microgen plc

annual report

2002

Microgen Information Management Solutions
11 Park Street, Windsor, Berkshire SL4 1LU
Telephone: 01753 847100. Facsimile: 01753 847171
Web: www.microgen.co.uk Company Registered Number: 1602662

Directors
and Advisers

Directors of Microgen plc

Martyn Ratcliffe

Executive Chairman (Aged 41)
Martyn Ratcliffe was appointed a non-executive director of Microgen on 7 May 1998 and Executive Chairman on 31 July 1998. Prior to joining Microgen, he was a senior vice-president and general manager of Dell Computer Corporation, responsible for the Europe, Middle East and Africa region.

David Sherriff (aged 39)

Managing Director
David Sherriff joined Microgen-Kaisha on 3 May 1999 as Divisional Managing Director. He became Managing Director on 5 October 2001 and became an Executive Director and was appointed to the Board on 1 August 2002. Prior to joining Microgen he held senior positions within ECsoft UK from 1993 to April 1999, the last two years as Managing Director.

Mike Phillips

Group Finance Director (Aged 40)
Mike Phillips was appointed to the Board of Microgen on the 3 August 1998. He qualified as a Chartered Accountant with KPMG, and then specialised in Corporate Finance advisory work. He spent seven years in the Corporate Finance Department of Smith & Williamson and immediately prior to his appointment at Microgen he was a senior member of the Corporate Finance Technology Group of PricewaterhouseCoopers.

Paul Davies

Deputy Chairman and Non Executive Director (Aged 54)
Paul Davies was appointed on 1 December 1999 as Group Managing Director and was appointed Deputy Chairman and non executive Director on 5 September 2000. From 1994 to 1999 he was Chief Executive Officer of Parity plc and before this he was Managing Director of Easams Ltd, GEC's I.T. company. Mr Davies is also non-executive chairman of MSB International plc.

Patrick Barbour

Non Executive Director (Aged 68)
A major shareholder in Microgen, Patrick Barbour was appointed to the Board of Microgen as Chairman when the Company was incorporated in 1982, a position he held until 1991. He has remained as a non-executive Director at Microgen since that time. Until April 1999, he was also an executive director of Barbour Index plc.

Ralph Kanter

Non Executive Director (Aged 65)
Ralph Kanter was appointed to the Board of Microgen as a non-executive Director on 16 September 1998 and Chairman of the Audit Committee of the Board on 1 November 1998. He was Chairman and Chief Executive of TRACKER Network plc, a company he formed in 1990, until it was sold to a management buyout in 1999. He currently holds a wide range of non-executive directorships in small and medium-sized public and private companies.

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
1 Embankment Place
London WC2N 6NN

Solicitors

Clyde & Co
Beaufort House
Chertsey Street
Guildford
Surrey GU1 4HA

Stockbrokers and Financial Adviser

UBS Warburg
1-2 Finsbury Avenue
London EC2M 2PP

Registrars

Capita Registrars
Balfour House
390/398 High Road
Ilford
Essex IG1 1NQ

Registered Office

11 Park Street
Windsor
Berkshire SL4 1LU

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Information Management Solutions

Chairman's *Statement*

Despite the challenging market environment, the Board of Microgen reports a strong performance for the year ended 31 December 2002, in terms of both operating results and the strategic development of the Group. The three operating divisions are all profitable and the two acquisitions made during the year have been successfully integrated, with the objectives behind each acquisition being realised.

The Group continues to focus on information management solutions which enable customers to manage their data to enhance business processes and information. These solutions are delivered through managed services, software products and consultancy.

Financial Summary

For the year ended 31 December 2002, Microgen increased operating profit before tax, exceptional items and goodwill amortisation by 83% to £2.0 million on revenue of £25.3 million (2001: £1.1 million on revenue of £21.0 million). Operating costs have been well managed during the year, reducing by £3.5 million on continuing activities compared with 2001. Together with the acquisition integration strategy, this cost management has delivered a significant improvement in operating margin to 8.0% (2001: 5.3%), while continuing to invest in new products and services.

Profit before tax, exceptional items and goodwill amortisation increased by 33% to £2.2 million (2001: £1.7 million). Adjusted earnings per share, (to reflect the underlying operating performance; see note 19) was 2.6p, a 13.0% increase on prior year (2001: 2.3p). As a result of the integration of the acquisitions, a one-time exceptional charge of £1.5 million has been taken, primarily due to an excess property provision. Therefore the Group produced a net loss on ordinary activities after tax and goodwill amortisation of £2.6 million (2001: net profit of £0.7 million, restated following adoption of FRS19) and a fully diluted loss per share of 4.2p (2001: eps of 1.5p, restated following adoption of FRS19)

As a result of the acquisitions, headcount, including external contractors, peaked in March at 342, but was reduced to 289 at 31 December 2002 (31 December 2001: 234).

The Group produced a positive operating cash flow of £2.6 million and has maintained a strong balance sheet. Following the two acquisitions and a share buy-back of 9.8% of the issued share capital, the Group had a gross cash balance of £9.8 million with net free cash of £8.3 million at 31 December 2002. (The difference in gross cash and net free cash takes account of loan notes and deferred consideration resulting from acquisitions, and net corporation tax payable. All deferred considerations have now been finalised.) After careful consideration, the Board has concluded not to recommend a dividend (2001: nil) but believe that investment in the strategic development of the Group and/or buy-back of shares is more appropriate in the current market.

In accordance with FRS11, the Board has conducted a review of the goodwill held on the balance sheet. While market sentiment may infer an impairment of goodwill, the accounting treatment accepts the results of a discounted cash flow model and, on this basis, the Board have determined that there is currently no justification to take a charge for impairment of goodwill on the acquisitions of Kaisha Technology (1999), Telesmart Developments (2000) or OST Business Rules (2002). With regard to the goodwill associated with the acquisition of Wishstream in September 2002, the Board have decided to write the goodwill off in the first year of acquisition.

Microgen-Telesmart

Microgen-Telesmart provides added-value transactional services in billing, payment and hosted database and document management, where Microgen adds value by processing, distributing, storing and analysing data for a wide variety of applications, including the Group's market-leading business-to-business ("B2B") e-billing service. This position in the e-billing market was further reinforced in September through the acquisition of Wishstream Limited.

The division is also one of the leading providers of payment software and solutions. The next generation of BACS software is currently being developed in the Group's development facility in Poland and Microgen has been participating in a deployment programme of the new BACS IP technology with a leading UK bank.

For the year ended 31 December 2002, revenue from the division was £10.9 million, producing an operating profit of £1.4 million before Group overhead (2001: revenue of £12.2 million produced an operating profit of £1.0 million). The revenue decline in the legacy print business continued as anticipated while the annual revenue growth rate in managed e-services (database management, payment and billing) increased to 34% (2001: 24%), such that during the second half of the year, the legacy print business was less than half of the total divisional revenue for the first time. This transition also produced the increase in operating margin to 13.1% (2001: 8.4%), despite a significant increase in investment in product/service development.

Microgen-Kaisha

Microgen-Kaisha is the Group's consultancy division applying data warehousing and application integration techniques to transform data into information. By combining these skills with the provision of managed services and software available through the Group's other businesses, Microgen-Kaisha has developed a number of new business streams, including:

- Application Management: Providing greater forward visibility, this business area accounted for over 20% of the division's revenue in the second half of 2002 and benefits from the managed services infrastructure and expertise of the Microgen-Telesmart business.
- Payment Solutions: Using the technology and expertise from the Microgen-Telesmart payments business, large payment solutions have been deployed as a combination of software product and consultancy.
- Enterprise Information Integration: Developed from the Microgen-OST technology, but targeted at the commercial sector, this new product will be launched in the first half of 2003. This development continues to differentiate Microgen-Kaisha by combining the application of Group IPR using the skill base of application integration and data transformation.

