRS basis) have decreased slightly. Selling, general and administrative expenditure (excluding restructuring costs) remained stable at £10.6m and engineering development charges decreased, after the impact of the capitalisation of development expenditure discussed above, to £9.4m (2004: £10.1m). As a percentage of revenue, total overheads excluding restructuring costs, were 25% (2004: 14%). The deterioration in this ratio is due to the shortfall in revenue in the last six months and is expected to reverse in the six months to 3 June 2006. The gross margin of 13.5% is lower than the comparative period, reflecting the competitive environment and also partly as a result of the impact of reduced revenue on fixed costs of sales and the strengthened US dollar. The gross margin is also expected to improve in the six months to 3 June 2006.

Net assets at 3 December 2005, excluding goodwill decreased to £51.2m (4 June 2005: £60.3m). Net current assets were £35.6m (4 June 2005: £51.5m). Net cash balances at the period-end were £13.6m (4 June 2005: £26.4m).

Stocks at the period end amounted to £18.8m (4 June 2005: £10.1m), comprising £7.9m of raw materials and work in progress and £10.9m of finished goods. Debtors of £43.4m (4 June 2005: £51.8m) included insured balances of £35.0m (2005: £36.8m).

The Group has arranged new bank facilities to cover its anticipated working capital requirements as the business builds in the second half.

Chief Executive

At the Company’s AGM in September it was announced that John Dyson would retire from the Pace Board upon the appointment of a new Chief Executive. The search is now reaching its final stages and the Board expects to make an announcement shortly.

Outlook

Revenues are expected to improve significantly during the second half through shipments to the US as well as Premiere in Germany, UPC in The Netherlands, Foxtel in Australia and Sky New Zealand. This growth will be offset somewhat as in the UK we expect units and revenues to continue to decline in the short-term. In addition, the Board expects Pace's engineering capacity to expand through improved productivity, recruitment and the increased use of outsourcing, to drive more advanced product development and improve Pace's product cost-reduction cycles.

A number of risks in completing the engineering development for the US shipments still remain and the Group is committed to substantial orders of components to fulfil its delivery schedules and to provide a level of protection against possible component shortages.

The Board remains confident that Pace is well positioned for a solid performance in the next financial year due to its growing customer base, demand for new technologies such as high definition, MPEG-4 and multiroom and from shipments into the US that are expected to be flowing strongly by then. Although short-term issues may impact immediate expectations, the Board continues to be enthusiastic about the Group's position and has confidence in the ability of Pace's employees to progress our business.

Sir Michael Bett
Chairman
17 January 2006

CONSOLIDATED INTERIM INCOME STATEMENT

FOR THE 26 WEEKS ENDED 3 DECEMBER 2005

	Note	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
Revenue	2	78,940	150,547	253,326
Cost of sales		(68,288)	(125,227)	(199,812)
Gross profit		10,652	25,320	53,514
Administrative expenses:				
Research and Development expenditure		(9,416)	(10,147)	(23,160)
Other administrative expenses:				
Before restructuring costs and non-recurring credit		(10,647)	(10,627)	(21,656)
Restructuring costs	3	(970)	-	(325)
Non-recurring credit	4	-	-	180
Total Administrative expenses		(21,033)	(20,774)	(44,961)
Operating (loss)/profit		(10,381)	4,546	8,553
Financial income		592	211	728
Financial expenses		(51)	(92)	(318)
(Loss)/profit before tax		(9,840)	4,665	8,963
Tax (charge)/credit	5	(264)	4,896	4,717
(Loss)/profit after tax		(10,104)	9,561	13,680
Attributable to:				
Equity holders of the Company		(10,104)	9,561	13,680
Basic (loss)/earnings per ordinary share	6	(4.6)p	4.4p	6.2p
Diluted (loss)/earnings per ordinary share	6	(4.6)p	4.3p	6.1p

All figures are unaudited. The figures for the period to 4 June 2005 have been restated from the audited UK GAAP figures presented on 12 July 2005, for which an unqualified auditors' report was received. Details on the IFRS impact on the Group's historical numbers are contained in an appendix to this document.

