

**MACFARLANE GROUP PLC**

**Report and Financial Statements**

**31 December 2002**





## OUR STRATEGY

Macfarlane Group's strategy is clear with a focus to be a leading distributor and value added service provider in the packaging industry

## OUR NETWORK

Macfarlane Group's UK and international network of operations offers customers a competitive and consistent service

### OUR 5 UK REGIONS

- 1 Scotland and North East
- 2 North West
- 3 West Midlands and South West
- 4 East Midlands
- 5 South Midlands, South East and South Coast

### GLOBAL OPERATIONS

- Ireland
- USA
- Mexico
- Sweden
- Hungary

### Regional Distribution Centre

Labels

Electronics

Injection Moulding

## CHAIRMAN'S STATEMENT

Macfarlane Group's 2002 results reflect the ongoing transition within our distribution business, which will conclude in 2003. Recently issued economic statistics, identifying lower levels of activity in the manufacturing sector in the first two months of this year, are confirmed by our activity levels. The difficult market conditions, referred to in my previous statements, continue with no indication of improvements in the short-term. Management effort continues to focus on the transition programme to change fundamentally the shape and scope of our business, enabling the Group to provide best in class service to all our customers whilst at the same time seeking reductions in overheads to right-size our cost structure to match prevailing levels of activity. The majority of this programme is now completed and the teams in our new locations are now ready and eager to deliver the expected benefits.

Your Board remains fully committed to the strategic direction, which will see the replacement of over 45 trading branches and manufacturing sites with the creation of a national network of 15, state-of-the-art, regional distribution centres coupled with two manufacturing centres of excellence, providing a solid platform to take advantage of future growth opportunities. Although we made the expected progress towards our objectives in the second half of the year, with 11 of the 15 locations now fully operational and our new management information system in place at all UK locations, the transition has taken longer to achieve and caused greater costs and disruption in the business than originally envisaged, with a consequent impact on results. Consolidation at four remaining locations, originally scheduled in 2002, will now take place in 2003. The considerable dislocation of the business, which is inevitable during a programme of such magnitude, is now starting to recede enabling our staff to focus on increasing market share. As announced last October, the Chief Executive will continue to focus on the recovery in the Distribution business. The Board has now initiated a process to recruit a Chief Operating Officer with wide business experience, who should have the potential to become Chief Executive.

The teams in our new locations are now ready and eager to deliver the expected benefits

As I have stated previously, this is a bold and challenging realignment of our business, particularly in the current economic climate. The programme will complete this year with further disposals of surplus properties continuing to deliver cash and earnings to support the costs of the transition. As reported in previous statements, although the benefits are taking longer to achieve than originally envisaged, your Board remains confident that Macfarlane Group can secure a strong market position, particularly once the trading cycle starts to show signs of improvement. We are not relying on the economy to make any recovery in 2003 and consequently we are cautious in terms of the immediate trading outlook, nevertheless your Board expects to make further progress streamlining the business in the current year.

### FINANCIAL PERFORMANCE

	2002		2001	
	Sales £000	Profit/(loss) £000	Sales £000	Profit/(loss) £000
Packaging	149,618	(1,951)	159,623	8,234
Discontinued/Plastics	-	-	38,577	2,767
	149,618		198,200	
(Loss)/profit before interest and exceptional charges		(1,951)		11,001
Net finance charge		(398)		(418)
(Loss)/profit before exceptional charges		(2,349)		10,583
Gain on disposal of properties		2,145		822
		(204)		11,405
Operating exceptional charges		(5,044)		(10,058)
Loss on disposal of business		(410)		(2,770)
Pre-tax loss		(5,658)		(1,423)

The loss before tax for the year to 31 December 2002 was £5.7m, compared to £1.4m in 2001. The loss per share, as restated for the effects of applying FRS 19 "Deferred Tax", totalled 3.25p compared with 3.63p in the previous year. Turnover reduced to £149.6m in 2002 from £198.2m in 2001, reflecting the business disposals in 2001 and challenging market conditions with lower levels of activity apparent particularly from electronics and manufacturing customers.

### PROPERTY DISPOSALS

Your Board has consistently articulated that part of its strategy of reshaping the business is to fund the transition through the earnings and cash generated from property disposals. This is reflected in our 2001 and 2002 results and even as we near the end of the programme, will continue into 2003 and 2004 with anticipated net proceeds from disposals in these two years in excess of £12.0m.

## DIVIDEND

The directors recommend payment of a final dividend of 3.20p to be paid on 29 May 2003 to shareholders on the register at 25 April 2003, which together with the interim dividend of 1.80p per share paid on 10 October 2002 makes a total of 5.00p for the year (2001 - 5.00p). Whilst your Board remains cautious of immediate trading prospects as market conditions continue to be challenging, we are well aware of the importance of dividends to shareholders and would intend to use funds from property disposals to support existing levels of dividend. However the level of dividend payments will, as always, require to be considered as prospective trading performance becomes clearer, allowing the Board to assess the immediate and longer-term ability to underpin dividend payments.

## FINANCE

Shareholders approved two special resolutions on 9 May 2001 and 14 May 2002 giving the Company authority to buy back shares in the Company. During 2002, the Company bought back 4,256,000 ordinary shares, representing 3.57% of the Company's called up share capital for a total consideration of £2,608,000 for cancellation. The purchases took place at a number of dates between 14 January 2002 and 13 November 2002. The prices paid for the shares ranged from 38½p per share to 87p per share. It is the Directors' intention to seek shareholder approval to renew this authority at the AGM on 13 May 2003 to continue to have the flexibility to buy back shares should this be appropriate.

Cash outflow from operating activities was £0.3m (2001 cash inflow - £17.7 million) and the Group's financing requirements have been met by short-term borrowings. Following acquisitions and capital expenditure totalling £14.4m during the year and share buy-backs costing £2.6m the Group had net debt of £14.0m at 31 December 2002, compared to net funds of £2.7m the previous year. There was a net interest charge of £0.4 million, the same as in 2001. Macfarlane Group still faces modest investments to establish an appropriate base for future growth but our executive remains confident that, by a continued realignment of the asset base, the necessary investments can be funded in a cash neutral manner.

The transitional arrangements of Financial Reporting Standard 17 on retirement benefits have again been adopted, requiring certain disclosures at 31 December 2002 of the net pension scheme asset or deficit. Our UK defined benefits pension scheme has a deficit net of tax of £11.6m (2001 deficit £4.8m). The ongoing funding of the pension scheme is determined by a full actuarial valuation performed by the Group's independent actuary. As a result of the valuation carried out on 1 May 2002, the final salary scheme was closed to new entrants and the employer contribution rate increased from 13.5% to 15.5% of pensionable salary, and the employee contribution rate increased from 5.0% to 7.0% of pensionable salary with effect from 1 July 2002. This contribution level is expected to reverse the deficit over the estimated remaining service lives of the employees.

## MANAGEMENT AND EMPLOYEES

Delivering the benefits from such a fundamental transition programme in our business is no easy task. We have a number of good management teams with a wealth of experience in packaging as well as some exciting new talent. All our management teams and employees deserve our continuing gratitude for their commitment in addressing the challenges readily evident in today's business environment as well as taking the hard decisions necessary to obtain the benefits from the restructuring programme.

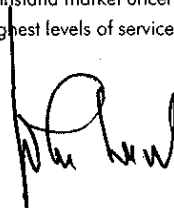
## FUTURE PROSPECTS

Macfarlane Group's strategy is to be a leading packaging distributor and value added service provider. Investments in manufacturing will be made where it can provide robust and sustainable earnings while providing critical manufacturing skills to augment both the benefits of scale now within the Group and the extensive choice of products available to our 50,000 customers.

Our property divestment programme continues and is expected to generate additional profits and cash in 2003 to offset the costs of transition. Major progress has been made in recent months to exit vacant premises and this will have a major impact in our efforts to reduce our cost base. Although the expected benefits in our Distribution business are taking longer to achieve and causing greater disruption than originally envisaged, *there are encouraging signs that where the transition has been completed, our people are ready to deliver the benefits of the strategy.* Your Board believes that our distribution business will benefit in 2003 from the actions being taken to streamline the business.

Market activity, particularly in recent months, remains at lower than expected levels. Whilst trading conditions remain challenging and the prospects of economic growth in 2003 are limited, much of our recent activity has been of necessity inward focused given the need to concentrate our activities on our people, new premises and the introduction of the new information systems. As the greater part of this activity is now behind us, our teams have a real appetite and a clear opportunity to focus on increasing our market share.

The Board believes that the strategic direction of the Group is sound and the continuing steps being taken to streamline the business will strengthen trading prospects by reducing the Company's cost base. The Board's objective is to ensure that a robust business is created, which can not only withstand market uncertainty, but also gain market share by providing the highest levels of service to our customers.



SIR JOHN WARD CBE  
Chairman

## OPERATING REVIEW

### TRADING PERFORMANCE

The restructuring of the Distribution business continued throughout the year, with 23 sites closed by the end of 2002, in most cases simply eliminating duplication of sites in key regions, consolidating all these sites into 11 large, more efficient centres providing a platform for future growth. In 2003 there are a further 4 consolidations on to new sites, with the closure of a further 7 sites during the year.

Whilst economic conditions have impacted our ability to achieve profitability in the Distribution business in the final quarter of 2002 and the opening months of 2003, the steps being taken to right-size the overhead base in the Company, reducing breakeven points, are expected to bear fruit as the advantages of our new capability provides the opportunity to increase market share. However given current economic conditions, it is likely to take until the final quarter of 2003 to achieve profitable trading across the business as a whole.

Our Labels and Plastic Injection Moulding businesses continue to be at the forefront of technology in providing solutions for major customers with branded products. Both businesses have made considerable efforts to grow sales with existing customers and develop into new markets. Our Packaging Manufacturing business has continued to reduce its cost base and become more efficient. Whilst our strategy and focus continues to shift from selling only what we traditionally manufactured to sourcing what customers request, we will maintain and invest in value added manufacturing and assembly businesses where this is determined to be of strategic benefit in providing the required service to our customers.

All our overseas locations continued to trade in line with expectations throughout 2002, with particularly strong performances recorded in Ireland and in Hungary. Macfarlane Western Foam Inc., our business based in California, acquired the trade and assets of a smaller competitor in the same geographical area and is now starting to reap the benefits of the additional scale in its operations.

*Our new capability provides  
the opportunity to increase  
market share*

## **A STRATEGIC NETWORK FOR ENHANCED SERVICE**

Our customers require to have all their packaging needs serviced on a national, centrally-managed basis, whilst still enjoying the benefits of a local branch network with local stock holding and next day deliveries.

## OPERATING REVIEW continued

In July 2002 we acquired Tom Brands Electrical Services Limited ("Brands"), supporting our strategy to provide a wider range of services to key customers. The acquisition provides opportunities to meet the requirements of major customers seeking partners who can demonstrate a capability to meet outsourcing needs both in the UK, USA, Latin America and Europe. Brands' operation in Mexico and our Hungarian operation are good examples of the opportunity to develop this strategy overseas.

The Board believes that there are considerable opportunities from the acquisition of Brands, both in approaching Brands' own customers and supporting the service offering to Macfarlane Group's customers. This acquisition is now being integrated into the Group to support the service offering to customers using Brands' sophisticated track and trace software. The potential is being tested through a number of enquiries, which will help quantify the opportunity for future sales but given current economic conditions the timing of the conversion of these opportunities is uncertain and as a result the Directors consider that it would be inappropriate to maintain the goodwill, which arose on acquisition. An impairment charge of £2,720,000 was taken against the cost of the investment in Tom Brands Electrical Services Limited. The impairment review considered discounted cash flows, appropriately adjusted to reflect the current economic climate and the uncertainty in the timing of converting opportunities into sales.

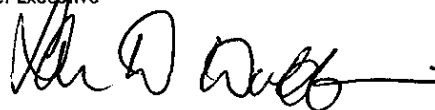
**We have a safe working environment for  
the benefit of our employees, customers,  
shareholders and the communities around  
us, in each country in which we operate**

### HEALTH SAFETY AND THE ENVIRONMENT

In Macfarlane Group our goal is to ensure that we have a safe working environment for the benefit of our employees, customers, shareholders and the communities around us, in each country in which we operate. Good Health Safety and Environmental ("HSE") management not only protects our stakeholders and the environment, it also makes a positive contribution to our business. We are committed to continuous improvement in our HSE performance as we strive to balance the need to reduce and control the HSE impact with our aspirations for growth.

Site ownership of health and safety, fire safety and environmental responsibilities rests with our local teams who are encouraged to adhere to the Group's objectives for HSE. We shall support our staff by assisting them to develop their understanding of the implications of their actions and guiding them to take appropriate steps to improve matters.

IAIN D. DUFFIN  
Chief Executive



## **LEADING EDGE SOLUTIONS**

We have made further investments to enhance our design capabilities which will enable us to provide our customers with high quality cost effective packaging.

## FINANCIAL REVIEW

Group turnover for the year reduced to £149.6 million from the previous year's figure of £198.2 million. Losses before exceptional restructuring charges and the losses on disposal of business amounted to £0.2 million, compared to profits of £11.4 million in 2001.

### INTEREST AND BORROWINGS

Net interest payable amounted to £0.4 million the same as in 2001. The interest charge is relatively modest, despite continued capital expenditure, the cash cost of acquisitions and borrowings inherited from these acquisitions.

### DIVIDENDS AND TAXATION

The Directors have declared a final dividend of 3.20p, maintaining the level paid in 2001, reflecting the Group's anticipated cash flows in 2003. The final dividend will be paid on Thursday 29 May 2003 to those shareholders on the register at the close of business on Friday 25 April 2003.

The overall rate of tax for the year was 32.4% compared with 16.4% on earnings before exceptional charges and credits the previous year (as restated for FRS19). The prior year tax charge is below the standard rate, due to the availability of capital losses, which covered the capital gain on disposal of certain properties.