Considering the deterioration in the IT consultancy market, Microgen-Kaisha produced a laudable performance, achieving the strategic objective of maintaining profitability at 25% (2001: 25%). For the year ended 31 December 2002, revenue for the division was £6.6 million, producing an operating profit of £1.6 million before Group overhead and goodwill amortisation. (2001: revenue of £8.8 million, operating profit of £2.2 million). The legacy support services now account for less than 10% of the division's revenue.

Microgen-OST

Microgen-OST was established following the acquisition of OST Business Rules Ltd in February 2002.

The division provides business rules based application integration solutions, using OST-developed software, incorporating user-defined business rules to integrate the front, middle and back office systems of major financial institutions. In addition the cross-selling of Microgen-Kaisha consultancy services into the financial services sector made progress in the second half of the year, enabling Microgen-OST to offer a broader range of services to their customer base.

During the year, the division was affected by the slow down in the financial services sector, with project deferrals and pressure on consultancy fee rates. Action to realign the cost base has been taken during the second half of the year, including a property provision associated with the relocation of the London offices, in order to position the business more appropriately for 2003.

Despite these difficult market conditions, the division produced a creditable performance. For the period from completion of the acquisition to 31 December 2002, revenue of £7.8 million produced an operating profit before Group overhead, exceptional items and goodwill amortisation of £1.1 million, an operating margin of 14%.

Group Development Capability

One of the assets acquired with OST was a high quality, cost-effective software product development operation based in Wroclaw, Poland. In order to realise the benefits of scale and establish consistency of process, a Group Development operation was established in Q3 such that all development programs are managed by a Group Development Director responsible for the two facilities in Poland and UK. The Poland development centre is focused on software product development while the UK development operation primarily supports the Microgen-Telesmart services business.

A number of development programs have been transferred to Poland and new products for all three divisions are scheduled for launch in the first half of 2003. These include:

- The next generation BACS IP payment products, currently being implemented in the deployment programme.
- Two new reconciliation products, based on the same OST-based technology, but with one solution for commercial applications, compatible with the Payment Solutions business (Microgen-Telesmart & Microgen-Kaisha) and a high end product designed for the financial services industry (Microgen-OST).
- A new Enterprise Information Integration ("EII") product for Microgen-Kaisha. Using the core technology of OST Business Rules, the EII product has been designed for commercial system integration applications.

These new products will support Microgen's position at the forefront of Information Management technology.

Development staff now account for approximately 20% of the headcount of the Group and consequently the Group's research and development expenditure increased significantly in 2002 to £2.5 million. (2001: 1.3 million). In accordance with the Group's accounting policy, all research and development expenditure is charged to the profit and loss account as incurred.

Share Buy-Back

During the second half of the year, 6,320,000 shares equivalent to 9.8% of the issued share capital of the Group were purchased for cancellation for a total consideration of £1.96 million. At the forthcoming Annual General Meeting, the Board shall propose to continue this program and will be seeking authorisation to purchase 14.99% of the outstanding issued share capital of the Group. However, it should not be assumed that the Board will exercise any or all of the authorisation which will be a considered decision determined by the Board at the appropriate time, taking into account the strategic objectives of the Group, enhancement of earnings per share and the best interests of shareholders.

Future Prospects

While the Group has experienced the impact of the slowdown in the IT sector, the Board's strong financial management continues to prove effective in maintaining both profitability and positive operating cash flow. Furthermore, during 2002, Microgen completed two acquisitions, OST Business Rules Ltd and Wishstream Ltd and the strategic benefits anticipated at the time of each acquisition are being achieved, with both of these businesses now successfully integrated into the Group. This strategy of active integration of acquisitions to realise the operational and cost benefits of scale and thereby deliver increased profitability has proven successful. Furthermore, as the business models of Microgen-OST and Microgen-Kaisha converge with consultants from both divisions being deployed on projects in the Financial Services sector and the OST Business Rules technology being repackaged for the Commercial sector, the Board has now decided to merge these two business units into a single operating division.

In planning for 2003, the Board has done so on the assumption that market conditions will not improve in the near term. However the actions taken in integrating the acquisitions, together with the disciplined management approach adopted by the Board, have positioned the Group appropriately for the year ahead. Furthermore, the Board continues to believe that the IT sector is likely to consolidate and will continue to explore strategic opportunities for the further development of Microgen.

In summary, despite the deterioration in market conditions, Microgen has delivered improved operating margin on increased revenue, producing growth in operating income and adjusted (operational) earnings per share, together with strong positive cash flow. The Board is pleased with this performance and with the organic and strategic development of the Group during the past year.

Martyn Ratcliffe
Executive Chairman

10 February 2003

M R Ratcliffe

Report of the
Directors

The directors submit their report together with the audited financial statements for the year ended 31 December 2002.

Results and Dividends

The results for the period are set out in the financial statements and notes that appear on pages 17 to 37. As explained in the Chairman's Statement, the directors do not recommend the payment of a final dividend (2001: Nil).

Principal Activities

The Company is a holding company, with the Group's principal activity being the provision of Information Management Solutions to the business community. The Group's services enable its customers to manage their data to improve business processes and information. Further details of the Group's activities and developments in the business during the period are provided in the Chairman's Statement.

Repurchase of own shares

At the Annual General Meeting held on 23 April 2002, members renewed the Company's authority under section 166 of the Companies Act 1985 to make market purchases on the London Stock Exchange of up to 6,463,384 Ordinary Shares at 5p each of the Company at not more than 5 per cent. above their middle market quotation in the London Stock Exchange Daily Official List on the five business days prior to the date of purchase, nor less than 5p each.

Pursuant to this authority, the Company has in the financial year ended 31st December 2002 purchased an aggregate of 6,320,000 Ordinary Shares of 5p each (representing 9.8 per cent. of the Company's issued share capital as at 31st December 2001) for an aggregate consideration of £1,960,000 an average cost of 31p per share. The Company considers that these purchases were beneficial to Members as they have resulted in an increased earnings per share.

The renewed authority given by Members at the last Annual General Meeting for the Company to purchase its own shares expires on 23 July 2003 or (if earlier) at the Annual General Meeting should a similar resolution be proposed. The Directors believe that it is in the best interests of the Company for the authority to be increased to 14.99 per cent. at the forthcoming Annual General Meeting for a period that will expire at the end of 15 months from the end of the meeting or (if earlier) the next Annual General Meeting if an increase in this authority is approved. Accordingly it is intended to propose as Special Business, at the forthcoming Annual General Meeting, a Special Resolution to grant authority to purchase shares of the Company which shall be limited to 8,755,522 Ordinary Shares of 5p each.

Research and Development

The Group carries out research and development as a fundamental part of keeping its products and services relevant and competitive. Research and development costs are expensed as incurred.

The Euro

The Company has limited exposure to the Euro. The accounting system implemented in 1998 is Euro compliant. The Board will continue to review the Group's position regarding the Euro and take appropriate action to implement the necessary changes at the appropriate time.