CONSOLIDATED INTERIM BALANCE SHEET
AT 3 DECEMBER 2005

	Note	3 Dec 2005 £000	4 Dec 2004 £000	4 June 2005 £000
ASSETS				
Non Current Assets				
Property, plant and equipment		7,278	6,618	6,185
Goodwill		9,436	9,436	9,436
Intangible assets – development expenditure		12,972	8,318	7,450
Investments in other companies		777	200	674
Deferred tax assets		4,009	3,958	4,009
Total Non Current Assets		34,472	28,530	27,754
Current Assets				
Inventories		18,822	17,611	10,135
Trade and other receivables		43,413	67,868	51,827
Cash and cash equivalents		13,864	11,688	26,647
Total Current Assets		76,099	97,167	88,609
Total Assets		110,571	125,697	116,363
EQUITY				
Issued capital		11,487	11,347	11,349
Share premium		36,038	35,671	35,677
Cumulative translation adjustment		215	266	150
Retained earnings		12,868	18,086	22,576
Total Equity attributable to equity holders of the parent		60,608	65,370	69,752
LIABILITIES				
Non Current Liabilities				
Borrowings		182	242	205
Provisions	7	9,310	10,602	9,304
Total Non Current Liabilities		9,492	10,844	9,509
Current Liabilities				
Trade and other payables		35,274	43,040	31,561
Current tax liabilities		220	628	49
Borrowings		57	52	56
Provisions	7	4,920	5,763	5,436
Total Current Liabilities		40,471	49,483	37,102
Total Liabilities		49,963	60,327	46,611
Total Equity and Liabilities		110,571	125,697	116,363

CONSOLIDATED INTERIM STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Share premium	Cumulative translation adjustment	Retained earnings	Total equity
	£000	£000	£000	£000	£000
Balance at 29 May 2004	11,339	35,647	-	8,152	55,138
Profit for the period	-	-	-	9,561	9,561
Employee share incentive charges	-	-	-	371	371
Issue of shares	8	24	-	-	32
Currency translation adjustments	-	-	266	2	268
Balance at 4 December 2004	11,347	35,671	266	18,086	65,370
Profit for the period	-	-	-	4,119	4,119
Employee share incentive charges	-	-	-	372	372
Issue of shares	2	6	-	-	8
Currency translation adjustments	-	-	(116)	(1)	(117)
Balance at 4 June 2005	11,349	35,677	150	22,576	69,752
Loss for the period	-	-	-	(10,104)	(10,104)
Employee share incentive charges	-	-	-	314	314
Movement in employee share trusts	-	-	-	82	82
Issue of shares	138	361	-	-	499
Currency translation adjustments	-	-	65	-	65
Balance at 3 December 2005	11,487	36,038	215	12,868	60,608

CONSOLIDATED INTERIM CASH FLOW STATEMENT

FOR THE 26 WEEKS ENDED 3 DECEMBER 2005

	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
Cash flows from operating activities			
(Loss)/profit before tax	(9,840)	4,665	8,963
Adjustments for:			
Share based payments charge	314	371	744
Depreciation of property, plant and equipment	1,960	2,198	4,419
Amortisation of development expenditure	3,317	5,025	11,035
Loss on sale of property, plant and equipment	72	-	1
Net financial income	(541)	(119)	(410)
Movement in trade and other receivables	8,414	(6,890)	9,152
Movement in trade and other payables	3,797	1,998	(9,046)
Movement in inventories	(8,687)	(7,605)	(129)
Movement in provisions	(510)	(26)	(1,653)
Cash (used in)/ generated from operations	(1,704)	(383)	23,076
Interest paid	(51)	(67)	(385)
Tax paid	(93)	(69)	(1,378)
Net cash (used in)/ generated from operating activities	(1,848)	(519)	21,313
Cash flows from investing activities			
Acquisition of trade investments	(103)	(200)	(674)
Purchase of property, plant and equipment (PPE)	(3,090)	(1,837)	(3,594)
Development expenditure	(8,839)	(6,709)	(11,851)
Proceeds from sale of PPE	-	2	6
Proceeds from exercise of employee share options	82	18	29
Interest received	572	119	728
Net cash used in investing activities	(11,378)	(8,607)	(15,356)
Cash flows from financing activities			
Proceeds from issue of share capital	499	32	40
Repayment of loans	(22)	(5)	(38)
Net cash generated from financing activities	477	27	2
Net change in cash and cash equivalents	(12,749)	(9,099)	5,959
Cash and cash equivalents at start of period	26,647	20,705	20,705
Effect of exchange rate fluctuations on cash held	(34)	82	(17)
Cash and cash equivalents at end of period	13,864	11,688	26,647

NOTES

1 Basis of preparation

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

Consequently this interim financial information has been prepared on the basis of the recognition and measurement requirements of IFRS in issue that are either endorsed by the EU and effective (or available for early adoption) at 3 June 2006, the Group's first annual reporting date at which it is required to use Adopted IFRS. Based on these IFRS, the directors have made assumptions about the accounting policies expected to be applied when the first annual IFRS financial statements are prepared for the 52-week period ending 3 June 2006.

The Adopted IFRS that will be effective in the annual financial statements for the 52-week period ending 3 June 2006 are still subject to change and to additional interpretations and therefore cannot be determined with complete certainty. Accordingly, the accounting policies for that annual period will be determined finally only when the annual financial statements are prepared for the 52-week period ending 3 June 2006.