### CAPITAL EXPENDITURE AND ACQUISITIONS

During the third quarter of 2002, Macfarlane Group acquired Tom Brands Electrical Services Limited and Brands Electronics de Mexico SA, de CV, an outsourcing specialist, and the trade and assets of Pacific Tech Products Inc. at a cash cost of £7.5m. In addition the Group spent nearly £6.9m on capital expenditure in 2002 and continues to invest where there are needs or opportunities to meet future growth plans.

During the period from January 2002 until November 2002, Macfarlane Group repurchased a total of 4,256,000 ordinary shares of 25p each, at an average price of 61p and a total cost of £2.6m for cancellation. The repurchases were in line with the authority given at recent Annual General Meetings and enhance earnings per share. It is the intention of the Board to continue to make tactical share buy-backs in accordance with the authority limits given, provided there is a clear enhancement to earnings per share. The Directors will seek shareholder approval to renew this authority at the AGM in May 2003 to continue to have the flexibility to buy-back shares in the coming year.

### FUNDING AND CASH FLOW

Cash outflow from operating activities was £0.3m (2001 cash inflow – £17.7 million) and the Group's financing requirements have been met by short-term borrowings. Access to adequate funds is ensured by maintaining committed levels of borrowing facilities. Bank facilities are in place to meet the Group's future anticipated financing requirements.

Following the acquisitions and the capital expenditure totalling £14.4m during the year and share buy-backs costing £2.6m the Group had net debt of £14.0m at 31 December 2002, compared to net funds of £2.7m the previous year. There was a net interest charge of £0.4 million, the same as in 2001. Macfarlane Group still faces modest investments to establish an appropriate base for future growth but our Executive remains confident that, by a continued realignment of the asset base, the necessary investments can be funded in a cash neutral manner.

The transitional arrangements of FRS 17 on retirement benefits have again been adopted, requiring certain disclosures at 31 December 2002 of the net pension scheme asset or deficit. Our UK defined benefits pension scheme has assets at current market value of £29.5m (2001 – £33.2m) and liabilities discounted using specified bond yields of £46.1m (2001 – £40.0m). On this valuation basis there is a deficit of £16.6m (2001 – £6.8m), which is partially offset by a deferred tax asset of £5.0m (2001 – £2.0m) giving a net deficit of £11.6m (2001 – £4.8m).

## SHAREHOLDERS' FUNDS

Shareholders' funds have decreased from £70.7 million to £58.5 million. Losses set against reserves amounted to £9.6 million. The cost of purchasing shares for cancellation resulted in a charge to reserves of £2.6 million.

At the year end the Company's market capitalisation was £38.5 million, compared with £90.6 million last year. The share price at 31 December 2002 was 33½p, compared with 76p at 31 December 2001.

At our Annual General Meeting on 14 May 2002, the Board obtained shareholder approval to buy back up to 15% of the shares in the Company and has used this facility to make tactical share buy-backs. It is the Directors' intention to seek shareholder approval to renew this authority at the AGM in May 2003 to continue to have the flexibility to buy back shares.

## FINANCIAL INSTRUMENTS

The Group's principal financial instruments comprise borrowings, cash and short-term deposits, and other items, such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising are interest rate risk, liquidity risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged since the beginning of 2002.

### Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings, where necessary. The Group borrows in the desired currencies at floating rates of interest. Interest rate exposures are reviewed regularly and financial instruments considered. At present it is not deemed necessary to cover these exposures by financial instruments.

### Liquidity risk

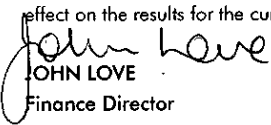
Whilst the Group currently holds balances in cash and short-term deposits, the Group's policy with regard to liquidity remains ensuring adequate access to funds by maintaining appropriate levels of overdraft facilities, which are then reviewed on a regular basis. The maturity profile of debt outstanding at 31 December 2002 is set out in notes 16 and 17 to the accounts.

### Currency risk

The Group has six overseas subsidiaries, two operating in Ireland and the others operating in the USA, Mexico, Sweden and Hungary. Revenues and expenses are denominated exclusively in Euros, US dollars, Swedish krone and Hungarian forints respectively. As a result, movements in the Euro/sterling, US dollar/sterling, Swedish krone/sterling and the Hungarian forint/sterling exchange rates, could affect the Group's sterling balance sheet. The Group's policy during 2002 has been to review the need to hedge exposures on a monthly basis. No hedging was deemed necessary in 2002 in respect of these exposures. For 2003 onwards the Group's policy will continue to be to review the need to hedge such exposures on a monthly basis.

## ACCOUNTING POLICIES

The Group continues to comply with all mandatory Financial Reporting Standards and has adopted the reporting requirements of the new FRSs issued during the year as set out in the accounting policies on page 26, again adopting the transitional provisions of FRS 17. The Company has adopted FRS 19 in these accounts, reflecting a prior period adjustment on the results for the preceding financial year, but other than this it is the Directors' view that the adoption of these FRSs has not had a material effect on the results for the current year.

  
JOHN LOVE  
Finance Director

## DIRECTORS AND ADVISERS

### **SIR JOHN WARD CBE Non-Executive Chairman**

Joined the Group Board on 1 January 1996 and was appointed Chairman at the Annual General Meeting in May 1998 and is the Chairman of the Nominations Committee. A chartered accountant aged 62, he is the Chairman of Scottish Qualifications Authority, European Assets Trust NV and Chairman of the Governing Body of Queen Margaret University College in Edinburgh. In December 2002 John was appointed Chairman of Dunfermline Building Society. He was knighted in the 2003 New Year's Honours list for services to Public Life.

### **GRAHAM CASEY Executive Director**

Aged 43, Graham joined Macfarlane Group's labels business in 1976. He became Managing Director of the business in 1999 and was appointed as the Chief Executive of the newly formed Packaging Division in January 2001. Graham joined the Group Board on 1 June 2001.

### **IAIN DUFFIN Group Chief Executive**

Iain Duffin was appointed Group Chief Executive on 14 June 1999. Aged 56 he was with Hughes MicroElectronics from 1968, becoming Managing Director in 1983, becoming CEO of Hughes MicroElectronics Europe, then moving to Hughes Aircraft in the United States. Iain moved to ITT Cannon in 1997 to become Corporate Vice President and then accepted the position of Senior Vice President of LucasVarity based in the UK. In 2000 Iain was appointed Non-Executive Chairman of Origo Services, a company facilitating the development of e-commerce applications in the financial services market and is also a Non-Executive Director of Stagecoach Holdings plc.

### **JOHN LOVE Group Finance Director**

A member of the Institute of Chartered Accountants of Scotland, he has been with the Group for seven years and was appointed Group Finance Director on 12 July 1999. Aged 42, John was with Deloitte & Touche and its predecessor firms for sixteen years before moving to Macfarlane Group in 1996.

**SIR JOHN WARD**

**IAIN D. DUFFIN**

**GRAHAM H. CASEY**

**JOHN LOVE**

**ARCHIE HUNTER Non-Executive Director**

Appointed on 1 October 1998, he was formerly the senior partner of KPMG in Scotland. Aged 59, Archie was a member of KPMG's UK Governing Body from 1992 until 1999 and is also a past President of The Institute of Chartered Accountants of Scotland. Archie is a Non-Executive Director of The Beatson Cancer Research Institute and chairs the Court of Strathclyde University. He is Chairman of the Remuneration Committee and a member of the Audit Committee and Nominations Committee.

**BOB SPEIRS Senior Independent Director and Non-Executive Director**

Appointed on 1 October 1998, Bob was Group Finance Director of The Royal Bank of Scotland plc until 23 October 1998. Aged 66, his other directorships include the posts of Chairman of Stagecoach Holdings plc, Bell Group plc and The Miller Group Limited and Non-Executive Director of Martin Currie Income & Growth Trust plc and Canary Wharf Group plc. Bob is a member of the Audit, Nominations and Remuneration Committees and is Macfarlane Group's Senior Independent Director.

**GUY STENHOUSE Non-Executive Director**

Appointed on 26 May 1998, he is a director of Noble Grossart Limited the Edinburgh based merchant bank and a Non-Executive Director of CALA Group Limited. Aged 41, Guy is Chairman of the Audit Committee and a member of the Nominations Committee and the Remuneration Committee.

**ANDREW COTTON Company Secretary**

Andrew joined Macfarlane Group in 1999 as Finance Director in the labels business. He then moved to Macfarlane Group's offices in Glasgow in the first half of 2001 supporting the Executive in corporate activity. Andrew was appointed Company Secretary on 3 August 2001.

**ARCHIE S. HUNTER**

**R. GUY T. STENHOUSE**

**BOB SPEIRS**

**ANDREW COTTON**

**REGISTRATION NUMBER**

No. 4221  
Registered in Scotland

**COMPANY SECRETARY**

Andrew Cotton

**REGISTERED OFFICE**

21 Newton Place,  
Glasgow  
G3 7PY

Tel: 0141 333 9666  
Fax: 0141 333 1988

**PRINCIPAL BANKERS**

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Corporate Banking West,  
123 St. Vincent Street,  
Glasgow G2 5EA

HSBC Bank plc,  
2 Cloth Hall Street,  
Huddersfield HD1 2ES

**SOLICITORS**

Wright Johnston &  
Mackenzie,  
302 St Vincent Street,  
Glasgow G2 5RZ

Dundas & Wilson,  
191 West George Street,  
Glasgow G2 2LD

**STOCKBROKERS**

HSBC Bank plc,  
Level 18,  
8 Canada Square,  
London E14 5HQ

Speirs & Jeffrey Limited,  
36 Renfield Street,  
Glasgow G2 1NA

**INDEPENDENT AUDITORS**

Deloitte & Touche,  
Glasgow

**REGISTRARS**

Lloyds TSB Registrars  
Scotland,  
PO Box 28448,  
Finance House,  
Orchard Brae,  
Edinburgh EH4 1QW

## REPORT OF THE DIRECTORS

The Directors present their annual report and the audited financial statements of the Group for the year ended 31 December 2002.

### PRINCIPAL ACTIVITIES

There have been no significant changes in the activities of the Company and its subsidiaries, which continue to be the manufacture and distribution of packaging, specialist printing and the provision of storage, warehousing and haulage services. During the year the Group acquired Tom Brands Electrical Services Limited and Brands Electronics de Mexico SA, de CV, an outsourcing specialist, and the trade and assets of Pacific Tech Products Inc. with the details as set out in note 23. Details of the principal subsidiary companies and their activities are set out on the inside back cover.

### REVIEW OF THE BUSINESS

A review of the business during and following the end of the financial year and comments on future developments in the Group are contained in the Chairman's Statement and the Operating and Financial Reviews on pages 2 to 9.

### RESULTS AND DIVIDENDS

The Group's loss on ordinary activities before taxation was £5,658,000 after recording a gain on disposal of fixed assets of £2,145,000 and charging operating exceptional costs of £5,044,000 and a loss on disposal of business of £410,000. (2001 - loss on ordinary activities before taxation was £1,423,000 after recording a loss on disposal of business of £2,770,000, a gain on disposal of fixed assets of £822,000 and charging operating exceptional costs of £10,058,000). The directors recommend payment of a final dividend of 3.20p to be paid on 29 May 2003 to shareholders on the register at 25 April 2003, which together with the interim dividend of 1.80p per share paid on 10 October 2002 makes a total of 5.00p for the year (2001 - 5.00p). Losses for the year amounting to £9,567,000 will be set against reserves (2001 - £10,544,000).

### SHARE CAPITAL

At the last Annual General Meeting the directors were given authority to allot further ordinary shares for cash beyond those committed to the share option schemes up to an aggregate amount of £1,490,313. That authority expires at the conclusion of the forthcoming Annual General Meeting. A resolution will be put to shareholders to renew for a further year the authority over the existing unissued and uncommitted ordinary share capital. This authority is limited to a maximum nominal amount of £1,437,738.

Shareholders approved two special resolutions on 9 May 2001 and 14 May 2002 giving the Company authority to buy back shares in the Company. During 2002, the Company bought back 4,256,000 ordinary shares, representing 3.57% of the Company's called up share capital for a total consideration of £2,608,000 for cancellation. The purchases took place at a number of dates between 14 January 2002 and 13 November 2002. The prices paid for the shares ranged from 38½p per share to 87p per share.

The Board intends to continue to use this facility to make tactical share buy-backs. It is therefore the Directors' intention to seek shareholder approval to renew this authority at the AGM on 13 May 2003 to buy back up to 15% of the shares in the Company.

### SUBSTANTIAL HOLDINGS OF SHARES IN THE COMPANY

The Company has received notification that at 25 March 2003 the following members held more than 3 per cent of the ordinary share capital of the Company.

	Holding	Percentage
Funds managed or advised by		
Credit Suisse Asset Management Limited	13,041,454	11.34%
Funds managed or advised by		
Deutsche Morgan Grenfell	7,554,378	6.57%
Funds managed or advised by		
Schroder Investment Management Limited	7,527,083	6.54%
Lord Macfarlane of Bearsden KT and Lady Macfarlane	4,783,170	4.16%
Funds managed or advised by		
Prudential plc/M&G Investment Management	4,425,000	3.85%
Funds managed or advised by		
Legal & General Investment Management	4,297,762	3.74%
Funds managed by		
Lion Trust Asset Management Limited	4,144,196	3.60%
J. Godfrey Lane and Mrs Winnifred L. Lane	4,000,000	3.48%
The Alliance Trust PLC and The Second Alliance Trust PLC	3,732,024	3.24%

## BOARD OF DIRECTORS

The names of the Directors who served throughout the year together with short biographical details are set out on pages 10 and 11.