Directors' Responsibilities

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

- Select suitable accounting policies and then apply them consistently
- make judgments and estimates that are reasonable and prudent
- state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained in the financial statements

- prepare financial statements on the going concern basis unless it is inappropriate to presume the Company will continue in business

The directors confirm they have complied with the above requirements in preparing the financial statements.

The directors are responsible for ensuring proper records are kept 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 taking reasonable steps to safeguard the assets of the Company and the Group and hence for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Microgen website upon which the financial statements will be available. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

Going Concern

The directors, having made appropriate enquiries, consider that the company and the Group have adequate resources to continue in operational existence for the foreseeable future and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

Employment Policies

The Group is committed to offering equal employment opportunities and its policies are designed to attract, retain and motivate the best staff regardless of sex, race, religion or disability. The Group encourages the participation of all employees in the operation and development of the business and has a policy of regular communications. The Group incentivises employees through the payment of bonus and profit share schemes linked to performance objectives, which are agreed and approved by the Remuneration Committee at the start of the year.

Environmental Policy

Microgen's operations by their very nature have minimal environmental impact. Microgen adopts an environmental management system based upon the requirements of ISO 14001 through which specific objectives and targets for improvement, particularly in the areas of energy efficiency and recycling of resources, are set and periodically reviewed.

Health and Safety

The Group adopts a health and safety policy which is designed to provide and maintain safe and healthy working conditions for all employees. Appropriate information, training and supervision is provided by the Company to support this policy.

Donations

Charitable donations of £nil (2001: £380) have been made by the Company and its subsidiaries during the year. No political donations have been made.

Substantial Shareholdings

The directors have been informed of the following interests in excess of 3 per cent. of the issued share capital at 7 February 2003 and are not aware of any other such interests.

	Number of Shares	% of Issued Share Capital
Schroder Investment Management Limited	7,154,205	12.25%
P F Barbour	6,865,327	11.75%
Edinburgh Fund Managers	5,897,441	10.10%
M R Ratcliffe	4,559,524	7.81%
Mrs H Crisp and L G Crisp	3,721,102	6.37%
Legal & General Investment Management	1,851,557	3.17%
Phillips and Drew Life	1,784,084	3.05%

Report of the
Directors

Significant Contracts

There was not existing at any time during the period any contract involving the Company or any of its subsidiaries in which a director of the Company was or is materially interested or any contract which was either a contract of significance with a controlling shareholder or a contract for the provision of service by a controlling shareholder.

Directors

Details of directors who have held office during the period are given below:

Executive directors

M R Ratcliffe (Executive Chairman)

D Sherriff (Managing Director Appointed 1 August 2002)

M S Phillips (Group Finance Director)

Non-executive directors

P Davies (Deputy Chairman and Remuneration Committee Chairman)

P F Barbour

R Kanter (Audit Committee Chairman)

Biographical details of the current directors are given on the inside front cover. At the forthcoming Annual General Meeting D Sherriff and P F Barbour will stand for re-election.

None of the executive directors has a service contract expiring or determinable after more than one year and without payment of predetermined compensation which equals or exceeds one year's salary and benefits in kind.

Auditors

During the year the Audit and Tax compliance work for the group was put out to tender. Three firms were approached and PricewaterhouseCoopers were re-appointed by the Audit Committee and, in accordance with corporate best practice have rotated the lead audit partner.

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopersLLP have been appointed as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company and to authorise the directors to set their remuneration will be proposed at the Annual General Meeting.

Annual General Meeting

The Annual General Meeting will be held at 9.00a.m. on 17 March 2003 at 11, Park Street, Windsor, Berkshire, SL4 1LU. The notice of the Annual General Meeting, enclosed with this report, contains the full text of resolutions to be proposed.

Creditor Payment Policy

The Group agrees terms and conditions for its business transactions with suppliers. Payment is then made in line with these terms, subject to the terms and conditions being met by suppliers.

The Company has no trade creditors.

At 31 December 2002, for the main UK trading subsidiaries the average number of days of annual purchases represented by year end creditors was 36, (31 December 2001: 25 days).

By Order of the Board

G E Liddle

Secretary 10 February 2003

Statement of Compliance

The Group has applied the principles set out in section 1 of the Combined Code on Corporate Governance issued by the Financial Services Authority, as incorporated in the FSA Listing Rules. The Directors have further considered the recommendations contained in the Higgs review of the role and effectiveness of non-executive directors. A full statement of compliance with the proposed amended Code of Best Practice is detailed on page 12.

Board of Directors

The Board of Directors meets regularly to review strategic, operational and financial matters, including proposed acquisitions and divestments. It approves the interim and preliminary financial statements, the annual financial plan, significant contracts and capital investment in addition to reviewing the effectiveness of the internal control systems and business risks faced by the Group. Where appropriate, it has delegated authority to committees of directors. Information is supplied to the board in advance of meetings and the Chairman ensures that all directors are properly briefed on the matters being discussed.

Executive responsibility is split between the Executive Chairman and the Managing Director. The Executive Chairman is primarily responsible for strategy and corporate development. The Managing Director, who was appointed to the Board in August 2002, has specific responsibility for the Group's operating businesses.

Non-executive directors are appointed for specified terms, up to a maximum of three years, and re-appointment is not automatic. There is a formal selection process to appoint non-executive directors and a separate Nomination Committee was formed in 2001. Mr Davies is the senior non-executive director.

All of the non-executive directors have extensive business experience and are considered by the Board to be independent of the management of the company and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

All directors have access to the advice and services of the Company Secretary, and all the directors are able to take independent professional advice, if necessary at the Company's expense.

Directors offer themselves for re-election at the AGM following their appointment and thereafter in accordance with the Company's articles, which require one-third of directors to retire in rotation at each AGM.

Board Committees

All non-executive directors serve on the Nomination, Remuneration and Audit Committees. The committees have written terms of reference which clearly specify their authority and duties.

The nomination Committee is chaired by Mr Ratcliffe and Mr Davies is chairman of the Remuneration Committee. The report of the directors on remuneration appears on page 13.

Mr Kanter is chairman of the Audit Committee. The Audit committee meets regularly with management and the external auditors to review audit procedures, internal controls and financial matters. It also recommends the appointment of the Company's external auditors. The Executive Chairman, Managing Director and Finance Director attend the meetings by invitation. The auditors have unrestricted access to the Audit Committee.

Operating Board

The Operating Board comprises the Executive Chairman, Managing Director, and Group Finance Director, together with the Commercial Director and the Managing Directors of the business units. The Operating Board meets on a monthly basis to discuss policy and operational issues. Those issues outside the delegated authority levels set by the plc Board are referred to the plc Board for its decision.

Relations with Shareholders

In order to maintain dialogue with institutional shareholders the executive directors meet with them following interim and final results announcements, and non-executives have also visited major institutional shareholders on an occasional basis. Where practicable the Annual Report is sent to shareholders 20 working days before the AGM and each issue for consideration at the AGM is proposed as a separate resolution. All directors including the non-executive directors, are expected to attend the AGM.

Social, ethical and environmental risks

The Board takes regular account of the significance of social, environmental and ethical ("SEE") matters to the Company's business of providing Information Management Solutions to the business community.

The Board considers that it has received adequate information to enable it to assess any significant risks to the Company's short and long-term value arising from SEE matters and has concluded that the risks associated with SEE matters are minimal.

Internal Control

The Group maintains an ongoing process in respect of internal control to safeguard the shareholders' investment and the Group's assets and to facilitate the effective and efficient operation of the Group.