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

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. The note below "Business Environment" gives further detail on the nature of some these factors.

These interim financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative instruments.

The interim financial information for the 26-week period ended 3 December 2005 has not been audited, nor has the interim financial information for the 27-week period ended 4 December 2004. The IFRS figures for the 53-week period ended 4 June 2005 are not the Company's statutory accounts for the financial year. These accounts, which were prepared under UK GAAP, have been reported on by the Company's auditors and delivered to the Registrar of Companies. The report of the auditors was unqualified and did not contain statements under Section 237(2) or (3) of the Companies Act 1985.

Business Environment

Strategy
The Group continues to develop its set-top box strategy on three fronts:
- To develop increasingly technologically advanced products
- To match the geographic spread of its business with that of the global payTV operator market
- To identify and exploit opportunities for additional recurring revenue streams

Customers and Markets
The global market for payTV products (primarily set-top box products) is growing, although concentrated within a limited number of operators, some of which are currently in an unprofitable business development phase. The payTV market is attractive, and as with most modern markets, it is highly competitive with Pace's competitors ranging from divisions of large multinational electronics companies to specialist smaller companies. There are a number of barriers to market entry, in particular a requirement for complex post-deployment support to ensure deployed set-top boxes can continue to deliver over time a payTV service as this service grows in size and sophistication.

Orders placed by Pace's payTV customers are typically large one-off orders for delivery over a number of months with supplemental orders for additional volumes. As the eventual deployment of the set-top boxes can be unpredictable, revenues can be volatile. The difficulty in predicting Pace's business flow can be exacerbated by a number of other factors including, for example, the development process for an advanced set-top box which can take over 12 months. The Group works on long lead times (e.g. four months) for component supply and manufacture, typical of the industry. There are third party delivery risks, for example, difficulties in the delivery of components or software code, and the final go ahead for manufacture is usually dependent on product approvals both from the operator that has placed an order and from third parties. In addition, there is a strong customer demand for frequent design revisions that take into account price deflation and introduction of new, more cost effective electronic components. The revision process places increased demand on engineering resources but, at the same time, provides a further barrier to entry to new competitors.

The combined impact of these factors, together with the need to meet customer delivery requirements, imposes risk on Pace's product introduction programme.

Currency Risks

The standard 'industry currency' is the US dollar, with the majority of components and manufacturing capacity purchased in this currency. As a result, due to part of the Group's sales being in Sterling and Euros (the prices of which will be fixed for months in advance), the Group remains exposed to the risk of foreign currency movements. To manage this risk, the Group's treasury policy is to progressively cover cash flows over a six month period, and to seek a greater percentage of US dollar sales to provide a commercial hedge against currency exposures.

Engineering

The Group is dependent on the technological skills of its employees and is working to increase the average skill base at all of the main development sites. At the same time Pace is seeking to outsource a larger part of its development and next generation cost down activity to independent development centres and design and manufacturing partners. During the year a significant number of new products for new customers have been developed. Development costs directly attributable to these products are capitalised according to specified criteria and amortised over the product life. The nature of the development work, and the new product launch dates, will result in a significant capitalisation impact in this year.

To improve business effectiveness, so the Group is better able to manage the significant volume of development work currently underway and in plan, there is a significant internal re-organisation programme in place. The programme, which is nearing completion, has focussed on business processes; in particular improving the effectiveness of Pace's development process and the ability of the Group to outsource more development work.

Third Party and Other Risks

Pace provides product warranties for its set-top boxes. Although it is difficult to make accurate predictions of potential failure rates or the possibility of an epidemic failure, as a warranty estimate must be calculated at the outset of a project before field deployment data is available, these estimates improve during the lifetime of the product in the field.

Pace's products incorporate third party technology, usually under licence. Inadvertent actions may expose Pace to the risk of infringing third party intellectual property rights. Potential claims can still be submitted many years after a product has been deployed. Any such claims are always vigorously defended.

The Group outsources its manufacture to third party specialist electronics manufacturers, in particular Solectron Corporation Inc. Solectron manufactures a significant percentage of the Group's products at plants in Romania and Shenzhen China, with a further plant in Mexico coming on line for Pace in the six months to 3 June 2006.

Regulatory

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

Current Financial Position

The Group has new bank facilities to September 2007, based upon 50% of relevant trade debtors, up to a maximum of £50million.

The Group is working on a number of major new projects for customers, completion dates for which have slipped from original plans, and for which customer acceptance will be required and is expected. To fulfil commitments to these customers, purchase orders for components have been and continue to be raised. Further variations in timings could have a short-term effect on revenues, profits and working capital.

The Board has built these circumstances into their working capital forecasts and modelled a number of business scenarios. Based upon these, whilst recognising that there is some uncertainty, the Board has concluded that the Group has appropriate banking arrangements and that therefore it is appropriate to use the going concern basis of preparation for these interim financial statements.