I.D. Duffin and J. Love retire by rotation at the Annual General Meeting in 2003 and in accordance with the Articles of Association offer themselves for re-election. I.D. Duffin has a service contract with the Company for a period of one year, although the notice period would extend to two years in the event of a takeover of the Company before 13 June 2003. J. Love has a service contract with the Company for a period of one year.

No director, either during or at the end of the financial year, had an interest in any contract relating to the business of the Company or any of its subsidiaries. The statement of directors' interests in the ordinary share capital of Macfarlane Group PLC is contained in note 3 on page 29.

## DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

The Company has maintained directors' and officers' liability insurance cover throughout the financial year.

## EMPLOYEE SHARE SCHEMES

During the year no ordinary shares were issued on the exercise of options under the Group's share option schemes.

Options over 625,000 ordinary shares were granted during the year. These options were granted on 5 April 2002 at a price of 88p per share under The Macfarlane Group Company Share Option Plan 2000 and The Macfarlane Group PLC Executive Share Option Scheme 2000. These options are exercisable between 5 April 2005 and 5 April 2012, subject to the satisfactory completion of the scheme's conditions. Options over 1,336,576 ordinary shares in the Company's share option schemes lapsed during 2002.

Details relating to options granted to parent company directors are set out in note 3 on pages 29 and 30. All remaining options outstanding under the Company's share option schemes at 31 December 2002 are set out in note 20 on page 38.

The Board and Remuneration Committee have conducted a review of the Company's remuneration policy in the light of the recommendations in the Combined Code, the views of institutional shareholders and current market practice. It has considered appropriate long-term incentive schemes for senior management and has concluded that share option schemes remain the most effective type of long-term incentive for the Company.

The Remuneration Committee supervises the grant of options, which are only capable of being exercised if the performance condition to which they are subject has been satisfied. The Remuneration Committee will specify the performance condition at the time of the grant of the option, having regard to the objectives of the Company and to market practice

at the relevant time. Details of the performance conditions are set out in The Directors' Remuneration Report.

In 2002 £174,000 (2001 – £227,000) was allocated to the Trustees of the Macfarlane Group All Employee Share Ownership Plan for the appropriation of ordinary shares to eligible employees.

The Macfarlane Group Savings Related Share Option Scheme 2000 was also introduced in 2001 with the intention of encouraging employees to take up shareholdings in the Company. Options over 2,033,959 ordinary shares were granted on 9 May 2001 at a price of 59p per share. These options are exercisable after 1 July 2004, subject to the satisfactory completion of the scheme's conditions. Options over 960,052 shares (2001 – 222,283 shares) lapsed during the year.

## ACQUISITIONS

The Company acquired the whole of the issued share capital of Tom Brands Electrical Services Limited and Brands Electronics de Mexico SA, de CV on 4 July 2002, and Macfarlane Western Foam Inc. acquired the business and assets of Pacific Tech Products Inc. on 11 July 2002. Further information on these acquisitions is contained in note 23 on page 39.

## FIXED ASSETS

The movements in tangible assets are set out in note 12 on pages 33 and 34. Significant changes during the year arose from investments in new plant and equipment and the sale of surplus buildings in the Group's property portfolio.

## ENVIRONMENTAL POLICY

*In Macfarlane Group our goal is to ensure that we have a safe working environment for the benefit of our employees, customers, shareholders and the communities around us, in each country in which we operate. Good Health Safety and Environmental ("HSE") management not only protects our stakeholders and the environment, it also makes a positive contribution to our business. We are committed to continuous improvement in our HSE performance as we strive to balance the need to reduce and control the HSE impact with our aspirations for growth.*

It is Group policy to attempt to minimise the impact of our activities on the environment whilst seeking to safeguard it. The Group is a member of Valpak, a legal compliance scheme which aims to recycle packaging and develop markets for recycled products. A number of the Group's manufactured products contain a high proportion of recycled material.

## REPORT OF THE DIRECTORS

### EMPLOYMENT OF DISABLED PERSONS

The Group policy is to encourage the employment of disabled persons where the disabilities do not handicap these persons in the performance of their duties. Where an employee becomes disabled every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. Registered disabled persons, once employed, receive equal opportunities for training, career development and promotion.

### EMPLOYEE INVOLVEMENT

The Group recognises the importance of meaningful communication and consultation in maintaining good employee relations. Group policy of having efficient autonomous units facilitates the involvement of employees in the businesses in which they work, either through joint committees or less formal but equally effective methods of communication and consultation.

### SUPPLIER PAYMENT POLICY

The Group recognises the importance of maintaining good business relationships with its suppliers. Group policy is to negotiate terms with suppliers and settle liabilities in accordance with these terms. All companies in the Group follow this policy and the staff who deal with payments to suppliers are made aware of it. Further details of the policy are made known to suppliers on request. At 31 December 2002 the Company had an average of 39 days purchases outstanding in trade creditors.

### POLITICAL AND CHARITABLE CONTRIBUTIONS

No charitable contributions or political donations were made during the current or preceding financial year.

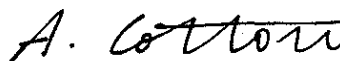
### CLOSE COMPANY STATUS

The Company is not a close company within the provisions of the Income and Corporation Taxes Act 1988.

### AUDITORS

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to re-appoint them will be proposed at the forthcoming Annual General Meeting.

By Order of the Board



ANDREW COTTON

Company Secretary

21 Newton Place

Glasgow G3 7PY

25 March 2003

# CORPORATE GOVERNANCE

## INTRODUCTION

The Company is committed to the principles of corporate governance contained in the Combined Code on Corporate Governance ("the Combined Code"), which is appended to the Listing Rules of the Financial Services Authority ("the Listing Rules").

## COMPLIANCE STATEMENT

Throughout the year ended 31 December 2002 the Company has been in compliance with the Code provisions set out in Section 1 of the Combined Code on Corporate Governance.

## APPLICATION OF THE PRINCIPLES OF GOOD CORPORATE GOVERNANCE

This is a key priority for the Board, which is accountable to shareholders for good corporate governance. A narrative statement on how the Company has applied the principles of good corporate governance to ensure compliance with the Combined Code contained in the Listing Rules is set out on the next three pages and, in connection with directors' remuneration, in the Directors' Remuneration Report on pages 18 to 20.

## DIRECTORS, BOARD MEETINGS AND PROCEDURES

The Company is controlled through the Board of Directors comprising three executive and four non-executive directors. The biographies appear on pages 10 and 11 and demonstrate a range of experience for the purposes of applying independent judgement on issues of strategy, performance, resources and standards of conduct, which are considered vital in Macfarlane Group. The Board is responsible to shareholders for the management of the Group and a statement of the Directors' Responsibilities in respect of the accounts is set out on page 20.

For a number of years the Company has separated the roles of the Chairman and Chief Executive. As the non-executive Chairman, Sir John Ward is responsible for the running of the Board, he ensures that all directors receive sufficient relevant information on financial, business and corporate issues prior to meetings to allow the directors to bring an independent judgement to bear on all issues. As Chief Executive, Iain Duffin's responsibilities focus on co-ordinating the Company's business and implementing the Group strategy.

The Board has a formal schedule of matters reserved to it and meets at least eight times a year and as necessary for any matters arising between regular Board meetings. The Board is responsible for overall Group strategy, acquisition and divestment policy, approval of major capital

expenditure projects and consideration of significant financing matters. It monitors the exposure to key business risks and reviews the direction of individual business units, their annual budgets, progress towards the achievement of those budgets and their capital expenditure programmes. At each meeting, the Board considers reports from Sir John Ward (Chairman), Iain Duffin (Chief Executive) and John Love (Finance Director).

The non-executive directors monitor the performance of the Company and the executive management. They play a key role in the development of Group policy and form a number of the Board Committees. The non-executive directors are appointed for a specific term and their re-appointment is not automatic. The Board has minuted its view that A.S. Hunter, R. Speirs and R.G.T. Stenhouse are independent non-executive directors as defined by the Combined Code.

All directors have access to the Company Secretary who is responsible for ensuring that Board procedures are met. Directors are authorised to take, at the Company's expense, independent professional advice on legal and financial matters in furtherance of their duties as directors, subject to certain limits and procedures. All directors, in accordance with the Code, will submit themselves for re-election by shareholders at least once every three years.

## BOARD COMMITTEES

The Board has established a number of standing committees, each operating within defined terms of reference. The principal committees are the Nominations Committee, the Audit Committee, the Remuneration Committee and the Executive Committee.

**The Nominations Committee** comprises the Chairman and the three independent non-executive directors and makes recommendations to the Board on all new Board appointments, having regard to the balance and structure of the Board. Its members meet routinely once each year, with other meetings as necessary. The Committee considers the extent of any training required for newly appointed directors.

**The Audit Committee** comprises the three independent non-executive directors and has specific terms of reference dealing with its authority and duties. The committee is chaired by Guy Stenhouse and meets routinely four times a year, with other meetings as necessary and minutes are circulated to all Board members. The Finance Director, internal auditors and external auditors attend such meetings by invitation and provide reports as required by the committee. At each meeting attended

## CORPORATE GOVERNANCE

by the external auditors, part of the meeting is held between the external auditors and the non-executive directors in private, where appropriate. The committee reviews the monitoring of the adequacy of the Group's internal controls, accounting policies and financial reporting and also makes recommendations to the Board where it feels it is appropriate. The committee is also responsible for advising the Board on the appointment of the external auditors and for considering the levels of fees for external auditors including the split between audit and non-audit work.

The **Remuneration Committee** comprises the three independent non-executive directors and has specific terms of reference dealing with its authority and duties. The committee is chaired by Archie Hunter and meets routinely twice each year, with other meetings as necessary and the minutes are circulated to all Board members. The committee considers the performance of executive directors as a prelude to determining their annual remuneration, bonus awards and long-term incentive awards. The report of the Board on Directors' Remuneration is set out on pages 18 to 20.

The **Executive Committee** comprises the three executive directors and two other Group executives and is responsible for the day-to-day management of the Company. The committee meets at least eight times each year.

### RELATIONS WITH SHAREHOLDERS

Communications with shareholders are given high priority. Detailed reviews of the performance and financial position are included in the Operating and Financial Reviews on pages 4 to 9. The Board uses this together with the Chairman's Statement on pages 2 and 3 and the Report of the Directors on pages 12 to 14 to present a balanced and understandable assessment of the Company's position and prospects. There is a regular dialogue with institutional shareholders, including presentations by certain members of the Board after the Company's preliminary announcement of the year-end results and the announcement of the results at the half-year. The Board uses the Annual General Meeting in May each year to communicate with private and institutional investors and welcomes their attendance and participation. Details of the resolutions to be proposed at the Annual General Meeting can be found in the proxy card accompanying the Annual Report and Accounts. In line with the requirements of the Combined Code, the results of proxy votes are disclosed at the Annual General Meeting and the Notice of Meeting is sent out more than 20 working days in advance of the Meeting.

### INTERNAL CONTROL

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and by its nature can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board confirms that an ongoing process for identifying, evaluating and managing the significant risks faced by the Group was in place in compliance with the guidance of the Turnbull Committee – Internal Control: Guidance for Directors on the Combined Code. The process has been in place for the full year under review and has continued up to the date of approval of the annual report and accounts. The key elements of this process are summarised as follows:

The Board reviews the strategic direction of the Group and has primary responsibility for identifying the major business risks facing the Group and developing appropriate strategies, actions and approaches to manage those risks;

A regular programme of risk assessments has been introduced where the business risks, which impact the achievement of business objectives, are evaluated and prioritised. This ensures that the Board and senior management review and reflect upon the overall risk profile facing the business and that all key risks receive the appropriate level of management attention on an ongoing basis;

A Group risk management policy has been developed to structure and formalise the roles and responsibilities in managing risk throughout the Group; and

Structured quarterly meetings are held between the management team for each business unit and Group Executive Directors. Financial performance and the management of key business risks are discussed in detail. Actions, responsibilities and targets are set and performance reviewed at subsequent meetings. The outputs from this process as well as the underlying process itself is regularly reviewed by the Board in order to develop and further embed risk management and risk awareness throughout the Group.

#### **MAINTENANCE OF A SOUND SYSTEM OF INTERNAL CONTROL**

The key elements of the system of internal control can be summarised as follows:

- The Group operates with a clearly defined management structure with clear lines of reporting and defined management roles and responsibilities;
- A comprehensive budgeting and performance management system is in place, covering financial results as well as key operational and process statistics. Variances from budget are reported, monitored and investigated on a monthly basis;
- As noted above, structured quarterly meetings are held between the management team for each business unit and certain members of the Executive Committee. Financial performance and the management of key business risks are discussed in detail. Actions, responsibilities and targets are set and performance reviewed at subsequent meetings;
- Clearly defined guidelines and levels of authority are established for all areas of expenditure and capital investment. For expenditure *beyond agreed levels, written proposals are submitted to the Board for consideration and review;*
- The senior finance managers within the business are required, on a regular basis throughout the year, to provide a written confirmation that they have reviewed the adequacy of key financial controls within the relevant business unit and to report any control weaknesses or issues; and
- Internal Audit reviews key business process and controls and reports its findings directly to the Audit Committee.

In compliance with Provision D.2.1 of the Combined Code, the Board continuously reviews the effectiveness of the Group's system of internal control. The key elements of this review process include:

- Review of monthly business unit performance reports and investigation of variances from budget and target;
- Review of monthly business unit results presentations and assessment of the actions taken at subsequent presentations;
- Review of the outputs of the risk assessment process and monitoring the change in the risk profile facing the business; and
- Review of key findings from Internal Audit reports.

The Board also received and reviewed the output from a specific assessment for the purpose of this annual report in line with the guidance included within Internal Control: Guidance for Directors on the Combined Code (the Turnbull Guidance). This assessment included a review of the change in the nature and extent of the significant risks facing the Group and of the adequacy and effectiveness of the procedures and structures in place to manage those risks and to ensure that an effective system of internal control is maintained.