These processes enable the Group to respond appropriately, and in a timely fashion, to significant business, operational, financial, compliance and other risks which may otherwise prevent the achievement of the Group's objectives.

The Group recognises that it operates in a highly competitive market that can be affected by factors and events outside its control. It is committed to minimising risks arising wherever possible and accepts that internal controls, rigorously applied and monitored, are an essential tool in achieving this objective.

The key elements of Group internal control, which have been fully effective during 2002, are set out below.

- The existence of a clear organisational structure with well defined lines of responsibility and delegation of authority from the Board to its executive directors and operating divisions;
- A procedure for the regular review of reporting of business issues and risks by operating divisions;
- Regular review meetings with the operating management;
- A comprehensive planning and management reporting system operated by each division and the executive directors;
- The establishment of prudent operating and financial policies.

The directors have overall responsibility for establishing financial and other reporting procedures to provide them with a reasonable basis on which to make proper judgements as to the financial position and prospects of the Group, and have responsibility for establishing the Group's system of internal control and for monitoring its effectiveness. The Group's systems are designed to provide directors with reasonable assurance that physical and financial assets are safeguarded, transactions are authorised and properly recorded and material errors and irregularities are either prevented or detected with the minimum delay. However, systems of internal financial control can provide only reasonable and not absolute assurance against material misstatement or loss.

The key features of the systems of internal financial control include:

- comprehensive financial planning process with an annual financial plan approved by the Board. The plan is updated each quarter to provide a rolling four quarter forecast;
- monthly comparison of actual results against plan;
- written procedures detailing operational and financial internal control policies which are reviewed on a regular basis;
- regular reporting to the board on treasury and legal matters;
- clearly defined investment control guidelines and procedures;
- periodic reviews by the Audit Committee of the Group's systems and procedures.

The majority of the Group's financial and management information is processed and stored on computer systems. The Group is dependant on systems that require sophisticated computer networks. The Group has established controls and procedures over the security of data held on such systems, including business continuity arrangements.

The Group has in place appropriate treasury policies and procedures, which are approved by the Board. The treasury function manages interest rates for both borrowings and cash deposits for the Group and is also responsible for ensuring there is sufficient headroom against the banking covenants contained within its credit facilities, and for ensuring there are appropriate facilities available to meet the Group's strategic plans.

In order to mitigate and manage exchange rate risk, during the year the Group has entered into forward contracts in respect of monthly transactions with the group's Polish Development operation.

All these treasury policies and procedures are regularly monitored and reviewed and conservatively managed. It is the Group's policy not to undertake any speculative transactions which create additional exposures over and above those arising from normal trading activity.

On behalf of the board, the Audit Committee has reviewed the operation and effectiveness of this framework of internal control for the year ended 31 December 2002.

R Kanter
Audit Committee Chairman

10 February 2003

Corporate governance

	COMPLIANCE WITH THE PRINCIPLES OF THE CODE OF BEST PRACTICE, INCORPORATING THE RECOMMENDATIONS OF THE HIGGS REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS	
	Code of Best Practice — section 1	***Microgen Compliance Statement***
A	**DIRECTORS**	
1	**The Board** Every listed company should be headed by an effective board. The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs.	*The directors responsibilities are outlined in the Report of the Directors. The board meets regularly on a formal basis plus additional ad hoc meetings as necessary.*
2	**Chairman and Chief Executive** There are two key tasks at the top of every public company — the running of the board and the executive responsibility for the running of the company's business. There should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority such that no one individual has unfettered powers of decision.	*Executive responsibility is split between the Executive Chairman and the Managing Director. The Executive Chairman is primarily responsible for strategy and corporate development. The Managing Director has specific responsibility for the Group's operating businesses. The Executive Chairman is responsible for running the board.*
3	**Board Balance and Independence** The board should include a balance of executive and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision taking.	*The board consists of three executive directors (the Executive Chairman, Managing Director and Finance Director) plus three non-executive directors. All of the non-executive directors are considered by the board to be independent in character and judgement of the management of the company and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.*
4	**Appointments to the Board** There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.	*A separate Nomination Committee, comprising all of the non-executive directors together with the Executive Chairman, is responsible for identifying and nominating candidates to fill board vacancies.*
5	**Information and Professional Development** The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All new directors should receive induction on joining the board and should continually update and refresh their skills and knowledge.	*The board is supplied with full management accounts and detailed operational reviews prior to each meeting. All directors have extensive, and/or relevant business experience and possess relevant and updated skills and knowledge to perform their duties.*
6	**Performance Evaluation** Boards should evaluate their performance.	*Given Microgen's size and board structure, performance evaluation is an ongoing process. A performance evaluation is undertaken for all directors at the time of their proposed re-appointment. Executive directors receive an annual performance appraisal as part of the Senior Management Bonus Scheme. Commencing in 2003 the performance of all Board Committees will be reviewed on an annual basis.*
7	**Re-election** All directors should be required to submit themselves for re-election at regular intervals and at least every three years subject to continued satisfactory performance.	*Non-executive directors are appointed for specific terms, up to a maximum of three years and re-appointment is not automatic. All directors offer themselves for re-election at the AGM following their appointment and thereafter in accordance with the company's articles, which require one-third of directors to retire in rotation at each AGM.*
B	**REMUNERATION**	
1	**The Level and Make-up of Remuneration** Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. A proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.	*Executive directors' remuneration consists of basic salary and a variable annual bonus. Basic salaries are reviewed annually in the light of individual performance and market comparisons for similar jobs. Annual bonus may be paid, at the sole discretion of the Remuneration Committee, at a target level of up to 50% with an overall cap of 100% of basic salary. The annual bonus payment is determined on the basis of individual and corporate performance.*
2	**Procedure** Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.	*Remuneration packages for individual directors are set by the Remuneration Committee after receiving information from independent sources and the company's Human Resources function. The executive directors may be invited to attend the Committee's meetings, although no individual is present when his own remuneration is being discussed.*
3	**Disclosure** The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.	*A statement of remuneration policy and details of the remuneration of each director is included within the Annual Report.*
C	**RELATIONS WITH SHAREHOLDERS**	
1	**Dialogue with Institutional Shareholders** Companies should enter into a dialogue with major shareholders based on the mutual understanding of objectives.	*The executive directors meet on a regular basis with the company's major shareholders. Non-executive directors are encouraged to meet institutional shareholders on an ad hoc basis, usually independent of the executive directors.*
2	**Constructive Use of the AGM** Boards should use the AGM to communicate with investors and encourage their participation.	*All directors generally make themselves available at the AGM to respond to any questions raised by the investors in attendance.*
D	**ACCOUNTABILITY AND AUDIT**	
1	**Financial Reporting** The board should present a balanced and understandable assessment of the company's position and prospects.	*The board considers it is in compliance with this requirement.*
2	**Internal Control** The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.	*The company operates a detailed internal control process which is reviewed at least on an annual basis by the Audit Committee and endorsed by the board.*
3	**Audit Committee and Auditors** The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.	*The Audit Committee consists of all non-executive directors and meets at least three times a year. Executive directors are invited to attend but the Audit Committee meets at least annually with the company's auditors without the executive directors present. The terms of reference of the Audit Committee fully comply with the Code of Best Practice.*

This report by the Remuneration Committee has been approved by the Board of Directors for submission to shareholders for their approval at the forthcoming Annual General Meeting.

Membership

The membership of the Remuneration Committee during the year ended 31 December 2002 comprised entirely of non-executive directors. The current members are Mr Kanter, Mr Barbour and Mr Davies. During the year the committee was chaired by Mr Davies.