2 Revenue

	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
The geographical analysis of revenue by destination is as follows:			
United Kingdom	40,064	58,043	106,269
Continental Europe	23,191	71,118	98,095
Asia Pacific	5,176	11,760	24,547
North America	10,509	9,245	23,531
Rest of the World	-	381	884
	78,940	150,547	253,326

3 Restructuring costs

	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
Restructuring and reorganisation costs	970	-	325

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

4 Non-recurring credit

	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
Release regarding reference to Financial Services and Markets Tribunal	-	-	(180)

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

5 Tax (charge)/credit

	26 weeks ended 3 Dec 2005 £000	27 weeks ended 4 Dec 2004 £000	53 weeks ended 4 June 2005 £000
The tax (charge)/credit is based on the estimated effective rate of taxation on trading for the period and represents:			
United Kingdom corporation tax at 30%	-	-	-
Overseas tax	(264)	(110)	(240)
Adjustment in respect of a prior year (see below)	-	4,860	4,760
Deferred tax	-	146	197
	(264)	4,896	4,717

Following the agreement of an outstanding Corporation Tax matter with the Inland Revenue in the UK, a one-off tax credit was taken in the 27 weeks ended 4 December 2004 in respect of a prior year.

6 (Loss)/earnings per ordinary share

Basic (loss)/earnings per ordinary share have been calculated by reference to the (loss)/profit after taxation, and the average number of qualifying ordinary shares of 5p in issue of 220,428,226 (2004: 219,057,810).

Diluted (loss)/earnings per ordinary share vary from basic (loss)/earnings per ordinary share due to the effect of the notional exercise of outstanding share options. The diluted earnings are the same as basic (loss)/earnings. The diluted number of qualifying ordinary shares was 224,995,218 (2004: 224,548,028).

7 Provisions

	Foreign exchange contracts marked to market £000	Royalties under negotiation (see below) £000	Onerous contracts £000	Warranties £000	Total £000
At 4 June 2005	113	6,440	1,026	7,161	14,740
Charge/(credit) for the period	-	136	-	2,750	2,886
Utilised	(113)	(152)	(895)	(2,236)	(3,396)
At 3 December 2005	-	6,424	131	7,675	14,230
Due within one year	-	-	*131*	*4,789*	*4,920*
Due after more than one year	-	*6,424*	-	*2,886*	*9,310*

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

8 Contingent liabilities

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

The Company was informed in the previous period of a potential claim from a former customer relating to the supply of set top boxes in 2000/01 to a maximum liability of c£7.5m. The Directors believe that they have good defences to such a claim and therefore, in the absence of any liability, no provision has been made.

Circulation to shareholders

Copies of this Interim Report will be sent shortly to shareholders and are available on application to the Registered Office: Pace Micro Technology plc, Victoria Road, Saltaire, Shipley, West Yorkshire, BD18 3LF.

There will be an analysts' presentation on 17th January 2006 at 9.30am at Citigate Dewe Rogerson's office at 3 London Wall Buildings, London Wall, London EC2M 5SY.

Appendix 1 – additional notes to the IFRS statements

1. Basis of preparation and summary of significant accounting policies

Basis of preparation

These interim financial statements have been prepared in accordance with the accounting policies the Company expects to adopt in its 2006 annual report. These accounting policies are based on the IAS, IFRS and IFRIC interpretations that the Company expects to be applicable at that time. The IFRS and IFRIC interpretations that will be applicable at 3 June 2006, including those that will be applicable on an optional basis, are not known with certainty at the time of preparing these interim financial statements.

The Group's consolidated financial statements were prepared in accordance with UK GAAP until 4 June 2005. The Company has applied the same accounting policies and methods of computation in these interim financial statements as those published by the Group on 12 July 2005 within its 2005 Annual Report, except as explained in notes 2 and 3 of this appendix, where the effects of changes in accounting policies arising as a result of the adoption of IFRS are set out. Reconciliations between previously reported financial statements prepared under UK GAAP and the IFRS equivalents are presented for profit for the year ended 4 June 2005 and the six months ended 4 December 2004 and net assets as at 4 June 2005, 4 December 2004 and 29 May 2004. Further disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRS are also given in notes 2 and 3 of this appendix.

IFRS 1 provides certain optional exemptions from full retrospective application of all accounting standards effective at the Company's reporting date. As discussed in more detail in the relevant sections below, the Company has taken advantage of the exemptions relating to: business combinations, cumulative translation differences and share-based payment transactions. The Company has not taken advantage of the available optional exemption relating to fair value measurement of financial assets and financial liabilities at initial recognition.

Use of estimates

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Principles of consolidation

The consolidated interim financial statements incorporate the interim financial statements of the Company and all its subsidiaries. Intra-group transactions, including sales, profits, receivables and payables, have been eliminated on the Group consolidation.