#### **GOING CONCERN BASIS**

*After making enquiries, the directors have formed a judgement at the time of approving the financial statements that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.*

# DIRECTORS' REMUNERATION REPORT

## INTRODUCTION

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002, which introduced new statutory requirements for the disclosure of directors' remuneration in respect of the periods ending on or after 31 December 2002. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the Principles of Good Governance relating to directors' remuneration. As required by the regulations, a resolution to approve the report will be proposed at the Annual General Meeting of the Company on 13 May 2003 at which the financial statements will be approved.

The regulations require the auditors to report to the company's members on the auditable part of the directors' remuneration report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The report has therefore been divided into separate sections for audited and unaudited information. All audited information is set out in note 3 to the accounts on pages 28 to 30. The unaudited information is set out on this page and the following page.

## REMUNERATION COMMITTEE

The Company has established a Remuneration Committee, which is constituted in accordance with the recommendations of the Combined Code. The Remuneration Committee comprises three independent non-executive directors namely, Archie Hunter (Chairman), Bob Speirs and Guy Stenhouse. None of the members of the Remuneration Committee has any personal financial interests, conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. The Committee consults the chairman about its proposals and has access to professional advice from inside and outside the Company. During 2002 the Committee used the services of KPMG to advise on all aspects of directors' remuneration packages. The Remuneration Committee meets routinely twice each year with other meetings as considered necessary. The chairman of the Remuneration Committee will be available to answer questions on any aspect of remuneration policy at the Annual General Meeting.

## REMUNERATION POLICY

It is a Group objective that it should attract and retain executives of high calibre and that the executives should be rewarded in a manner, which encourages value creation for shareholders. The Committee is consulted on Board appointments and measures the performance of the executive directors, the key members of senior management. The three independent non-executive directors comprising the Remuneration Committee determine Board remuneration and bonus scheme targets together with performance conditions under which executive share option schemes operate.

The Company's policy is that for executive directors the three main elements in their remuneration packages are a basic annual salary (with benefits-in-kind comprising a company car, private medical insurance and pensioning), an annual performance related bonus and long-term incentives in the form of share options. The committee takes a balanced view of remuneration policy considering each element relative to the market. The position was established by research and analysis of the market situation against a comparator Group of public companies of similar size and complexity to the Company. After careful consideration, the committee's view is that the Company's remuneration policy is appropriate.

The intention is to ensure that the remuneration package is set at a competitive rate for comparable posts and that the achievement of clearly defined objectives will provide the opportunity to achieve attractive remuneration levels albeit for that year only. Accordingly executive directors can earn incentive payments based on Group target profits and performance. The maximum payment achievable was 50% of basic salary for 2002, however no bonuses were paid for the year. Levels of basic salaries are reviewed each year or when an individual has a change of responsibility.

Executive directors are entitled to accept appointments outside the Company provided the Board's permission is obtained. The Board may require the fees from such appointments to be accounted for to the Company. All non-executive directors have letters of appointment with the Company for periods not exceeding three years. The Board of Directors, having regard to the time commitment required and the level of fees in similar companies, determines remuneration for non-executive directors. No director plays a part in any discussion about his own remuneration.

#### **SHARE OPTION SCHEMES**

The Remuneration Committee has responsibility for the share option schemes in force and approved the grant of options under the Macfarlane Group PLC Company Share Option Plan 2000 and the Macfarlane Group PLC Executive Share Option Scheme 2000. The Remuneration Committee has determined that the performance criterion that must be met for options requires the growth in the Group's earnings per share to exceed the growth in the Retail Price Index increase by between 3% and 8%, for the three or four-year period respectively, over which such conditions must be met. The Remuneration Committee has determined that for options granted after 1 January 2002, the performance criteria requires the growth in the Group's normalised earnings per share to exceed the growth in the Retail Price Index increase, by an average of at least 3% per annum over any three year period during the option's life. It is the Company's policy to phase the granting of share options rather than to award them in a single large block to any individual. The Remuneration Committee has reviewed the range of long-term incentives available and remains committed to share option schemes, which reflect current practice and align executive rewards with the creation of shareholder value. The underlying objective remains ensuring that schemes are in line with best practice and promote long-term interests of shareholders.

#### **PENSION ARRANGEMENTS**

The Group operates four types of pension scheme, one based on final pensionable salary, two based on defined contributions and a stakeholder pension plan. The final salary scheme was closed to new entrants during 2002. Every employee of the Group is eligible to join one of the two defined contribution schemes after a suitable qualifying period.

G.H. Casey, I.D. Duffin and J. Love are members of the final salary scheme with retirement benefits based on pensionable earnings in the years prior to retirement. This is consistent for all members of the pension scheme, throughout the Group, who have their benefits calculated on this basis. Bonuses for Group Board Directors do not form part of pensionable earnings. Where the Group's pension schemes are restricted in respect of any executive director by reason of the statutory capping limit of pension, the Company may contribute to a Funded Unapproved Retirement Benefit Scheme ("FURBS") for the executive director and the Committee keeps this under review.

There have been no changes to the directors' pension entitlements during the year. There are no unfunded pension promises or similar arrangements for directors.

#### **PERFORMANCE GRAPH**

The following graph shows the Company's performance, measured by total shareholder return (rebased to 100), compared with the performance of the FTSE Index for Support Services, also measured by total shareholder return. The Index for Support Services has been selected for this comparison because it includes a range of companies, which the Directors consider to be broadly comparable to Macfarlane Group PLC.

## DIRECTORS' REMUNERATION REPORT

### DIRECTORS' SERVICE CONTRACTS

Details of those directors retiring by rotation at the forthcoming Annual General Meeting are set out in the report of the directors on page 13 and directors' contracts of service will be available for inspection at the AGM in May 2003.

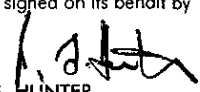
Messrs. G.H. Casey, I.D. Duffin and J. Love have service contracts with a standard notice period of one year, which terminate on attaining the age of 65. Where the terms and conditions agreed by the Nominations Committee provide for an initial notice period in excess of one year, the Committee recommends that this principle should also apply and that there should be a reduction to one year as soon as practicable. The Committee considers the length of the notice periods to be in the best interests of the Company in maintaining the services of its key directors however it supports the principle of mitigation relative to the compensation settlement on the departure of an Executive Director.

### AUDITED INFORMATION

The emoluments of the Directors, including details of share options, representing the sections of the directors' remuneration report subject to audit, are disclosed in note 3 on pages 28 to 30.

### APPROVAL

This report was approved by the Board of Directors on 25 March 2003 and signed on its behalf by

  
A. S. HUNTER  
25 March 2003

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

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United Kingdom company law requires the directors 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 as at the end of the financial year and of the profit or loss of the Group for that year. 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; and
- state whether applicable accounting standards have been followed.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MACFARLANE GROUP PLC

We have audited the financial statements of Macfarlane Group PLC for the year ended 31 December 2002, which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, the note of historical cost profits and losses, the reconciliation of movements in shareholders' funds, the statement of accounting policies and the related notes numbered 1 to 30. We have also audited the information in the part of the directors' remuneration report 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 auditors' 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

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the directors' remuneration report. Our responsibility is to audit the financial statements and the part of the directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

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 described as having been 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 Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, 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 directors' report and the other information contained in the annual report, for the above year as described in the contents section including the unaudited part of the directors' remuneration report and 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 United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes an 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 described as having been 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 circumstances of the Company and the Group, consistently applied and adequately disclosed. We planned and performed our audit so as to obtain all the information and explanations which we consider 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 described as having been 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 described as having been audited.

## 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 December 2002 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

CHARTERED ACCOUNTANTS AND REGISTERED AUDITORS  
Glasgow

25 March 2003

# CONSOLIDATED PROFIT AND LOSS ACCOUNT

Year ended 31 December 2002

	Note	Before exceptional £000	Exceptional £000	2002 £000	Before exceptional £000	Exceptional £000	2001 As restated* £000
<b>TURNOVER</b>							
Continuing		142,370	–	142,370	159,623	–	159,623
Acquisitions		7,248	–	7,248	–	–	–
		<b>149,618</b>	<b>–</b>	<b>149,618</b>	<b>159,623</b>	<b>–</b>	<b>159,623</b>
Discontinued operations		–	–	–	38,577	–	38,577
Total turnover	1	149,618	–	149,618	198,200	–	198,200
Cost of sales		99,189	–	99,189	129,532	–	129,532
		<b>50,429</b>	<b>–</b>	<b>50,429</b>	<b>68,668</b>	<b>–</b>	<b>68,668</b>
<b>GROSS PROFIT</b>							
Other operating expenses (net)	1	52,380	5,044	57,424	57,667	10,058	67,725
<b>OPERATING (LOSS)/PROFIT</b>	1	<b>(1,951)</b>	<b>(5,044)</b>	<b>(6,995)</b>	<b>11,001</b>	<b>(10,058)</b>	<b>943</b>
<b>OPERATING (LOSS)/PROFIT</b>							
Continuing		(729)	(2,241)	(2,970)	8,234	(10,058)	(1,824)
Acquisitions		(1,222)	(2,803)	(4,025)	–	–	–
		<b>(1,951)</b>	<b>(5,044)</b>	<b>(6,995)</b>	<b>8,234</b>	<b>(10,058)</b>	<b>(1,824)</b>
Discontinued operations		–	–	–	2,767	–	2,767
<b>OPERATING (LOSS)/PROFIT</b>	4	<b>(1,951)</b>	<b>(5,044)</b>	<b>(6,995)</b>	<b>11,001</b>	<b>(10,058)</b>	<b>943</b>
<b>Exceptional items</b>							
Gain on disposal of fixed assets continuing		–	2,145	2,145	–	822	822
Loss on disposal of business discontinued	24	–	(410)	(410)	–	(2,770)	(2,770)
		<b>(1,951)</b>	<b>(3,309)</b>	<b>(5,260)</b>	<b>11,001</b>	<b>(12,006)</b>	<b>(1,005)</b>
<b>(LOSS)/PROFIT BEFORE INTEREST</b>							
Investment income	5	215	–	215	1,172	–	1,172
Interest payable and similar charges	6	(613)	–	(613)	(1,590)	–	(1,590)
		<b>(2,349)</b>	<b>(3,309)</b>	<b>(5,658)</b>	<b>10,583</b>	<b>(12,006)</b>	<b>(1,423)</b>
<b>(LOSS)/PROFIT ON ORDINARY</b>							
<b>ACTIVITIES BEFORE TAXATION</b>							
Tax on loss on ordinary activities	7			(1,836)			3,071
<b>LOSS FOR THE FINANCIAL YEAR</b>	8			<b>(3,822)</b>			<b>(4,494)</b>
Dividends on equity shares	9			5,745			6,050
<b>LOSS FOR THE YEAR</b>	21			<b>(9,567)</b>			<b>(10,544)</b>
<b>Retained by:</b>							
Macfarlane Group PLC				(9,208)			16,071
Subsidiaries				(359)			(26,615)
				<b>(9,567)</b>			<b>(10,544)</b>
<b>Loss per ordinary share of 25p</b>	10			<b>(3.25p)</b>			<b>(3.63p)</b>
<b>Diluted loss per ordinary share of 25p</b>	10			<b>(3.25p)</b>			<b>(3.63p)</b>

\* The consolidated profit and loss account for the year ended 31 December 2001 has been restated for the adoption of FRS19 (see note 7 for details).

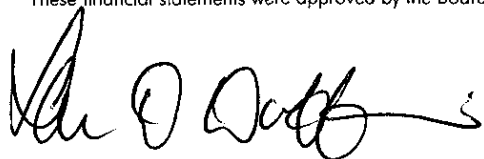
## BALANCE SHEETS

At 31 December 2002

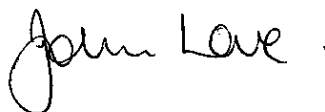
	Note	Group		Company	
		2002 £000	2001 As restated* £000	2002 £000	2001 £000
<b>FIXED ASSETS</b>					
Intangible assets	11	18,250	19,084	–	–
Tangible assets	12	35,951	39,511	611	602
Investments	13	825	–	32,019	54,990
		<b>55,026</b>	<b>58,595</b>	<b>32,630</b>	<b>55,592</b>
<b>CURRENT ASSETS</b>					
Stocks	14	12,883	11,175	–	–
Debtors	15	37,055	37,755	36,901	14,079
Cash at bank and in hand		2,915	7,501	10,173	13,474
		<b>52,853</b>	<b>56,431</b>	<b>47,074</b>	<b>27,553</b>
<b>CREDITORS: amounts falling due within one year</b>	16	<b>48,196</b>	<b>41,135</b>	<b>23,232</b>	<b>18,341</b>
<b>NET CURRENT ASSETS</b>		<b>4,657</b>	<b>15,296</b>	<b>23,842</b>	<b>9,212</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>59,683</b>	<b>73,891</b>	<b>56,472</b>	<b>64,804</b>
<b>CREDITORS: amounts falling due after more than one year</b>	17	<b>1,080</b>	<b>1,763</b>	<b>4,018</b>	<b>500</b>
<b>PROVISIONS FOR LIABILITIES &amp; CHARGES</b>	19	<b>115</b>	<b>1,459</b>	<b>–</b>	<b>34</b>
<b>TOTAL NET ASSETS</b>		<b>58,488</b>	<b>70,669</b>	<b>52,454</b>	<b>64,270</b>
<b>CAPITAL AND RESERVES</b>					
Called up share capital	20	28,755	29,819	28,755	29,819
Capital redemption reserve	21	2,952	1,888	2,952	1,888
Share premium account	21	7,547	7,547	7,547	7,547
Revaluation reserve	21	374	1,411	–	–
Profit and loss account	21	18,860	30,004	13,200	25,016
<b>TOTAL EQUITY SHAREHOLDERS' FUNDS</b>		<b>58,488</b>	<b>70,669</b>	<b>52,454</b>	<b>64,270</b>

\* The consolidated balance sheet for the year ended 31 December 2001 has been restated for the adoption of FRS19 (see note 7 for details).