The company is in compliance with the Code of Best Practice annexed to the FSA Listing Rules.

Policy Statement

The Remuneration Committee sets the overall policy on remuneration and other terms of employment of executive directors of the Company and of the Senior Management of its principal operating subsidiaries.

The Committee determines remuneration packages by reference to individual performance, experience and market conditions with a view to providing a package which is appropriate for the responsibilities involved. The Committee also oversees the operation of the Company's Executive Share Option Schemes.

It is the Committee's intention to continue to seek to align the interests of the executive directors and Senior Management with those of the shareholders.

The Committee has given full consideration to the Code of Best Practice annexed to the FSA Listing Rules.

Components of Remuneration

Base Salary

Base salaries are reviewed on an annual basis by the remuneration committee or when an individual changes roles or responsibilities.

Senior Management Bonus Scheme

The group operates a Senior Management bonus scheme, which is determined by the Remuneration Committee on an annual basis by reference to financial and operational performance of the Group and Division relative to Financial Plan and personal performance of the individual. Annual bonus targets for the executive directors for the financial period were set at a level up to 50 per cent, with an overall cap of 100 per cent of basic salary.

Share Options

Option grants are made to senior executives and managers across the group, as well as other staff to recognise significant achievement.

For executive share options granted after 20 March 1997 exercise is not permitted until either three or five years after the date of grant and only if specific criteria, aligning the interests of executives with those of shareholders, have been met.

The present criteria are based on a combination of factors including earnings per share and share price growth over a minimum period of three years. The criteria are reviewed on an annual basis by the Remuneration Committee prior to the grant of executive share options.

The Company's policy is to grant share options to senior management at the discretion of the committee based on personal performance. 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.

No significant amendments are proposed to be made to the terms and conditions of any entitlement of a director to share options.

Sharesave Scheme

All eligible employees may contribute up to £250 per month over a 3 or 5 year term to purchase Microgen shares at a discount. For the 2002 grant, the discount was 20 per cent. of the market price at the time share options were granted. The Scheme is Inland Revenue approved. The executive directors are eligible to participate in the Scheme, but did not participate in the 2002 invitation.

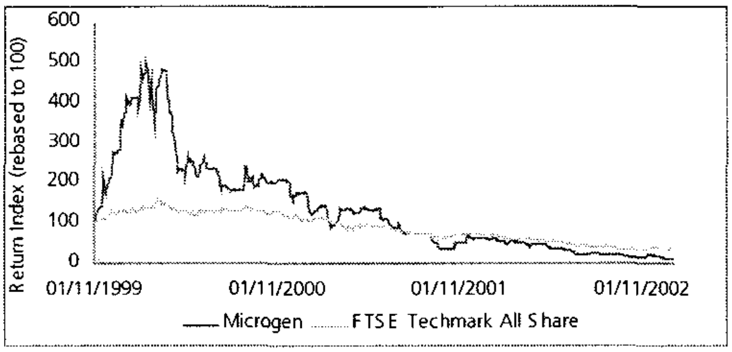
Service Contracts

All executive directors are employed under standard Microgen employment contracts. It is the Committee's policy that executive directors' service contracts should incorporate no more than one year's notice of termination from the Company. All of the executive directors have contracts requiring 6 months' notice from either party.

Report of the Directors on
Remuneration

Performance Graph

The following graph shows the company's performance, measured by total shareholder return, compared with the performance of the FTSE Techmark Index for the period 1 November 1999 to 31 December 2002.



The Remuneration Committee has selected the above index as it is most relevant for a company of Microgen's size and sector.

In determining senior management compensation, the Remuneration Committee takes into account the relative operational performance of Microgen compared with that of companies of a similar size in the same sector. The Remuneration Committee do not directly take account of relative share price performance given the volatility and liquidity of the Small Cap Technology sector.

Directors' Remuneration

The remuneration of all directors who served during the period was as follows:

	2002 £	2001 £
Emoluments	720,369	644,965
Pension Contributions	26,889	21,467
	747,258	666,432

	Basic salary/fees £	Variable reward £	Benefits in kind £	Pension £	2002 total £	2001 total £
Current Directors						
MR Ratcliffe	213,800	100,000	864	14,877	329,541	368,870
MS Phillips	144,633	66,500	1,417	9,158	221,708	179,964
D Sherriff*	66,514	25,000	2,041	2,854	96,409	—
P Davies	52,600	—	—	—	52,600	52,600
R Kanter	25,000	—	—	—	25,000	25,000
P F Barbour	22,000	—	—	—	22,000	21,667
Former Directors						
A Goodman**	—	—	—	—	—	18,331
Total all directors	524,547	191,500	4,322	26,889	747,258	666,432

* from date of appointment

** to date of resignation

Directors' Interests

The interest of the current directors as to 31 December 2002 and at 31 December 2001 in the share capital of the Company are as follows:

	Ordinary shares of 5p	
	31-Dec-01	**31-Dec-02**
Current Directors		
MR Ratcliffe	4,500,000	4,559,524
D Sherriff	—	189,000
MS Phillips	27,000	32,953
P Davies	70,000	78,929
PF Barbour	6,805,803	6,865,327
R Kanter	70,200	79,129
	11,473,003	11,804,862

2,130,796 of P F Barbour's Shares are held in trusts and as such P F Barbour is not able to vote these shares.

Executive Options

	Options over ordinary shares of 5p			
	31-Dec-01	**Granted**	**Exercised**	**31-Dec-02**
MR Ratcliffe	1,000,000	—	—	1,000,000
D Sherriff	200,000*	25,000	—	225,000
MS Phillips	337,145	50,000	—	387,145

* from date of appointment as a director on 1st August 2002

No directors share options were exercised in the period.

No other changes to the directors' shareholdings took place between 1 January 2003 and the date of this report.

The Company's Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to subscribe.

Executive share options by option price, date of grant, exercise date and expiry date are:

Exercise price	Date of grant	Earliest exercise date	Expiry date	M R Ratcliffe	D Sherriff	M S Phillips
90p	31-Jul-98	31-Jul-01	31-Jul-08	1,000,000		
89.17p	12-Oct-98	12-Oct-03	12-Oct-08			112,145
159.8p	25-May-99	25-May-02	25-May-09		150,000	50,000
397.5p	04-May-00	04-May-03	04-May-10			50,000
168.0p	27-Feb-01	27-Feb-04	27-Feb-11			50,000
87.5p	26-Oct-01	28-Oct-04	26-Oct-11		50,000	75,000
42.5p	22-Jul-02	22-Jul-05	22-Jul-12		25,000	50,000
				1,000,000	225,000	387,145

On 17 December 2002 Paul Davies waived the right to 200,000 Share options granted in December 1999 at an exercise price of 363.5 pence per share. These options were granted to Mr Davies at a time when he was an executive director and in accordance with good practice these have been returned to the Company's option pool.

The mid-market price of the Company's shares at 31 December 2002 was 20 pence and the range during the year was 19 pence to 117.5 pence.

No director had at any time during the year a material interest in any contract of significance to which the Company or any of its subsidiaries was a party.

Pension Schemes

The directors, management and staff are all eligible to participate on the same basis in the Group's Pension Scheme. The scheme is a defined contribution scheme to which the Company contributes up to 7 per cent. of basic earnings and the employee contributes a minimum of 4 per cent., subject to the Inland Revenue cap. With effect from 1 January 2000, variable rewards, including those of the directors, were excluded from gross earnings for contribution purposes. The Company contributes 7 per cent. of basic earnings on behalf of each of the executive directors. The contribution for Mr Ratcliffe is paid into a personal pension scheme.