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included from the date that control commences until the date that control ceases.

Business combinations

The results of subsidiaries acquired in the period are included in the income statement from the date they are acquired. On acquisition, all of the subsidiaries' assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date.

Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents the excess of the fair value of the consideration paid on acquisition of a business over the fair value of the assets, including any intangible assets identified and liabilities acquired. Goodwill is not amortised but is measured at cost less impairment losses. In determining the fair value of consideration, the fair value of equity issued is the market value of equity at the date of completion, and the fair value of contingent consideration is based upon the extent to which the directors believe performance conditions will be met and thus whether any further consideration will be payable.

As permitted by IFRS 1, goodwill arising on acquisitions before 29 May 2004 (date of transition to IFRS) has been frozen at the UK GAAP amounts subject to being tested for impairment at that date. Goodwill is tested for impairment annually. The Company performs its annual impairment review at the cash-generating unit level. For 2004, goodwill was assigned to the cash-generating units of the Group. The subsequent impairment test showed no goodwill impairment.

Research and development expenditure

All on-going research expenditure is expensed in the period in which it is incurred. Where a product is technically feasible, production and sale are intended, a market exists, and sufficient resources are available to complete the project, development costs are capitalised and amortised on a straight-line basis over the estimated useful life of the product concerned. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Capitalised development expenditure is stated at cost less accumulated amortisation (see below) and impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Goodwill and intangible assets with an indefinite life are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives for development expenditure are estimated to be in a range of between 6 and 18 months.

Impairment charges

The Company considers at each reporting date whether there is any indication that non-current assets are impaired. If there is such an indication, the Company carries out an impairment test by measuring an asset's recoverable amount, which is the higher of its fair value less costs to sell and its value in use (effectively the expected cash to be generated from using the asset in the business). If the recoverable amount is less than the carrying amount an impairment loss is recognised, and the asset is written down to its recoverable amount.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits associated with the transaction will flow into the Company.

Revenue comprises the value of sales of goods and services to third party customers occurring in the period, stated exclusive of value added tax and net of trade discounts and rebates.

Revenue on the sale of goods is recognised when substantially all of the risks and rewards in the product have passed to the customer, which is usually upon delivery to the customer.

Revenue in respect of services rendered, including engineering consultancy and support and software services, is recognised over the period over which they are performed, in relation to the level of work undertaken, project milestones achieved and any future obligations remaining.

Government grants

Grants in respect of specific research and development projects are credited to research and development costs within the income statement to match to the project's related expenditure.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. The Company considers all highly liquid investments with original maturity dates of three months or less to be cash equivalents. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management system are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Allowance for doubtful debts

Trade receivables are assessed individually for impairment, or collectively where the receivables are not individually significant. Movements in the provision for doubtful debts are recorded in the income statement.

Inventory

Inventory is stated at the lower of cost and net realisable value. In general, cost is determined on a first-in-first-out basis and includes transport and handling costs but excludes royalties due only on ultimate sale. Where necessary, provision is made for obsolete, slow-moving and defective inventory.

Property, plant and equipment

The cost of items of property, plant and equipment is its purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off, on a straight-line basis over the expected useful economic lives of the asset concerned, the cost of property, plant and equipment, less estimated residual values, which are adjusted, if appropriate, at each balance sheet date. The principal economic lives used for this purpose are:

Long Leasehold properties	Period of lease
Short Leasehold properties	Period of lease
Plant and machinery	One to ten years
Motor vehicles	Four years

Provision is made against the carrying value of items of property, plant and equipment where an impairment in value is deemed to have occurred.

Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases**.** 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 income statement over the period of the lease.

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

Currency translation

Transactions in foreign currencies are translated at the exchange rate ruling at the date of transaction. Monetary 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 income statement. Exchange differences on the restatement of the net investment in overseas subsidiaries and the difference between the income statement translated at the average rate and the closing rate are recognised directly as a separate component of equity.

Derivative financial instruments

The Group uses derivative financial instruments, usually forward foreign exchange contracts, to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

Taxes

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates that have been enacted or substantively enacted by the balance sheet date. For the purposes of interim statements, the current tax charge is based upon a prudent expectation of the likely full year tax position.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the asset is realised or the liability settled.

A net deferred tax asset is recognised only when it is probable that sufficient taxable profits will be available in the foreseeable future from which the reversal of the temporary differences can be deducted.

Share-based payments

The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. Fair value is measured by use of the Black-Scholes pricing model. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will eventually vest.

The Company has applied the exemption available under IFRS 2, to apply its provisions only to those options granted after 7 November 2002 and which were outstanding at 1 January 2005.