These financial statements were approved by the Board of Directors on 25 March 2003 and signed on its behalf by



IAIN D. DUFFIN  
Chief Executive



JOHN LOVE  
Finance Director

# CONSOLIDATED CASH FLOW STATEMENT

Year ended 31 December 2002

	Note	2002 £000	2001 £000
<b>CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES</b>	22	(281)	17,726
<b>RETURNS ON INVESTMENTS AND SERVICING OF FINANCE</b>			
Interest and other investment income received		229	481
Interest paid		(517)	(1,459)
Interest element of finance lease rentals		(30)	(12)
<b>NET CASH OUTFLOW FROM RETURNS ON INVESTMENTS AND SERVICING OF FINANCE</b>		(318)	(990)
<b>TAXATION</b>			
UK corporation tax paid		(3,683)	(3,443)
Foreign tax paid		(97)	(211)
<b>TAX PAID</b>		(3,780)	(3,654)
<b>CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT</b>			
Purchase of tangible fixed assets		(6,898)	(6,798)
Purchase of own shares for employee share options and awards		(825)	-
Disposal of tangible fixed assets		8,458	5,199
Disposal of current asset investments		-	12,956
<b>NET CASH INFLOW FROM CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT</b>		735	11,357
<b>ACQUISITIONS AND DISPOSALS</b>			
Purchase of subsidiaries/businesses	23	(7,460)	(26,596)
Disposal of subsidiaries/businesses	24	3,038	43,184
<b>NET CASH (OUTFLOW)/INFLOW FROM ACQUISITIONS AND DISPOSALS</b>		(4,422)	16,588
<b>EQUITY DIVIDENDS PAID</b>		(5,917)	(6,230)
<b>NET CASH (OUTFLOW)/INFLOW BEFORE USE OF LIQUID RESOURCES AND FINANCING</b>		(13,983)	34,797
<b>FINANCING</b>			
Capital element of finance lease rentals		(322)	(234)
Repayment of bank loans and loan notes		(1,186)	(1,065)
Purchase of ordinary shares		(2,608)	(6,175)
<b>NET CASH OUTFLOW FROM FINANCING</b>		(4,116)	(7,474)
<b>(DECREASE)/INCREASE IN CASH IN THE PERIOD</b>	25	(18,099)	27,323

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

Year ended 31 December 2002

	2002 £000	2001 As restated* £000
Loss attributable to members of the Company	(3,822)	(4,494)
Deferred taxation provided on revalued assets in revaluation reserve	-	(222)
Exchange movement on retranslation of the net investment in overseas subsidiaries	(6)	(14)
	<u>(3,828)</u>	<u>(4,730)</u>
Prior year adjustment (see note 7)	(250)	
<b>TOTAL GAINS AND LOSSES RECOGNISED SINCE THE LAST ANNUAL REPORT</b>	<u><b>(4,078)</b></u>	

## NOTE OF HISTORICAL COST PROFITS AND LOSSES

Year ended 31 December 2002

	2002 £000	2001 As restated* £000
Reported loss on ordinary activities before taxation	(5,658)	(1,423)
Realisation of property revaluation gains of previous years	1,032	351
Difference between the historical cost depreciation charge and the actual depreciation charge for the year	5	26
<b>HISTORICAL COST LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	<u><b>(4,621)</b></u>	<u><b>(1,046)</b></u>
<b>HISTORICAL COST LOSS FOR THE YEAR RETAINED AFTER TAXATION AND DIVIDENDS</b>	<u><b>(8,530)</b></u>	<u><b>(10,167)</b></u>

## RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

Year ended 31 December 2002

	Note	2002 £000	2001 As restated* £000
Loss for the financial year		(3,822)	(4,494)
Dividends on equity shares		(5,745)	(6,050)
		<u>(9,567)</u>	<u>(10,544)</u>
Purchase of ordinary shares		(2,608)	(6,175)
Exchange movement on retranslation of the net investment in overseas subsidiaries		(6)	(14)
Deferred taxation provided on revalued assets in revaluation reserve		-	(222)
Write back of goodwill on disposal of business/subsidiary		-	19,977
<b>NET (REDUCTION IN)/ADDITION TO SHAREHOLDERS' FUNDS</b>		<u><b>(12,181)</b></u>	<u><b>3,022</b></u>
Opening shareholders' funds as previously stated		70,919	68,837
Prior year adjustment	7	(250)	(1,190)
Opening shareholders' funds as restated		<u>70,669</u>	<u>67,647</u>
<b>CLOSING SHAREHOLDERS' FUNDS AT 31 DECEMBER</b>		<u><b>58,488</b></u>	<u><b>70,669</b></u>

\* The comparative figures for the year ended 31 December 2001 have been restated for the adoption of FRS19 (see note 7 for details).

# ACCOUNTING POLICIES

Year ended 31 December 2002

## BASIS OF PREPARATION

The financial statements have been prepared in accordance with the historical cost convention as modified by the revaluation of certain of the Group's properties and in accordance with applicable United Kingdom accounting standards.

## CONSOLIDATION

The consolidated profit and loss account and balance sheet include the accounts of the parent company and all its subsidiaries made up to the end of the financial year. The Group has adopted Financial Reporting Standard 19 in these accounts, reflecting a prior period adjustment on the results for the preceding financial year (see note 7 for details).

Pre-acquisition profits are eliminated on consolidation and goodwill representing the excess of the purchase consideration over the fair values of the assets acquired was written off reserves in respect of acquisitions up to 31 December 1997. From 1 January 1998, in accordance with FRS 10, goodwill arising on consolidation, representing any excess of the fair value of the consideration over the fair value of the identifiable assets and liabilities acquired, is capitalised and amortised over its estimated economic useful life, which is twenty years. Provision is made for any impairment. The consolidated profit or loss on disposal of a subsidiary is the difference between the net proceeds of sale and the Group's share of the subsidiary's net assets together with any attributable goodwill originally written off on acquisition or not yet amortised since 1 January 1998. Purchased goodwill in respect of subsidiaries is included within intangible fixed assets.

## TURNOVER

Turnover is the value of goods sold and services provided to third parties stated net of value added tax.

## INVESTMENTS

Investments held as fixed assets are stated at cost less provision for impairment.

## DEPRECIATION

Tangible fixed assets are stated at cost to the Group except in the case of certain properties, which are stated at valuations by professional valuers. The Company adopted the transitional provisions of FRS 15 in 2001 and has frozen the valuations at modified historic cost. The historic valuations of assets are as set out in note 12 to the accounts. No depreciation is provided on land. Depreciation is calculated at fixed rates on a straight-line basis to write off the cost or valuation of the assets over the period of their expected useful lives. The rates of depreciation vary between 2% - 5% per annum on buildings and 7% - 25% per annum on plant, vehicles and fittings.

## STOCKS

Stock and work in progress are consistently valued at the lower of cost and net realisable value. Such cost is determined by the first-in first-out method and is stated less any provisions required for obsolescence. In the case of work in progress and finished goods, cost comprises direct cost and attributable overheads. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal.

## DEFERRED TAXATION

In accordance with FRS 19, deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax is not provided on timing differences arising from the revaluation of investment properties where there is no commitment to sell the asset.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

## LEASES

The cost of assets held under finance leases is included in tangible assets and depreciation provided in accordance with the Group's accounting policy for the class of asset concerned. Interest costs are charged over the lease term and future obligations included in creditors. Rental costs for operating leases are charged to profit and loss account as incurred.

## FOREIGN CURRENCY TRANSLATION

Assets and liabilities denominated in foreign currencies and financial statements of foreign subsidiaries are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange differences arising in the consolidated accounts on the retranslation at closing rates of the Group's net investments in foreign subsidiary companies and on foreign currency borrowings to the extent that they hedge the Group's investment in such operations are recorded as movements on reserves and reported in the statement of total recognised gains and losses. All other exchange differences are dealt with in the profit and loss account.

## PENSION COSTS

The expected cost of providing pensions is charged to profit and loss account in order to spread the cost over the service lives of the employees in the schemes in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll.

# NOTES TO THE ACCOUNTS

Year ended 31 December 2002

## 1. TURNOVER AND PRE-TAX LOSS

		2002 Total £000	2001 Continuing £000	2001 Discontinued £000	2001 Total £000
<b>Turnover</b>	Continuing	142,370	159,623	–	159,623
	Discontinued	–	–	38,577	38,577
	Acquisitions	7,248	–	–	–
		<b>149,618</b>	<b>159,623</b>	<b>38,577</b>	<b>198,200</b>
<b>Cost of sales</b>		<b>99,189</b>	<b>104,666</b>	<b>24,866</b>	<b>129,532</b>
<b>Gross profit</b>		<b>50,429</b>	<b>54,957</b>	<b>13,711</b>	<b>68,668</b>
Distribution costs		(8,781)	(7,622)	(2,333)	(9,955)
Administration costs		(48,831)	(49,340)	(8,611)	(57,951)
Other operating income		188	181	–	181
<b>Operating (loss)/profit*</b>		<b>(6,995)</b>	<b>(1,824)</b>	<b>2,767</b>	<b>943</b>
<b>Exceptional items</b>					
Gain on sale of properties		2,145	822	–	822
Loss on disposal of business		(410)	–	(2,770)	(2,770)
		<b>(5,260)</b>	<b>(1,002)</b>	<b>(3)</b>	<b>(1,005)</b>
<b>Loss before interest</b>		<b>(5,260)</b>	<b>(1,002)</b>	<b>(3)</b>	<b>(1,005)</b>
Investment income		215	1,172	–	1,172
Interest payable		(613)	(811)	(779)	(1,590)
<b>Loss before tax</b>		<b>(5,658)</b>	<b>(641)</b>	<b>(782)</b>	<b>(1,423)</b>
		<b>Total £000</b>			<b>Total As restated £000</b>
<b>Operating assets</b>					
Continuing activities		66,947			67,946
Acquisitions		5,552			–
<b>Operating assets</b>		<b>72,499</b>			<b>67,946</b>
(Net debt)/surplus funds		(14,011)			2,723
<b>Net assets</b>		<b>58,488</b>			<b>70,669</b>

\*Included in administration costs are exceptional operating costs of £5,044,000 (2001 - £10,058,000)

Included in the current year figures are £5,630,000 (cost of sales), £1,618,000 (gross profit), £2,840,000 (administration expenses), £83,000 exceptional operating costs and £1,305,000 (operating loss) attributable to acquisitions, which relate to Tom Brands Electrical Services Limited, Brands Electronics de Mexico SA, de CV and Pacific Tech Products Inc.

In 2001 the Group sold the trade assets and certain liabilities of its UK Plastics Division. This comprises the amounts shown in the comparative figures as discontinued.

	2002 £000	2001 £000
<b>Exceptional operating costs</b>		
<b>Cash costs:</b>		
Cost of headcount reductions	1,475	1,463
Costs to maintain and vacate empty properties	705	–
Externally supported programme to restructure distribution business	144	1,400
<b>Non-cash costs:</b>		
Charges for impairment of goodwill	2,720	5,178
Charges for impairment of tangible assets and other write down of assets	–	2,017
<b>Exceptional operating costs</b>	<b>5,044</b>	<b>10,058</b>

Exceptional items relating to gains on disposal of fixed assets relate primarily to gains on the sale of certain Group sites.

The Directors believe that the Group operates within one business segment. The disclosures of the geographical analysis in respect of the Group's business have not been given as the Directors consider them to be seriously prejudicial to the Group's interest.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 2. EMPLOYEES

Average monthly number of employees was:

	2002 No.	2001 No.
Production	568	871
Sales and distribution	598	523
Administration	238	398
	<b>1,404</b>	<b>1,792</b>

The costs incurred in respect of these employees were:

	2002 £000	2001 £000
Wages and salaries	27,913	33,599
Social security costs	2,267	3,106
Other pension costs	1,108	1,612
	<b>31,288</b>	<b>38,317</b>

### 3. DIRECTORS

The emoluments of the parent company directors are shown below:

#### (i) Emoluments

	Fees/ salaries £000	Benefits in kind £000	2002 £000	2001 £000
<b>Executive directors</b>				
I.D. Duffin	265	20	285	278
G.H. Casey	125	15	140	76
M. Clark	–	–	–	230
J. Love	119	13	132	130
<b>Non-Executive directors</b>				
Sir John Ward	69	1	70	70
A.S. Hunter	23	–	23	23
R. Speirs	23	–	23	23
R.G.T. Stenhouse	23	–	23	23
	<b>647</b>	<b>49</b>	<b>696</b>	<b>853</b>
Pension contributions			85	79
			<b>781</b>	<b>932</b>

The emoluments of the executive directors and the structure of bonuses are determined by the Remuneration Committee. Bonuses are based on performance targets for the year and no bonuses were payable for 2002 or 2001. The fees to Messrs R.G.T. Stenhouse and R. Speirs are paid to their firm and company respectively.

The figure for G.H. Casey for 2001 represents his remuneration for the period from the date of his appointment to the end of the year. The figure for M. Clark in 2001 represents his remuneration from the start of the year until the date of disposal of the Plastics Division together with compensation for loss of office.