The scheme also offers income protection for all employees, including the directors, in the case of permanent ill-health as well as lump sum and dependents' pension payable where death occurs in service or in retirement.

Resolution

A resolution to shareholders to approve the report of the Remuneration Committee will be put forward at the Annual General Meeting.

P Davies
Remuneration Committee Chairman

10 February 2003

Auditors' *Report*

Independent Auditors' report to the members of Microgen plc

We have audited the financial statements which comprise the group profit and loss account, the balance sheets, the group cash flow statement, the statement of total recognised gains and losses, and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report ("the auditable part").

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

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 auditable part of the directors' remuneration report 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 is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the report of the directors, the chairmans' statement, the corporate governance statement and the unauditable part of the directors remuneration report.

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 to form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the directors' remuneration report 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.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group at 31 December 2002 and the loss and cash flows of the group for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

The maintenance and integrity of the Microgen Plc website is the responsibility of the directors; the work carried out by PricewaterhouseCoopers LLP does not involve consideration of these matters and, accordingly, we accept no responsibility for any changes that may have have occurred to the financial statements since they were initially presented on the website.

PricewaterhouseCoopers LLP PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

10 February 2003

Group Profit and Loss Account *for the year ended 31st December 2002*

microgen
Information Management Solutions

	Notes	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 As restated £'000
Turnover			
Continuing operations		**17,394**	21,009
Acquisitions		**7,938**	—
	1(a)	**25,332**	21,009
Operating costs			
Continuing operations		**(17,771)**	(21,329)
Acquisitions		**(8,240)**	—
Exceptional items		**(1,495)**	—
	1(b)	**(27,506)**	(21,329)
Operating (Loss)/Profit			
Continuing operations		**1,024**	1,112
Acquisitions		**1,008**	—
Operating Profit before goodwill amortisation and exceptional items	1(c)	**2,032**	1,112
Goodwill Amortisation		**(2,711)**	(1,432)
Exceptional items		**(1,495)**	—
Operating loss after goodwill amortisation and exceptional items		**(2,174)**	(320)
Operating loss	1(d)	**(2,174)**	(320)
Net finance income	5	**210**	571
Profit on ordinary activities before tax, goodwill amortisation and exceptional items		**2,242**	1,683
Goodwill amortisation		**(2,711)**	(1,432)
Exceptional items		**(1,495)**	—
(Loss)/Profit on ordinary activities after goodwill amortisation and exceptional items and before tax		**(1,964)**	251
(Loss)/profit on ordinary activities before taxation		**(1,964)**	251
Tax on (loss)/profit on ordinary activities	6	**(616)**	490
(Loss)/profit for the financial year transferred to reserves		**(2,580)**	741
Earnings per Share			
Basic and Diluted	19	**(4.2)p**	1.5p
Adjusted Earnings per share (before goodwill amortisation, exceptional items and normalisation of tax charge)	19		
Basic and Diluted		**2.6p**	2.3p

Statement of Total Recognised Gains and Losses		2002 £'000	2001 As restated £'000
(Loss)/profit for the financial year		**(2,580)**	741
Exchange rate adjustments		**15**	—
Total recognised (losses)/gains for the year		**(2,565)**	741
Prior year adjustment	6	**930**	
Total recognised (losses)/gains since last annual report		**(1,635)**	

Notes on pages 20 to 37 form part of the Financial Statements

Balance

Sheets *as at 31st December 2002*

	Notes	Group 31 Dec 2002 £'000	Group 31 Dec 2001 As restated £'000	Company 31 Dec 2002 £'000	Company 31 Dec 2001 £'000
Fixed Assets					
Intangible assets	7	**37,149**	24,599	—	—
Tangible assets	8	**1,349**	1,215	—	—
Investments	9	**282**	114	**44,337**	28,257
		38,780	25,928	**44,337**	28,257
Current Assets					
Stocks – raw materials		**86**	91	—	—
Debtors	10	**6,439**	4,353	**6,364**	6,751
Cash at bank and in hand	11	**9,848**	13,168	**4,803**	241
		16,373	17,612	**11,167**	6,992
Creditors: amounts falling due within one year	12	**(8,115)**	(6,074)	**(22,229)**	(14,783)
Net current assets		**8,258**	11,538	**(11,062)**	(7,791)
Total assets less current liabilities		**47,038**	37,466	**33,275**	20,466
Creditors: amounts falling due after more than one year	13	**(650)**	—	**(650)**	—
Provisions for liabilities and charges	14	**(2,628)**	(1,273)	—	—
Net Assets		**43,760**	36,193	**32,625**	20,466
Capital and Reserves					
Called up share capital	16	**2,920**	2,561	**2,920**	2,561
Share premium account	17	**29,011**	17,594	**29,011**	17,594
Other reserves	17	**616**	300	**616**	300
Profit and loss account	17	**11,213**	15,738	**78**	11
Equity Shareholders' funds	18	**43,760**	36,193	**32,625**	20,466

Approved by the board of directors on 10 February 2003 and signed on its behalf by:

M R Ratcliffe M R Ratcliffe

M S Phillips Mike Phillips

Notes on pages 20 to 37 form part of the Financial Statements

Group Cash Flow
Statement *for the year ended 31 December 2002*

microgen
Information Management Solutions

	Notes	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Net cash inflow from operating activities	24	**2,640**	2,997
Returns on investments and servicing of finance			
Interest received		**404**	702
Interest paid		**(248)**	(87)
Interest element of finance lease payments		**—**	(16)
		156	599
Taxation			
Tax paid in respect of the current year		**(190)**	(313)
Tax paid relating to prior years		**(293)**	*(360)*
Tax refund		**8**	1,346
		(475)	673
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(367)**	(559)
Sale of tangible fixed assets		**1**	9
		(366)	(550)
Acquisition and disposals			
Purchase of subsidiary undertakings	20	**(4,108)**	—
Net cash acquired with subsidiary undertakings		**122**	—
Adjustment to consideration on purchase of subsidiary undertaking		**100**	—
		(3,886)	—
Equity dividends paid to shareholders		**—**	(512)
Cash (outflow)/inflow before financing		**(1,931)**	3,207
Financing			
Issue of share capital	17	**4,165**	2
Buy back of share capital		**(1,960)**	—
Purchase of shares for Trust	9	**(200)**	—
Redemption of loan notes		**(3,394)**	(2,994)
Payment of deferred consideration		**—**	(350)
Capital element of finance leases rental payments		**—**	(568)
		(1,389)	(3,910)
Decrease in cash in the year	25	**(3,320)**	(703)

Notes on pages 20 to 37 form part of the Financial Statements

Accounting Policies

Accounting Policies

A summary of the principal accounting policies is set out below.

Basis of accounting

The financial statements have been prepared under the historical cost convention and are in accordance with the Companies Act 1985 and applicable Accounting Standards. As allowed by section 230 of the Companies Act 1985 no profit and loss account is presented for Microgen plc.

Changes in accounting policies

The Group has adopted FRS 19 "Deferred Tax" in these financial statements. The adoption of this standard represents a change in accounting policy and comparative figures have been restated accordingly. Details of the effect of adopting FRS 19 are given in note 6.