Employee share ownership plans

The material assets, liabilities, income and costs of the Pace Micro Technology plc Employee Benefits Trust and the Pace Micro Technology QUEST are consolidated in the financial statements. Until such time as the Company's own shares vest unconditionally with employees, the consideration paid for the shares is deducted in arriving at equity.

Pension contributions

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred. The Group has no defined benefit arrangements in place.

Investment income

Investment income relates to interest income, which is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Dividends payable

Distributions to equity holders are disclosed as a component of the movement in shareholders' equity. A liability is recorded for a final dividend when the dividend is declared by the Company's shareholders, and, for an interim dividend, when the dividend is paid.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(a) Royalties

A provision for royalties is recognised where the owners of patents covering technology allegedly used by the Group have indicated claims for royalties relating to the Group's use (including past usage) of that technology. The provision is based on the latest information available.

(b) Warranties

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

(c) Restructuring

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Provisions are not recognised for future operating losses.

(d) Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

2. Explanation of transition to IFRS

The Company's financial statements for the year ending 3 June 2006 will be the first annual financial statements that comply with IFRS. These interim financial statements have been prepared as described in note 1 of this appendix. The Company has applied IFRS 1 in preparing these interim financial statements. The last financial statements under UK GAAP were for the 53 week period ended 4 June 2005 and the date of transition was therefore 29 May 2004. Presented below is the reconciliation of profit for the 53 week period ended 4 June 2005 and the reconciliations of equity at 29 May 2004, being the start of that period ("Transition Date") and at 4 June 2005 (date of last UK GAAP financial statements) as required by IFRS 1. In addition, the reconciliation of equity at 4 December 2004 and the reconciliation of profit for the 27 week period ended 4 December 2004 have been included below as required by IFRS 1 to enable a comparison of the 2005 interim figures with those published in the corresponding period of the previous financial year. For explanations of the nature and effect of the changes in accounting policies as a consequence of the transition to IFRS, refer to note 3 of this appendix.

(i) Reconciliations of UK GAAP profit and loss account to IFRS income statement

27 weeks ended 4 December 2004 (date of corresponding interim financial statements)

	Notes	UK GAAP Unaudited £000	Effect of transition to IFRS Unaudited £000	IFRS Unaudited £000
Revenue		150,547	-	150,547
Cost of sales		(125,227)	-	(125,227)
Gross profit		25,320	-	25,320
Administrative expenses				
Research and development	b	(11,831)	1,684	(10,147)
Other administrative expenses	a, d	(10,537)	(90)	(10,627)
Total Administrative expenses		(22,368)	1,594	(20,774)
Operating profit		2,952	1,594	4,546
Financial income		211	-	211
Financial expenses		(92)	-	(92)
Profit before tax		3,071	1,594	4,665
Tax credit		4,896	-	4,896
Profit after tax		7,967	1,594	9,561

(i) Reconciliations of UK GAAP profit and loss account to IFRS income statement (continued)

		53 weeks ended 4 June 2005 (end of last period presented under UK GAAP)		
		UK GAAP	Effect of transition to IFRS	IFRS
		Audited	Unaudited	Unaudited
	Notes	£000	£000	£000
Revenue		253,326	-	253,326
Cost of sales	e	(200,704)	892	(199,812)
Gross profit		52,622	892	53,514
Administrative expenses				
Research and development	b	(23,976)	816	(23,160)
Other administrative expenses	a, d	(21,621)	(180)	(21,801)
Total Administrative expenses		(45,597)	636	(44,961)
Operating profit		7,025	1,528	8,553
Goodwill write back	a	(360)	360	-
Financial income		728	-	728
Financial expenses		(318)	-	(318)
Profit before tax		7,075	1,888	8,963
Tax credit		4,717	-	4,717
Profit after tax		11,792	1,888	13,680

(ii) Reconciliation of UK GAAP profit to IFRS profit

	Notes	27 weeks ended 4 December 2004 £000	53 weeks ended 4 June 2005 £000
Profit after tax as reported under UK GAAP		7,967	11,792
Adjustments for:			
Product development; capitalisation and amortisation	b	1,684	816
Share-based payments; expensed to profit or loss	d	(371)	(744)
FX contracts not revalued in period under UK GAAP	e	-	892
Goodwill not amortised subsequent to Transition Date	a	281	564
Goodwill write back	a	-	360
Profit after tax as reported under IFRS		9,561	13,680

(iii) Reconciliations of equity and liabilities at 29 May 2004 from UK GAAP to IFRS