### 3. DIRECTORS (continued)

#### (ii) Directors' pension entitlements

The following executive directors are members of the Macfarlane Group PLC Pension & Life Assurance Scheme (1974), a defined benefit pension scheme. Details of the benefits accruing under the scheme are shown below:

	Years of service	Accrued pension at 31 December 2002 £000 p.a.	Increase in accrued pension during year £000 p.a.	Accrued pension at 31 December 2001 £000 p.a.
I.D. Duffin	4	6	2	4
G.H. Casey	27	32	3	29
J. Love	7	11	3	8

	Transfer value 31 December 2002 £000	Contributions made by the Director in 2002 £000	Decrease in transfer value in 2002 net of contributions £000	Transfer value 31 December 2001 £000
I.D. Duffin	45	6	( 1)	40
G.H. Casey	139	6	(36)	169
J. Love	44	6	( 6)	44

The Company made FURBS contributions for I. D. Duffin totalling £43,000 (2001 – £43,000)

#### (iii) Shareholdings

Directors at 31 December 2002 and their interests in ordinary shares of Macfarlane Group PLC were as follows:

	2002			2001		
	Beneficial	Non-beneficial	Option	Beneficial	Non-beneficial	Option
Sir John Ward	118,200	–	–	118,200	–	–
G.H. Casey	45,399	–	375,617	40,399	–	257,617
I.D. Duffin	357,127	–	1,882,809	323,427	–	1,882,809
J. Love	141,832	–	405,124	121,232	–	293,124
A.S. Hunter	93,500	–	–	93,500	–	–
R. Speirs	10,000	–	–	10,000	–	–
R.G.T. Stenhouse	–	25,000	–	–	25,000	–

G.H. Casey, I.D. Duffin and J.Love's beneficial holdings include 7,444, 49,627 and 22,332 shares respectively, which are held by nominees in The Macfarlane Group PLC Bonus Deferral Plan. No changes have occurred in these holdings between 1 January 2003 and 25 March 2003.

Directors' share options	G.H. Casey	I.D. Duffin	J. Love
Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme			
26 January 1996	35,000	–	–
5 July 1999	–	1,250,000	–
22 March 2000	95,339	–	144,915
The Macfarlane Group PLC Executive Share Option Scheme 2000			
2 June 2000	–	309,600	–
15 March 2001	75,274	271,205	96,205
5 April 2002	118,000	–	112,000
The Macfarlane Group PLC Company Share Option Plan 2000			
15 March 2001	43,795	43,795	43,795
The Macfarlane Group PLC Savings Related Share Option Scheme 2000			
9 May 2001	8,209	8,209	8,209
	<b>375,617</b>	<b>1,882,809</b>	<b>405,124</b>

On 26 January 1996 G.H. Casey was granted an option to acquire 35,000 shares at a price of 220p under the Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme. On 5 July 1999 I.D. Duffin was granted options to acquire 1,250,000 shares at a price of 80p per share under the terms of the same scheme. Both options are exercisable until 25 January 2006, subject to the satisfactory completion of the scheme's conditions. On 22 March 2000 G.H. Casey and J. Love were granted options to acquire 95,339 and 144,915 ordinary shares respectively at a price of 59p per share under the Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme. These options are exercisable between 22 March 2003 and 22 March 2010, subject to the satisfactory completion of the scheme's conditions. On 2 June 2000 I.D. Duffin was granted an option to acquire 309,600 ordinary shares at a price of 62½p per share under the Macfarlane Group PLC Executive Share Option Scheme 2000. This option is exercisable between 2 June 2004 and 2 June 2011, subject to the satisfactory completion of the scheme's conditions.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 3. DIRECTORS (continued)

On 15 March 2001 G.H. Casey, I.D. Duffin and J. Love were granted options to acquire 43,795 ordinary shares each at a price of 68½p per share under the Macfarlane Group PLC Company Share Option Plan 2000 and 75,274, 271,205 and 96,205 ordinary shares respectively at a price of 68½p per share under The Macfarlane Group PLC Executive Share Option Scheme 2000. These options are exercisable between 15 March 2004 and 15 March 2011, subject to the satisfactory completion of the plan and scheme's conditions. On 9 May 2001 G.H. Casey, I.D. Duffin and J. Love were granted options to acquire 8,209 ordinary shares each at a price of 59p per share exercisable from 1 July 2004 under The Macfarlane Group PLC Savings Related Share Option Scheme 2000.

On 5 April 2002 G.H. Casey and J. Love were granted options to acquire 118,000 and 112,000 ordinary shares respectively at a price of 88p per share under the Macfarlane Group PLC Executive Share Option Scheme 2000. These options are exercisable between 5 April 2005 and 5 April 2012, subject to the satisfactory completion of the plan and the scheme's conditions.

No other share options were granted and no share options were exercised during the year or in the period between 1 January 2003 and 25 March 2003. Sir John Ward, Messrs A.S. Hunter, R. Speirs and R.G.T. Stenhouse are non-executive Directors of the Company and do not participate in any share schemes. The performance conditions for all share options are set out in the Directors' Remuneration Report on page 19. The market value of Macfarlane Group PLC ordinary shares at 31 December 2002 was 33½p per share (2001 – 76p). The range of share prices during 2002 was 31p to 88½p for each ordinary share of 25p.

### 4. OPERATING (LOSS)/PROFIT

	2002 £000	2001 £000
<b>Operating (loss)/profit is arrived at after charging:</b>		
Depreciation and impairment of tangible assets	4,964	6,846
Amortisation and impairment of goodwill	3,699	6,215
Auditors' remuneration	142	172
Audit services	61	110
Non-audit services	223	1,090
Hire of plant and equipment	2,879	2,256
Operating lease rentals for land and buildings	3,966	3,073
Operating lease rentals for plant and machinery		

The audit fee payable by the parent company is £10,000 (2001 – £10,000). In addition to fees paid to auditors for non-audit services, fees were incurred in connection with the acquisitions during 2002 totalling £78,000, which have been capitalised within the costs of the relevant investments. Fees for non-audit services during 2001 included £45,000 charged in connection with the disposal of the UK Plastics business.

### 5. INVESTMENT INCOME

	2002 £000	2001 £000
Interest receivable and similar income	215	89
Investment income from current asset investment	–	406
Profit on disposal of current asset investment	–	677
	215	1,172

### 6. INTEREST PAYABLE AND SIMILAR CHARGES

	2002 £000	2001 £000
Bank loan and overdrafts repayable within five years	571	1,553
Loan notes repaid during the year	12	25
Finance lease charges	30	12
	613	1,590

## 7. TAXATION ON LOSS ON ORDINARY ACTIVITIES

	2002 £000	2001 As restated £000
United Kingdom corporation tax:		
Current at 30% (2001 - 30%)	(98)	5,136
Prior year adjustment	(635)	(357)
	(733)	4,779
Foreign tax	261	251
Total current tax	(472)	5,030
Deferred taxation	(1,364)	(1,959)
	(1,836)	3,071

The standard rate of current tax for the year, based on the UK standard rate of corporation tax is 30% (2001 - 30%).

The actual tax charge for the current and prior years is less than 30% for the reasons set out in the following reconciliation:

	2002 £000	2001 £000
Loss before tax	(5,658)	(1,423)
Tax on loss at 30%	(1,697)	(427)
Factors affecting charge:		
Depreciation in excess of capital allowances	794	2,134
Expenditure not deductible for tax purposes	129	2,465
Goodwill written off	836	2,054
Other differences	322	(766)
Difference on overseas tax rates	(221)	(73)
Prior year adjustment	(635)	(357)
<b>Current tax (credit)/charge for the year</b>	<b>(472)</b>	<b>5,030</b>

### Prior year adjustment

The results for the year ended 31 December 2001 have been restated for the effects of applying FRS 19 "Deferred Tax". FRS 19 requires full provision for future corporation tax liabilities resulting in a prior year adjustment, which has decreased shareholders' funds and increased provisions by £0.25m at 31 December 2001 and £1.19m at 31 December 2000 respectively. In adopting FRS 19 the Group has decided not to use the option of discounting liabilities allowed by the standard. The deferred taxation credit for the financial year ended 31 December 2001 increased by £0.94m. Comparative amounts have been restated and consequently reserves have decreased and provisions increased by £0.25m at 31 December 2001.

The adoption of FRS 19 has resulted in an increase in the profit and loss credit, which has increased the profit after tax by £258,000 in the year ended 31 December 2002.

Under FRS 19 the Company is required to make full provision for deferred tax in respect of timing differences recognising in total the potential future tax impact of past transactions. Under SSAP 15 provision for deferred tax was only required if it was expected that timing differences would reverse in the foreseeable future.

## 8. LOSS FOR THE FINANCIAL YEAR

	2002 £000	2001 As restated £000
Parent company	(3,463)	22,121
Subsidiaries	(359)	(26,615)
	(3,822)	(4,494)

The Company has taken advantage of Section 230 of the Companies Act 1985 and consequently a separate profit and loss account for the parent company is not presented as part of these accounts.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 9. DIVIDENDS ON EQUITY SHARES

		2002 £000	2001 £000
The cost of the dividends paid or proposed on the ordinary shares is:			
Interim paid 10 October 2002	1.80p net (1.80p)	2,102	2,235
Proposed final	3.20p net (3.20p)	3,643	3,815
		<u>5,745</u>	<u>6,050</u>

### 10. (LOSS)/EARNINGS PER ORDINARY SHARE

(Loss)/earnings per ordinary share are calculated on the basis of the weighted average of 117,605,351 ordinary shares in issue, (2001 - weighted average 123,689,153) and on a loss of £3,822,000 (2001 - loss of £4,494,000). Diluted earnings per ordinary share are calculated on the basis of the weighted average number of shares on a diluted basis, calculated in accordance with FRS 14 Earnings Per Share, of 117,882,668 (2001 - 124,680,084). The difference between the weighted average number of shares used in the basic and diluted earnings per share calculations is due to the dilutive effect of share options. As the diluted loss per share reduces the loss per share, the original loss per share has been reflected as the diluted figure in the accounts.

Earnings per ordinary share in 2002 before operating restructuring expenses and disposal of businesses are based on the above calculation as adjusted to exclude the exceptional items of £5,044,000, the loss on sale of business of £410,000 and associated tax credits of £698,000. This earnings per ordinary share before exceptional charges and business disposals is presented as the directors consider that this figure presents a fairer comparison with the earnings per share of prior years. Earnings per ordinary share in 2001 calculated on the same basis before exceptional charges and business disposals are based on a loss after taxation of £4,494,000 adjusted to exclude operating restructuring charges of £10,058,000, the loss on sale of business of £2,770,000 and associated tax charges of £1,200,000.

### 11. INTANGIBLE FIXED ASSETS

	2002 £000
<b>Group</b>	
<b>Goodwill arising on consolidation</b>	
At 1 January 2002	25,718
Arising during the year (see note 23)	3,187
Exchange movements	(377)
At 31 December 2002	<u>28,528</u>
<b>Amortisation of goodwill</b>	
At 1 January 2002	6,634
Charge for year (including impairment charges of £2,720,000)	3,699
Exchange movements	(55)
At 31 December 2002	<u>10,278</u>
<b>Net book value</b>	
At 31 December 2002	<u>18,250</u>
At 31 December 2001	<u>19,084</u>

Goodwill arising on acquisitions before 31 December 1997 remains eliminated against reserves and is charged to the profit and loss account on subsequent disposal of the business to which it related. Cumulative goodwill written off in these consolidated accounts is £16,097,000 as at 31 December 2002 and 31 December 2001.

## 12. TANGIBLE FIXED ASSETS

Group	Land & buildings £000	Plant, vehicles & fittings £000	Total £000
<b>Cost or valuation</b>			
At 1 January 2002	32,121	41,989	74,110
Assets of businesses acquired	257	3,091	3,348
Additions	2,146	4,609	6,755
Disposals	(8,036)	(6,393)	(14,429)
At 31 December 2002	<b>26,488</b>	<b>43,296</b>	<b>69,784</b>
<b>Depreciation</b>			
At 1 January 2002	8,133	26,466	34,599
Assets of businesses acquired	38	1,426	1,464
Charge for year	683	4,281	4,964
Disposals	(1,281)	(5,913)	(7,194)
At 31 December 2002	<b>7,573</b>	<b>26,260</b>	<b>33,833</b>
<b>Net book value</b>			
At 31 December 2002	<b>18,915</b>	<b>17,036</b>	<b>35,951</b>
At 31 December 2001	23,988	15,523	39,511

The net book value of tangible fixed assets of £35,951,000 (2001 – £39,511,000) includes an amount of £1,957,000 (2001 – £2,071,000) in respect of assets held under finance leases. The depreciation charge in respect of these assets is £397,000 (2001 – £69,000). Included in the depreciation charge in 2001 were impairment charges totalling £1,584,000.