Basis of consolidation

The Group financial statements consolidate the financial statements of Microgen plc and all of its subsidiary undertakings (subsidiaries). The accounts of all subsidiaries are prepared to 31 December annually. The result of subsidiaries acquired are included in the profit and loss account from the date that control passes to the Group. Intra-Group transactions are eliminated fully on consolidation. Acquisitions are accounted for under the acquisition method.

Revenue recognition

Software revenues are recognised in accordance with US GAAP SOP 97-2 which also complies with UK accounting standards. Software license fees are recognised as revenue when delivery of the software has occurred, provided a signed agreement is in place, the license fee is fixed and determinable, no specific vendor obligations remain and the collection of the fee is probable. In addition, where deferred payment terms are agreed for software licenses revenue is only recognised when the invoice date is within 90 days of the period end and the invoice is payable on standard 30 days terms.

Revenues from consulting and training services are recognised at the time the service is performed.

Revenues from maintenance contracts are recognised over the term of the contract on a straight line basis.

Intangible assets – goodwill

Goodwill arising on consolidation represents the excess of the fair value of the consideration given over the fair value of the identifiable net liabilities acquired. Goodwill is capitalised on the balance sheet and amortised on a straight line basis over its useful economic life, currently 20 years. Provision is made for impairment if required and reviewed annually in accordance with best practice.

Depreciation

Depreciation is provided so as to write off the cost of tangible fixed assets over their estimated useful lives by equal annual instalments at the following rates:

Leasehold improvements	20 per cent.
Plant and machinery	20-50 per cent.
Fixtures and fittings	20 per cent.

Estimation of useful life includes an assessment of the expected rate of technological developments and the intensity at which the assets are expected to be used.

Leasing

Tangible fixed assets acquired under finance leases are capitalised and the capital element of outstanding lease rentals is included in creditors. Depreciation is provided on the same basis as owned assets or over the unexpired portion of the lease if shorter. The interest element of lease rentals is charged in the profit and loss account. Operating lease rentals are charged in the profit and loss account as incurred.

Stocks

Stocks, which comprise raw materials and consumables, have been valued at the lower of cost and net realisable value.

Pensions

The Group operates money purchase pension schemes in respect of its UK employees. The schemes are defined contribution schemes and contributions are based on basic earnings for the current year. The schemes are funded by payments to a trustee-administered fund completely independent of the Group's finances. The charge for 2002, representing contributions payable by the group, amounted to £399,000 (2001:£394,000).

Taxation

Deferred taxation has been recognised as a liability or asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in future, or a right to pay less taxation in future. An asset is not recognised to the extent that the transfer of economic benefits in future is uncertain. Deferred tax is measured on a non-discounted basis.

Fixed asset investments

Investments in subsidiaries are stated in the accounts of the Company at cost less any provisions for impairment. Investments in own shares are stated at the lower of cost less any permanent diminution in value or option exercise value.

Research and development

Expenditure on research and development is written off against profits in the year in which it is incurred.

Foreign currency

Trading transactions by UK based companies within the Group are translated into sterling at the exchange rate ruling when the transaction was entered into, or the exchange rate fixed under forward exchange contracts. Monetary assets and liabilities denominated in foreign currencies in respect of UK companies, are translated into sterling at the exchange rate ruling at the balance sheet date or the exchange rate fixed under forward exchange contracts. Exchange gains or losses thereon are included in the profit and loss account. On consolidation the balance sheet of each overseas company is converted at the rate of exchange ruling on the balance sheet date of that company and the profit and loss account at the average rate of exchange for the year then ended. Exchange gains and losses arising thereon are included as a movement on reserves.

Financial instruments

The Group does not use derivatives to manage its exposure to interest rates. Financial instruments are recognised in the balance sheet at their historical cost with long term liabilities discounted to their present value.

In order to manage exchange rate risk, the group operates a policy of entering into forward contracts in respect of Polish Zloty transactions with the Group Polish development operation.

Accounting Policies

Employee share schemes

The Group has established an Employee Participation Scheme Trust. Where the Trust acquires shares in the company, these shares are included within investments at cost. Provision is made for any permanent diminution in value.

Share options

The cost to the Company of granting shares or rights to shares, including options, to employees is charged to the profit and loss account over the period in which the benefit vests to the employees. The cost is calculated as the difference between the market value of the shares at the date of grant and the cost to the employees of the rights.

Employers' National Insurance contributions on share options granted

The provision for employers National Insurance contribution is charged to the profit and loss account over the period in which the benefit vests to the employees. The provision is adjusted to reflect changes in the market value of the Company's shares. The adjustment is taken to the profit and loss account over the remaining period in which the benefit vests to the employees. The liability for employers' National Insurance contributions arising on options granted on or after 14 September 2000 is the responsibility of the option holder.

1. Turnover, profit and net assets analysis

(a) Turnover

	Continuing Operations £'000	Acquisitions £'000	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Microgen Telesmart	10,805	97	10,902	12,229
Microgen Kaisha	6,589	—	6,589	8,780
Microgen OST	—	7,841	7,841	—
	17,394	7,938	25,332	21,009

(b) Operating Costs

	Continuing Operations £'000	Acquisitions £'000	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Microgen Telesmart	(9,324)	(151)	(9,475)	(11,204)
Microgen Kaisha	(4,953)	—	(4,953)	(6,576)
Microgen OST	—	(6,779)	(6,779)	—
	(14,277)	(6,930)	(21,207)	(17,780)
Group costs	(2,195)	—	(2,195)	(2,198)
Movement in property provision	102	—	102	81
Operating costs before goodwill amortisation and exceptional items	(16,370)	(6,930)	(23,300)	(19,897)
Goodwill amortisation				
Microgen Telesmart	(158)	(690)	(848)	(180)
Microgen Kaisha	(1,243)	—	(1,243)	(1,252)
Microgen OST	—	(620)	(620)	—
	(1,401)	(1,310)	(2,711)	(1,432)
Operating costs before exceptional items	(17,771)	(8,240)	(26,011)	(21,329)
Exceptional items				
Property provision	—	(1,471)	(1,471)	—
Acquisition integration costs	—	(24)	(24)	—
	—	(1,495)	(1,495)	—
Total operating costs	(17,771)	(9,735)	(27,506)	(21,329)

(c) Profit before tax, goodwill amortisation and exceptional item

	Continuing Operations £'000	Acquisitions £'000	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Operating profit before goodwill amortisation and exceptional items				
Microgen Telesmart	1,481	(54)	1,427	1,025
Microgen Kaisha	1,636	—	1,636	2,204
Microgen OST	—	1,062	1,062	—
Divisional operating profit before group costs	3,117	1,008	4,125	3,229
Group costs	(2,195)	—	(2,195)	(2,198)
Movement in property provisions	102	—	102	81
Operating profit before goodwill amortisation and exceptional items	1,024	1,008	2,032	1,112
Net finance income	210	—	210	571
Profit before tax, goodwill amortisation and exceptional items	1,234	1,008	2,242	1,683

1. Turnover, profit and net assets analysis (continued)

(d) (Loss)/Profit on ordinary activities before tax

	Continuing Operations £'000	Acquisitions £'000	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Operating profit before goodwill amortisation and exceptional items	1,024	1,008	2,032	1,112
Goodwill amortisation	(1,401)	(1,310)	(2,711)	(1,432)
Exceptional items	—	(1,495)	(1,495)	
Operating loss	(377)	(1,797)	(2,174)	(320)
Net finance income	210	—	210	571
(Loss)/profit on ordinary activities before tax	(167)	(1,797)	(1,964)	251

(e) Net assets by region:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000 As restated
United Kingdom and Ireland	44,012	36,193
USA	(401)	—
Poland	149	—
	43,760	36,193
Net assets by type of business:		
Microgen Telesmart	37,093	10,687
Microgen Kaisha	6,122	25,506
Microgen OST	545	—
	43,760	36,193

Turnover and profit substantially arises in the UK.