		As at 29 May 2004		
		UK GAAP	Effect of transition to IFRS	IFRS
	Notes	Audited £000	Unaudited £000	Unaudited £000
ASSETS				
Non Current Assets				
Property, plant and equipment		7,010	-	7,010
Goodwill	a	9,436	-	9,436
Intangible assets – development expenditure	b	-	6,634	6,634
Deferred tax assets	f	-	3,812	3,812
Total Non Current Assets		16,446	10,446	26,892
Current Assets				
Inventories		10,006	-	10,006
Trade and other receivables		60,912	-	60,912
Cash and cash equivalents		20,705	-	20,705
Deferred tax assets	f	3,812	(3,812)	-
Total Current Assets		95,435	(3,812)	91,623
Total Assets		111,881	6,634	118,515
EQUITY				
Share capital		11,339	-	11,339
Share premium account		35,647	-	35,647
Retained earnings	a,b,d,e	2,523	5,629	8,152
Cumulative translation adjustment	c	-	-	-
Total Equity attributable to equity holders of the parent		49,509	5,629	55,138
LIABILITIES				
Non Current Liabilities				
Borrowings		246	-	246
Provisions	f	20,748	(9,580)	11,168
Total Non Current Liabilities		20,994	(9,580)	11,414
Current Liabilities				
Trade and other payables		40,738	-	40,738
Current tax liabilities		587	-	587
Borrowings		53	-	53
Provisions	e,f	-	10,585	10,585
Total Current Liabilities		41,378	10,585	51,963
Total Liabilities		62,372	1,005	63,377
Total Equity and Liabilities		111,881	6,634	118,515

(iv) Reconciliation of equity and liabilities at 4 June 2005 from UK GAAP to IFRS

		As at 4 June 2005		
		UK GAAP	Effect of transition to IFRS	IFRS
	Notes	Audited £000	Unaudited £000	Unaudited £000
ASSETS				
Non Current Assets				
Property, plant and equipment		6,185	-	6,185
Goodwill	a	8,872	564	9,436
Intangible assets – development expenditure	b	-	7,450	7,450
Investments in other companies		674	-	674
Deferred tax assets	f	-	4,009	4,009
Total Non Current Assets		15,731	12,023	27,754
Current Assets				
Inventories		10,135	-	10,135
Trade and other receivables		51,827	-	51,827
Cash and cash equivalents		26,647	-	26,647
Deferred tax assets	f	4,009	(4,009)	-
Total Current Assets		92,618	(4,009)	88,609
Total Assets		108,349	8,014	116,363
EQUITY				
Share capital		11,349	-	11,349
Share premium account		35,677	-	35,677
Retained earnings	a,b,d,e	14,825	7,751	22,576
Cumulative translation adjustment	c	-	150	150
Total Equity attributable to equity holders of the parent		61,851	7,901	69,752
LIABILITIES				
Non Current Liabilities				
Borrowings		205	-	205
Provisions	f	14,627	(5,323)	9,304
Total Non Current Liabilities		14,832	(5,323)	9,509
Current Liabilities				
Trade and other payables		31,561	-	31,561
Current tax liabilities		49	-	49
Borrowings		56	-	56
Provisions	f	-	5,436	5,436
Total Current Liabilities		31,666	5,436	37,102
Total Liabilities		46,498	113	46,611
Total Equity and Liabilities		108,349	8,014	116,363

(v) Reconciliation of equity and liabilities as at 4 December 2004 from UK GAAP to IFRS

		As at 4 December 2004		
		UK GAAP	Effect of transition to IFRS	IFRS
	Notes	Audited £000	Unaudited £000	Unaudited £000
ASSETS				
Non Current Assets				
Property, plant and equipment		6,618	-	6,618
Goodwill	a	9,155	281	9,436
Intangible assets – development expenditure	b	-	8,318	8,318
Investments in other companies		200	-	200
Deferred tax assets	f	-	3,958	3,958
Total Non Current Assets		15,973	12,557	28,530
Current Assets				
Inventories		17,611	-	17,611
Trade and other receivables		67,868	-	67,868
Cash and cash equivalents		11,688	-	11,688
Deferred tax assets	f	3,958	(3,958)	-
Total Current Assets		101,125	(3,958)	97,167
Total Assets		117,098	8,599	125,697
EQUITY				
Share capital		11,347	-	11,347
Share premium account		35,671	-	35,671
Retained earnings	a,b,d,e	10,756	7,330	18,086
Cumulative translation adjustment	c	-	266	266
Total Equity attributable to equity holders of the parent		57,774	7,596	65,370
LIABILITIES				
Non Current Liabilities				
Borrowings		242	-	242
Provisions	f	15,362	(4,760)	10,602
Total Non Current Liabilities		15,604	(4,760)	10,844
Current liabilities				
Trade and other payables		43,040	-	43,040
Current tax liabilities		628	-	628
Borrowings		52	-	52
Provisions	f	-	5,763	5,763
Total current liabilities		43,720	5,763	49,483
Total Liabilities		59,324	1,003	60,327
Total Equity and Liabilities		117,098	8,599	125,697