Company	Land & buildings £000	Plant, vehicles & fittings £000	Total £000
<b>Cost</b>			
At 1 January 2002	463	445	908
Additions	–	61	61
Disposals	–	(56)	(56)
At 31 December 2002	<b>463</b>	<b>450</b>	<b>913</b>
<b>Depreciation</b>			
At 1 January 2002	54	252	306
Charge for year	10	40	50
Disposals	–	(54)	(54)
At 31 December 2002	<b>64</b>	<b>238</b>	<b>302</b>
<b>Net book value</b>			
At 31 December 2002	<b>399</b>	<b>212</b>	<b>611</b>
At 31 December 2001	409	193	602

The Company had no assets held under finance leases in 2001 or 2002.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 12. TANGIBLE FIXED ASSETS (continued)

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
<b>Land and buildings at cost or valuation are stated:</b>				
At cost to the Group	20,546	22,750	463	463
At valuation 1987	4,392	6,131	–	–
At valuation 1990	1,550	3,240	–	–
	<b>26,488</b>	<b>32,121</b>	<b>463</b>	<b>463</b>
<b>Land &amp; buildings at net book value comprise:</b>				
	2002 £000	2001 £000	2002 £000	2001 £000
Freeholds	14,363	19,704	390	399
Long leaseholds	3,855	3,895	–	–
Short leaseholds	697	389	9	10
	<b>18,915</b>	<b>23,988</b>	<b>399</b>	<b>409</b>
<b>On an historical cost basis, land &amp; buildings would have been included at:</b>				
	2002 £000	2001 £000	2002 £000	2001 £000
Cost	25,016	29,584	463	463
Aggregate depreciation	6,697	7,257	64	54
Net historical cost value at 31 December	<b>18,319</b>	<b>22,327</b>	<b>399</b>	<b>409</b>

### 13. INVESTMENTS

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
<b>Investment in subsidiaries at cost</b>				
At 1 January	–	–	54,990	39,055
Acquired during the year	–	–	2,846	15,935
Group transfers	–	–	(3,264)	–
Written down during the year	–	–	(23,378)	–
At 31 December	–	–	<b>31,194</b>	<b>54,990</b>
<b>Own shares at cost</b>				
At 1 January	–	–	–	–
Acquired during the year	825	–	825	–
At 31 December	<b>825</b>	–	<b>825</b>	–
<b>Total</b>	<b>825</b>	–	<b>32,019</b>	<b>54,990</b>

During the year the parent company received dividend income of £20,636,000 from subsidiary companies, subsequent to which an impairment review was performed resulting in a charge of £20,531,000 being made to write down the cost of investments to their respective net asset values. In addition an impairment charge of £2,720,000 was taken against the cost of the investment in Tom Brands Electrical Services Limited. The impairment review considered cash flows, appropriately adjusted to reflect the current economic climate and the uncertainty in the timing of converting opportunities into sales, discounted at a risk free rate of 4½%.

Details of the principal operating subsidiaries are set out on the Inside Back Cover.

At 31 December 2002, the Company's Employee Share Ownership Trust ("ESOT") held 1,170,239 ordinary shares in Macfarlane Group PLC with a market value of £392,000 against the future exercise of share options. The ESOT has waived its right to receive dividends on these shares.

### 14. STOCKS

	2002 £000	2001 £000
<b>Group</b>		
Raw materials and consumables	2,285	2,069
Work in progress	359	239
Finished goods and goods for resale	10,239	8,867
	<b>12,883</b>	<b>11,175</b>

## 15. DEBTORS

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Trade debtors	29,375	29,737	–	–
Amounts owed by subsidiaries	–	–	35,519	8,649
Other debtors	4,187	4,835	1,167	5,254
Prepayments and accrued income	3,493	3,183	215	176
	<b>37,055</b>	<b>37,755</b>	<b>36,901</b>	<b>14,079</b>

Included in amounts owed by subsidiaries are loans due after more than one year of £122,000 (2001 – £10,000).

Included in other debtors is a loan made to one executive under the Group house purchase scheme. The total balance outstanding at 31 December 2002 amounted to £6,000 (2001 – £7,000). The amount outstanding at 1 January 2002 represented the maximum balance during the year.

## 16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Bank loans and overdrafts	15,207	1,793	17,171	–
Obligations under finance leases	639	437	–	–
Loan notes	–	785	–	385
Trade creditors	20,721	20,490	482	141
Amounts owed to Group companies	–	–	61	8,154
Corporation tax	–	4,120	–	–
Other taxation and social security	1,542	2,253	68	33
Other creditors	1,044	1,935	960	1,435
Accruals and deferred income	5,400	5,507	847	4,378
Proposed final dividend	3,643	3,815	3,643	3,815
	<b>48,196</b>	<b>41,135</b>	<b>23,232</b>	<b>18,341</b>

The Company and certain subsidiaries have given inter-company guarantees to secure their respective overdrafts. The overall credit lines for these borrowing facilities total £51,000,000.

The loan notes in existence at 31 December 2001 were all repaid at par during 2002.

## 17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		Company	
	2002 £000	2001 £000	2002 £000	2001 £000
Bank loans	–	302	–	–
Obligations under finance leases	1,080	1,461	–	–
Loans from subsidiaries	–	–	4,018	500
	<b>1,080</b>	<b>1,763</b>	<b>4,018</b>	<b>500</b>

### Bank loan repayments

	Group	
	2002 £000	2001 £000
Due within one year	–	99
Due between one and two years	–	108
Due between two and five years	–	194
	<b>–</b>	<b>401</b>

The bank loans detailed above were repaid in full during the year.

### Obligations under finance leases

	Group	
	2002 £000	2001 £000
Due within one year	639	437
Due between one and two years	411	381
Due between two and five years	669	1,080
	<b>1,719</b>	<b>1,898</b>

The finance leases are secured over the assets to which the leases relate.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

A summary of the Group's policies for financial instruments is included in the Financial Review on page 9. The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS13"). As permitted by FRS13, short-term debtors and creditors have been excluded from the above analysis.

#### Interest rates

All Group deposits and borrowings are held at floating rates of interest by reference to appropriate market rates. The currency profile of the Group's financial assets and financial liabilities is as set out below:

	Group	
	2002 £000	2001 £000
<b>Financial assets</b>		
<b>Currency</b>		
Sterling	1,051	5,081
Euros	972	1,321
Hungarian Forints	141	408
US Dollars	751	691
	<hr/>	<hr/>
	2,915	7,501
<b>Financial liabilities</b>		
<b>Currency</b>		
Sterling	15,639	3,974
Euros	293	804
US Dollars	994	-
	<hr/>	<hr/>
	16,926	4,778

#### Currency analysis of monetary assets and liabilities

At 31 December 2002 the Group had no significant currency exposure generating gains or losses within the profit and loss account. All monetary assets and liabilities are denominated in the functional currency of the Group operation to which they belong. At 31 December 2001 the only exception to this was the retention on disposal of the trade, assets and certain liabilities of the UK Plastics division, which was receivable in dollars, but denominated in its sterling equivalent of £3,448,000 in other debtors. Certain forward exchange contracts were put in place in the first half of 2002 to fix the level of sterling proceeds to be received in respect of the retention.

#### Fair value of financial instruments

Current assets and liabilities are all held at floating rates. The fair values of current asset investments, cash at bank and bank overdrafts, and at December 2001, bank loans and loan notes, all materially equate to book values.

#### Borrowing facilities

The Group has various committed undrawn overdraft facilities. The facilities available at 31 December 2002 in respect of which all conditions precedent had been met were as follows:

	Expiring within one year 2002 £000	Expiring within one year 2001 £000
Drawn down	15,207	1,291
Undrawn	35,793	69,709
	<hr/>	<hr/>
	51,000	71,000

The repayment profile of the Group's borrowings is set out in notes 16 and 17 on page 35.

## 19. PROVISIONS FOR LIABILITIES AND CHARGES

	Group		Company	
	2002 £000	2001 As restated £000	2002 £000	2001 £000
Deferred taxation				
At 1 January as previously reported	1,209	2,140	34	28
Prior period adjustment	250	1,190	-	-
At 1 January as restated	1,459	3,330	34	28
Exchange movements	20	-	-	-
Acquired on acquisition of subsidiaries	-	(134)	-	-
Provided on revalued assets	-	222	-	-
(Credit)/charge for the year	(1,364)	(1,019)	(34)	6
Prior period adjustment	-	(940)	-	-
At 31 December	115	1,459	-	34

Analysis of the deferred tax balances are as follows:

	Group		Company	
	2002 £000	2001 As restated £000	2002 £000	2001 £000
Provided in accounts:				
Capital allowances and other timing differences	115	1,459	-	34
Provision for deferred taxation liability	115	1,459	-	34

Deferred tax has not been provided in respect of gains realised that have been rolled over into the acquisition cost of replacement assets. This tax will become payable if the replacement assets are sold and further rollover relief is not obtained. The estimated amount of tax that would become payable in these circumstances is £1.4m.

Deferred tax has not been provided on revaluations of fixed assets. This tax will only become payable if the assets are sold and rollover relief not obtained. The estimated amount of tax that would become payable in these circumstances is £112,000.

### Prior year adjustment

Provision has been made for deferred taxation in accordance with FR519. Full details of the impact of this on current and prior year results are as set out in note 7.

## 20. SHARE CAPITAL

	Number of shares	2002 £000	2001 £000
Ordinary shares of 25p each			
Authorised	200,000,000	50,000	50,000
Allotted, issued and fully paid:			
At 1 January	119,275,000	29,819	31,707
Purchase of own shares	(4,256,000)	(1,064)	(1,888)
At 31 December	115,019,000	28,755	29,819

Shareholders approved two special resolutions on 9 May 2001 and 14 May 2002 giving the Company authority to buy back shares in the Company. the Company bought back 4,256,000 ordinary shares of 25p each, with a nominal value of £1,064,310, representing 3.57% of the Company's called up share capital for a total consideration of £2,608,000 for cancellation. The purchases took place at a number of dates between 14 January 2002 and 13 November 2002. The prices paid for the shares ranged from 38½p per share to 87p per share.

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 20. SHARE CAPITAL (continued)

A summary of share options granted to employees including executive directors and outstanding at 31 December 2002 under existing share option schemes together with the exercise prices and dates of exercise is set out below:

	Exercise price per share (p)	Exercise Date	Number of shares 2002	Number of shares 2001
The Macfarlane Group 1991 Share Option Scheme	80p	January 2002	–	270,000
The Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme	220p	January 2003 – January 2006	185,000	500,000
The Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme	80p	July 2002 – January 2006	1,250,000	1,250,000
The Macfarlane Group (Clansman) P.L.C. 1995 Executive Share Option Scheme	59p	March 2003 – March 2010	1,235,635	1,863,432
The Macfarlane Group PLC Executive Share Option Scheme 2000	62½p	June 2004 – June 2011	309,600	309,600
The Macfarlane Group Company Share Option Plan 2000	68½p	March 2004 – March 2011	400,369	456,648
The Macfarlane Group PLC Executive Share Option Scheme 2000	68½p	March 2004 – March 2011	482,884	482,884
The Macfarlane Group PLC Savings Related Share Option Scheme 2000	59p	1 July 2004	851,624	1,811,676
The Macfarlane Group Company Share Option Plan 2000	78½p	September 2004 – September 2011	204,648	265,364
The Macfarlane Group PLC Executive Share Option Scheme 2000	78½p	September 2004 – September 2011	20,352	27,136
The Macfarlane Group Company Share Option Plan 2000	88p	April 2005 – April 2012	106,783	–
The Macfarlane Group PLC Executive Share Option Scheme 2000	88p	April 2005 – April 2012	518,217	–
			<b>5,565,112</b>	<b>7,236,740</b>

### 21. RESERVES

Group	Capital redemption reserve £000	Share premium account £000	Revaluation reserve £000	Profit & loss account £000
At 1 January 2002 as previously reported	1,888	7,547	1,411	30,254
Prior period adjustment (see notes 7 and 19)	–	–	–	(250)
At 1 January 2002 as restated	1,888	7,547	1,411	30,004
Amortisation of revaluation surplus	–	–	(5)	5
Eliminated on disposal of properties	–	–	(1,032)	1,032
Foreign exchange translation differences	–	–	–	(6)
Arising on purchase of own shares	1,064	–	–	(2,608)
Loss for the year	–	–	–	(9,567)
At 31 December 2002	<b>2,952</b>	<b>7,547</b>	<b>374</b>	<b>18,860</b>
Company				
At 1 January 2002	1,888	7,547	–	25,016
Arising on purchase of own shares	1,064	–	–	(2,608)
Loss for the year	–	–	–	(9,208)
At 31 December 2002	<b>2,952</b>	<b>7,547</b>	–	<b>13,200</b>

## 22. RECONCILIATION OF OPERATING (LOSS)/PROFIT TO NET (OUTFLOW)/INFLOW FROM OPERATIONS

	Continuing operations £000	Acquisitions £000	2002 £000	2001 £000
Operating (loss)/profit	(2,970)	(4,025)	(6,995)	943
Gain on disposal of property	2,145	–	2,145	822
	(825)	(4,025)	(4,850)	1,765
Depreciation	4,760	204	4,964	6,846
Amortisation of intangible assets	900	2,799	3,699	6,205
Gain on disposal of tangible assets	(2,290)	–	(2,290)	(960)
(Increase)/decrease in stocks	(448)	449	1	2,505
Decrease in debtors	2,076	453	2,529	6,126
Decrease in creditors	(3,869)	(465)	(4,334)	(4,761)
Net cash (outflow)/inflow from operating activities	304	(585)	(281)	17,726

The impact of these acquisitions, which relates to Tom Brands Electrical Services Limited, Brands Electronics de Mexico SA, de CV and Pacific Tech Products Inc. on the reconciliation of operating (losses)/profit to operating cash flows is set out above. These acquisitions have no material impact on the remaining categories in the cash flow statement.

## 23. PURCHASE OF SUBSIDIARY UNDERTAKINGS

	Tom Brands Electrical Services £000	Pacific Tech Products Inc. £000	2002 £000	2001 £000
<b>Net assets acquired:</b>				
Tangible assets	1,072	812	1,884	2,608
Stocks	1,191	518	1,709	4,833
Debtors	2,666	1,354	4,020	10,564
Cash and bank balances	446	–	446	–
Bank overdraft	(2,578)	–	(2,578)	(850)
Creditors	(2,597)	–	(2,597)	(10,294)
Finance lease obligations	(143)	–	(143)	(16)
Deferred taxation	–	–	–	134
	57	2,684	2,741	6,979
Goodwill (see note 11)	2,789	398	3,187	18,980
	2,846	3,082	5,928	25,959
<b>Satisfied by:</b>				
Cash	2,246	3,082	5,328	25,159
Deferred consideration - loan notes	600	–	600	–
Loan notes issued	–	–	–	800
	2,846	3,082	5,928	25,959
<b>Analysis of the net cash outflow in respect of the purchase of subsidiaries</b>				
Cash consideration	2,246	3,082	5,328	25,159
Cash and bank acquired	(446)	–	(446)	–
Bank overdrafts acquired	2,578	–	2,578	850
	4,378	3,082	7,460	26,009
Deferred consideration paid in 2001 for acquisition made in 2000.			–	587
			7,460	26,596

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 23. PURCHASE OF SUBSIDIARY UNDERTAKINGS (continued)

The Directors have not incorporated any adjustments following their provisional assessment of the fair values of the assets and liabilities in respect of the acquisitions of Tom Brands Electrical Services Limited and Brands Electronics de Mexico SA, de CV on 4 July 2002 and Pacific Tech Products Inc. on 11 July 2002. Accordingly the fair values stated above currently equate to book values. The fair values will be finalised in 2003 once the companies have been integrated into the Group. No further fair value adjustments were made in these accounts in respect of the acquisition of National Packaging Group Limited in 2001.