(vi) Reconciliation of equity from UK GAAP to IFRS

	Notes	29 May 2004 £000	4 December 2004 £000	4 June 2005 £000
Total equity as reported under UK GAAP		49,509	57,774	61,851
Adjustments for:				
Intangible assets; product development capitalised	b	6,634	8,318	7,450
FX contracts not revalued in period under UK GAAP	e	(1,005)	(1,003)	(113)
Goodwill not amortised subsequent to Transition Date	a	-	281	564
Total equity as reported under IFRS		55,138	65,370	69,752

3. Explanation of material adjustments to equity at 4 June 2005, 4 December 2004 and 29 May 2004, and to profit for the year ended 4 June 2005 and for the six months ended 4 December 2004

The transition to IFRS resulted in the following changes in accounting policies:

a. Goodwill

Goodwill is not amortised under IFRS but is measured at cost less impairment losses. Under UK GAAP, goodwill was amortised on a straight-line basis over the time that the Group was estimated to benefit from it. The change does not affect equity at 29 May 2004 because, as permitted by IFRS 1, goodwill arising on acquisitions before 29 May 2004 (date of transition to IFRS) has been frozen at the UK GAAP amounts subject to being tested for impairment at that date, the results of which assessment indicated no such impairment.

Under UK GAAP, goodwill on acquisitions prior to 1 July 1998 was eliminated directly against reserves. The gain or loss on the disposal of a previously acquired business reflects the attributable amount of purchased goodwill in respect of that business. As the Group has opted not to restate business combinations prior to the date of transition, the goodwill written off to reserves under UK GAAP has been frozen and remains in reserves. During the period ended 4 June 2005, the Group completed the liquidation of Pace Italia srl and goodwill previously written off to reserves of £360,000 was recycled to the income statement and charged to the loss on disposal under UK GAAP. This adjustment is not required under IFRS with the result that no gain or loss from the liquidation of Pace Italia srl is reported in the IFRS income statement in contrast to the loss reported under UK GAAP.

b. Research and development; IAS 38 Intangible Assets

Under UK GAAP all expenditure on research and development was expensed as incurred. Under IFRS research expenditure is recognised as an expense as incurred but costs incurred on product development are capitalised as intangible assets when it is probable that the project will be a success, considering its commercial and technological feasibility, resources are available to complete the development and costs can be measured reliably. Other development expenditures are recognised as an expense as incurred. Capitalised product development expenditure is amortised over the expected useful life.

c. Other reserves

As permitted by IFRS 1, the cumulative translation adjustment has been re-set to zero as at 29 May 2004. This has had no effect on net equity but has decreased retained earnings by £473,000 as at 4 June 2005, 4 December 2004 and 29 May 2004 with equal and opposite adjustments to the cumulative translation adjustment reserve.

d. Share-based payments

The Group issues equity-settled share-based payments to certain employees. In accordance with IFRS 2, equity-settled share-based payments are measured at fair value at the date of grant, in respect of options granted after 7 November 2002 and which were outstanding at 1 January 2005. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest. Under UK GAAP, the charge recorded represented the difference between the share price at the date of grant and the exercise price of the option. In addition, the Group took advantage of an exemption under which no charge was made in respect of SAYE options. Thus, under UK GAAP, no charge was made in respect of share-based payments.

e. Derivative Financial Instruments

The IFRS standards relevant to the accounting for, and presentation of, financial instruments are IAS 32 *Financial Instruments: Disclosure and Presentation*, and IAS 39 *Financial Instruments: Recognition and Measurement*. The differences between IFRS and UK GAAP which are immediately relevant to the Group are the requirement to recognise all derivatives on the balance sheet (which are then "marked-to-market" each reporting period to reflect their fair value), and the detailed requirements that have to be met to qualify for hedge accounting.

f. Balance Sheet reclassifications

Provisions have been reclassified into amounts falling due within one year and amounts falling due after more than one year.

Deferred tax assets have been reclassified as Non Current Assets.

g. Exemptions

IFRS 1 First-time Adoption of International Financial Reporting Standards sets out the transition rules, which must be applied, when IFRS is adopted for the first time. The standard sets out certain mandatory exemptions to retrospective application and certain optional exemptions. The most significant optional exemptions available and taken by the Group are as follows:

(i) Share-based transactions; the Group adopted the exemption in IFRS 1 which allows a first-time adopter to apply the new standard only to share options and equity instruments granted after 7 November 2002 that have not vested by 1 January 2005.

(ii) Cumulative translation differences; under IAS 21 The Effects of Changes in Foreign Exchange Rates cumulative translation differences within reserves are recycled from equity to the income statement on disposal of a foreign operation. In order to eliminate the need to retrospectively apply this requirement, the Group took the exemption to set cumulative translation differences to zero at the date of transition.