Prior to acquisition Tom Brands Electrical Services Limited and Brands Electronics de Mexico SA, de CV disclosed the following levels of total turnover and losses before tax:

	£000
<b>In Statutory Accounts for the 12 months to 31 October 2001</b>	
Turnover	47,852
Loss before taxation	<u>(1,538)</u>
<b>In period from 1 November 2001 to date of acquisition</b>	
Turnover	9,604
Loss before taxation	<u>(2,284)</u>

The Company acquired the trade and assets of Pacific Tech Products Inc. on 11 July 2002 and as such statutory disclosures of turnover and profit before tax are not available for disclosure.

### 24. DISPOSAL OF SUBSIDIARY UNDERTAKINGS

#### Net assets disposed:

	2002 £000	2001 £000
Intangible assets	–	4,007
Tangible assets	–	16,421
Stocks	–	4,430
Debtors	–	17,226
Bank overdraft	–	(16,343)
Creditors	–	(12,537)
Finance leases	–	(122)
Net assets disposed of	–	13,082
Negative goodwill reinstated on disposal of business	–	19,977
Loss on disposal	(410)	(2,770)
<b>Consideration (net of attributable expenses)</b>	<b>(410)</b>	<b>30,289</b>

The negative consideration arose as a result of payments to conclude the settlement of warranties in relation to disposals of businesses in previous years.

#### Satisfied by:

	2002 £000	2001 £000
Cash	3,038	26,841
Deferred consideration	(3,448)	3,448
Total consideration	<u>(410)</u>	<u>30,289</u>

#### Analysis of the net cash inflow in respect of the disposal of business

	2002 £000	2001 £000
Cash consideration	3,038	26,841
Bank overdrafts repaid/divested	–	16,343
	<u>3,038</u>	<u>43,184</u>

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

	2002 £000	2001 £000
(Decrease)/increase in cash in the period	(18,099)	27,323
Cash inflow from decrease in debt and lease financing	1,508	1,299
(Decrease)/increase in net debt resulting from cash flows	(16,591)	28,622
New finance leases	-	(1,925)
Borrowings acquired with subsidiaries (see note 23)	(143)	(16)
New loan notes issued on acquisition of subsidiary (see note 23)	-	(800)
Finance leases disposed with business (see note 24)	-	122
Movement in net debt in the period	(16,734)	26,003
Opening net funds/(debt)	2,723	(23,280)
Closing (net debt)/funds	(14,011)	2,723

## 26. ANALYSIS OF (NET DEBT)/FUNDS

	Cash at bank and in hand £000	Bank overdrafts £000	Bank loans £000	Loan notes £000	Finance leases £000	Total £000
<b>2002</b>						
At 1 January 2002	7,501	(1,694)	(401)	(785)	(1,898)	2,723
Movement in the year	(4,586)	(13,513)	-	-	-	(18,099)
Borrowings repaid	-	-	401	785	322	1,508
Borrowings acquired (excluding cash and overdrafts acquired)	-	-	-	-	(143)	(143)
At 31 December 2002	2,915	(15,207)	-	-	(1,719)	(14,011)
<b>2001</b>						
At 1 January 2001	2,230	(23,746)	(979)	(472)	(313)	(23,280)
Movement in the year	5,271	22,052	-	-	-	27,323
Borrowings repaid	-	-	578	487	234	1,299
Borrowings raised	-	-	-	-	(1,925)	(1,925)
Borrowings raised on acquisition	-	-	-	(800)	-	(800)
Borrowings divested on disposal	-	-	-	-	122	122
Borrowings acquired (excluding cash and overdrafts acquired)	-	-	-	-	(16)	(16)
At 31 December 2001	7,501	(1,694)	(401)	(785)	(1,898)	2,723

## 27. FINANCIAL COMMITMENTS

### (i) Lease commitments

Annual commitments under non-cancellable operating leases comprise:

Leases which expire:	Land & buildings	Other	Land & buildings	Other
	2002 £000	2002 £000	2001 £000	2001 £000
Within one year	188	828	188	268
Within two to five years	1,326	2,426	540	3,503
After five years	4,348	-	3,485	-
	5,862	3,254	4,213	3,771

The majority of leases of land and buildings are subject to rent reviews.

### (ii) Contracts for capital expenditure

Contracts for capital expenditure for which no provision has been made in the accounts amounted to £6,383,000 (2001 - £291,000).

## NOTES TO THE ACCOUNTS

Year ended 31 December 2002

### 28. RELATED PARTY TRANSACTIONS

During the year the Group incurred fees for corporate advice amounting to £20,000 to Nable Grossart Limited (2001 – £370,000), of which R.G.T. Stenhouse, a non-executive director of the Company, is a director. The Directors have considered the implications of FRS 8 "Related Party Disclosures" and are satisfied that there are no other related party transactions occurring during the year, which require disclosure.

### 29. MACFARLANE GROUP ALL EMPLOYEE SHARE OWNERSHIP PLANS

A sum of £174,000 has been paid out of 2002 profits (2001 – £227,000) to the Trustees of the Macfarlane Group All Employee Share Ownership Plan, which was established in 2001 in order that it may buy and hold shares for specified employees for a tax efficient period. This Scheme bears its own administration expenses. The shares held by the trustees of the All Employee Share Ownership Plan vest unconditionally in the employees on normal maturity date and the dividends on the shares are paid to the employees. At 31 December 2002 the Scheme held 326,500 ordinary shares of 25p each, which had a market value of £109,000 on behalf of the employees. Transfers of ordinary shares to eligible employees out of the Plan take place each year following the completion of the five-year tax efficient period.

The Macfarlane Group All Employee Share Ownership Plan replaced the Company's Share Appropriation Scheme, which concluded in 2001. At 31 December 2002 the Scheme held 237,481 ordinary shares of 25p each, which had a market value of £80,000 on behalf of the employees. Transfers of ordinary shares to eligible employees out of the Scheme take place each year following the completion of the three-year tax efficient period.

### 30. PENSIONS

The Group operates a pension scheme based on final pensionable salary. The assets of the scheme are held separately from those of the Group in managed funds under the overall supervision of the scheme trustees. The pension charge for the year represents contributions payable by the Group to the funds and amounted to £894,000 (2001 - £982,000). No contributions were outstanding at the year end (2001 - £Nil). Contributions to the scheme are charged to the profit and loss account so as to spread the cost of the pensions over employees' working lives with the Group. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent triennial valuation was as at 1 May 2001. The principal assumptions adopted were that investment returns would average 6.5% per annum and that salary increases would average 4.5% per annum. The valuation showed that the market value of the relevant assets of the scheme was £36,689,000 and the actuarial value of these assets represented 95% of the value of benefits that had accrued to members.

Following an additional interim valuation at 1 May 2002, the final salary scheme was closed to new entrants during 2002 and the rate of contributions from both employees and the employer was increased. The employer contribution rate increased from 13.5% to 15.5% of pensionable salary, and the employee contribution rate increased from 5% to 7% of pensionable salary from 1 July 2002 following actuarial advice. This contribution level is expected to reverse the deficit over the estimated remaining service lives of the employees. The Group currently accounts for pensions under SSAP24. As required by SSAP24, the figures included in the accounts in respect of the Company pension scheme are based on the actuarial valuation carried out at 1 May 2002. This does not take into account the fall in stock market values since that date. Any such impact will be reflected in the next triennial valuation as at 1 May 2004, based upon which subsequent pension costs will be determined until the full adoption of FRS17. Under the transitional arrangements for FRS17, the Group is required to provide additional disclosures relating to its pension scheme and these are as follows:

#### FRS17

The figures below have been based on interim actuarial valuations as at 1 May 2002, updated to the current year-end. The assets in the scheme, the net asset position for the scheme as calculated under FRS17 at 31 December 2002 and the expected rates of return were:

Asset class	Fair value 2002 £000	Long-term Expected rate of return	Fair value 2001 £000	Long term Expected rate of return
Equities	15,600	8.50%	21,700	8.00%
Bonds	13,800	5.00%	11,100	5.50%
Other (cash)	100	4.50%	400	5.00%
Fair value of assets	29,500		33,200	
Present value of scheme liabilities	(46,100)		(40,000)	
Deficit in the scheme	(16,600)		(6,800)	
Related deferred tax asset	4,980		2,040	
Net pension liability	(11,620)		(4,760)	

### 30. PENSIONS (continued)

The liabilities of the scheme at 31 December 2002 were calculated on the following bases as required under FRS17:

Assumptions at 31 December 2002	2002	2001
Discount rate	5.50%	6.00%
Rate of increase in salaries	3.75%	4.00%
Rate of increase in pensions in payment	3% or 5% for fixed increases	3% or 5% for fixed increases
Inflation assumption	or 2.25% for LPI 2.25%	or 2.5% for LPI 2.50%

If the Group had to reflect the net pension liability through its reserves at 31 December 2002 then the net profit and loss account reserve figure would have been stated as shown below:

	2002 £000	2001 As restated £000
Profit and loss account excluding pension liability	18,860	30,004
Net pension liability	(11,620)	(4,760)
Profit and loss account	<u>7,240</u>	<u>25,244</u>

#### Analysis of amounts charged to operating profit

Current service costs	£000
	<u>510</u>
<b>Profit and loss account</b>	<b><u>510</u></b>

#### Analysis of amount credited to net finance charges

Expected return on pension scheme assets	£000
	2,367
Interest cost of pension scheme liabilities	<u>(2,400)</u>
<b>Net return</b>	<b><u>(33)</u></b>

#### Analysis of the actuarial loss as would be shown in the statement of total recognised gains and losses

Actual return less expected return on scheme assets	£000
	(5,786)
Experience gains & losses arising on scheme liabilities	(1,209)
Changes in assumptions underlying the present value of the scheme's liabilities	<u>(3,156)</u>
<b>Actuarial loss</b>	<b><u>(10,151)</u></b>

#### Movement in scheme deficit in the year

At 1 January 2002	£000
	(6,800)
Current service cost	(510)
Contributions	894
Past service costs	-
Other financial income	(33)
Actuarial loss in the year	<u>(10,151)</u>
At 31 December 2002	<b><u>(16,600)</u></b>

The Group also operates a number of defined contribution pension schemes. The assets of these schemes are held separately from those of the Group in independently administered funds. The pension cost charge represents contributions paid by the Group to the funds and amounted to £224,000 (2001 - £630,000). During 2001 Macfarlane Group also introduced a stakeholder pension arrangement for those employees not eligible for membership of any of the Group's contributory pension schemes.

## FIVE YEAR RECORD

	1998 £000	1999 £000	2000 £000	2001 As restated (See note 7) £000	2002 £000
<b>Turnover</b>	192,143	196,341	197,927	198,200	149,618
<b>Operating (loss)/profit before exceptional items</b>	16,325	14,936	15,219	11,001	(1,951)
Exceptional items – profit on disposal of assets	–	–	1,391	822	2,145
Exceptional items – restructuring costs	–	(4,917)	–	(4,880)	(2,324)
Exceptional items – goodwill impairment	–	–	–	(5,178)	(2,720)
Exceptional items – costs of lapsed bid	–	–	(4,471)	–	–
(Loss)/profit on disposal of operations	–	(6,580)	500	(2,770)	(410)
Net interest payable	(1,248)	(821)	(981)	(418)	(398)
<b>Profit/(loss) on ordinary activities before tax</b>	15,077	2,618	11,658	(1,423)	(5,658)
Taxation	4,464	3,016	3,926	3,071	(1,836)
<b>Profit/(loss) for the financial year</b>	10,613	(398)	7,732	(4,494)	(3,822)
Dividends	5,745	5,809	6,024	6,050	5,745
<b>Retained profit/(loss) for the year</b>	4,868	(6,207)	1,708	(10,544)	(9,567)
<b>Earnings/(loss) per ordinary share</b>	8.37p	(0.31)p	6.10p	(3.63)p	(3.25)p
<b>Earnings per ordinary share before exceptional charges and disposals</b>	8.37p	7.48p	9.03p	7.71p	0.79p
<b>Dividends per ordinary share</b>	4.53p	4.58p	4.75p	5.00p	5.00p
<b>Dividend cover</b>	1.8	*1.6	*1.9	*1.5	N/A

\*Dividend cover calculated before the disposal of businesses and exceptional charges.

## FINANCIAL DIARY

### RESULTS

Interim Announced – September  
Final Announced – March

### DIVIDEND PAYMENTS

Interim Paid – October  
Final Paid – May

### ACCOUNTS AND ANNUAL GENERAL MEETING

Report and accounts Posted to shareholders in April.  
Annual General Meeting Held in Glasgow in May.

### SHAREHOLDER ENQUIRIES

Enquiries regarding shareholdings, dividend payments, dividend mandate instructions, lost share certificates, tax vouchers, changes of address, transfers of shares to another person and other administrative matters should be addressed to the Company's registrars:

Lloyds TSB Registrars Scotland  
PO Box 28448  
Finance House  
Orchard Brae  
Edinburgh EH4 1QW

Telephone: 0870 601 5366  
Fax: 0870 900 0030

Website: [www.shareview.co.uk](http://www.shareview.co.uk)