2. Operating costs

An analysis of operating costs is shown below:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Staff costs (see note 3)	**11,182**	11,416
Depreciation of owned assets	**775**	1,257
Depreciation of leased assets	**—**	108
Goodwill amortisation	**2,711**	1,432
Credit relating to surplus property provision	**(102)**	(81)
Exceptional items	**1,495**	—
Other operating expenses	**11,445**	7,197
	27,506	21,329

In addition the following items are included within (loss)/profit on ordinary activities before taxation:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Auditors remuneration		
Audit*	**84**	64
Other services** (tax compliance services)	**61**	88
Operating lease rentals		
Property	**565**	422
Other	**131**	211
Loss on sale of tangible assets	**25**	14
Research and development	**2,477**	1,288

*Included in the above is the auditors' remuneration in respect of the Company of £2,000 (2001: £2,000)
**Other services charged to the Profit and Loss Account were in respect of Tax compliance services. In addition, non-audit fees of £404,000 payable to PricewaterhouseCoopers relating to financial and tax due diligence services as part of the Class 1 Circular in respect of the Acquisition of the OST Group were capitalised by the Group (2001: Nil).

3. Staff

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Staff costs		
Wages and salaries	**9,739**	9,742
Social security costs	**1,044**	1,280
Other pension costs	**399**	394
	11,182	11,416

The average monthly number of employees:

By location:		
United Kingdom and Ireland	**255**	255
Poland	**40**	—
USA	**3**	—
	298	255
By category:		
Development	**54**	22
Operations and support	**47**	55
Sales and Marketing	**41**	27
Management, Finance and Administration	**42**	32
Consultants*	**69**	62
Print bureau	**45**	57
	298	255

*Included within consultants are external contractors.

Notes to the
Financial Statements

4. Directors' remuneration

The information required by the Companies Act and the Listing Rules of the Financial Services Authority is contained in the Directors' Report on Remuneration on pages 13 to 15 and forms part of these financial statements:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Directors' emoluments	**747**	666

5. Net finance income

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Interest receivable:		
Bank	**429**	720
Interest payable on borrowings:		
Bank loans and overdrafts	**(7)**	(2)
Interest on overdue overseas tax	**(90)**	—
Finance lease charges	**—**	(16)
Interest payable on loan notes	**(82)**	(89)
Interest payable excluding amortisation of Discounts	**(179)**	(107)
Amortisation of discount on provision for surplus property	**(40)**	(42)
	210	571

6. Tax on (loss)/profit on ordinary activities

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 As restated £'000
Current Taxation:		
UK corporation tax charge @ 30%	**(692)**	(346)
Tax credit on exceptional items	**449**	—
Foreign Taxation	**(36)**	—
Current year taxation charge	**(279)**	(346)
UK corporation tax prior year tax (charge)/credit	**(196)**	1,544
Total current taxation (charge)/credit	**(475)**	1,198
Deferred taxation:		
Charge for timing differences arising in the year	**(141)**	(708)
Total deferred taxation	**(141)**	(708)
Total taxation on (loss)/profit on ordinary activities	**(616)**	490

Prior Year Adjustment

Microgen plc has adopted FRS 19 deferred tax for the first time in 2002 which has resulted in a deferred tax asset of £796,000 (2001 as restated: £930,000) due to timing differences relating to accounting provisions and capital allowances. In addition the UK group had a potential deferred tax asset of £420,000 (2001 as restated: £260,000) relating to taxable trading losses carried forward which has not been recognised in the accounts.

Within the prior year tax charge, £128,000 relates to additional UK tax payable in respect of dividends received in 1997 from the Group's former German subsidiary upon which agreement of the underlying tax rate was only reached in 2002.

6. Tax on (loss)/profit on ordinary activities (continued)

The differences between the total current tax charge and the amount calculated by applying the national rates of corporation tax (UK 30%, Poland 28%, US 35%) to the (loss)/profit on ordinary activities before tax is as follows:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000 As restated
(Loss)/Profit on ordinary activities before tax	**(1,964)**	251
Corporation tax credit/(charge) at standard rate of tax of 30% based on (loss)/profit on ordinary activities before tax	**589**	(68)
Adjustment for the effects of:		
Unrelieved trading losses	**(178)**	—
Goodwill amortisation not deductible for tax purposes	**(813)**	(430)
Other expenses not deductible for tax purposes	**(73)**	(59)
Capital allowances in excess of depreciation	**196**	211
Current Year taxation charge	**(279)**	(346)
UK Corporation tax prior year (charge)/credit	**(196)**	1,544
Group current tax (charge)/credit for the period	**(475)**	1,198

The current year taxation charge of £279,000 (2001: £346,000) represents an effective rate of tax for the group on its profit on ordinary activities before goodwill of 37.3% (2001: 20.6%).

7. Intangible assets

	Goodwill £'000
Group	
Cost	
As at 1 January 2002	28,195
Adjustment on acquisition of subsidiary – Telesmart	(300)
Acquisition of subsidiary – OST (see note 20(a))	14,871
Acquisition of subsidiary – Wishstream (see note 20(b))	690
At 31 December 2002	**43,456**
Amortisation	
As at 1 January 2002	3,596
Charge for the year	2,031
Impairment review – Wishstream	680
At 31 December 2002	**6,307**
Net book amount	
At 31 December 2002	**37,149**
At 31 December 2001	**24,599**

The adjustment on the acquisition of the subsidiary represents a reduction in the consideration for the acquisition of Telesmart negotiated during the year.

8. Tangible fixed assets

	Leasehold improvements £'000	Plant and machinery £'000	Fixtures and fittings £'000	Total £'000
Group				
Cost				
At 1 January 2002	769	6,281	314	7,364
Acquired from Acquisition	168	326	73	567
Additions	—	281	86	367
Disposals	(25)	(130)	(8)	(163)
At 31 December 2002	**912**	**6,758**	**465**	**8,135**
Depreciation				
At 1 January 2002	738	5,181	230	6,149
Charge for the year	56	617	102	775
Disposals	(24)	(113)	(1)	(138)
At 31 December 2002	**770**	**5,685**	**331**	**6,786**
Net book amount				
At 31 December 2002	**142**	**1,073**	**134**	**1,349**
At 31 December 2001	31	1,100	84	1,215

The net book amount of plant and machinery included above and held under finance lease is £nil (2001: £nil). Accumulated depreciation for those assets at 31 December 2001 was £nil (2001: £nil).

The company held no fixed assets.

9. Investments

	Investment in own shares Group £'000	Investment in own shares Company £'000	Investment in subsidiaries Company £'000	Total Company £'000
Cost				
At 1 January 2002	452	452	28,143	28,595
Additions	267	267	16,212	16,479
Adjustments	—	—	(300)	(300)
At 31 December 2002	**719**	**719**	**44,055**	**44,774**
Provision				
At 1 January 2002	338	338	—	338
Charge for the year	99	99	—	99
At 31 December 2002	**437**	**437**	**—**	**437**
Net book amount				
At 31 December 2002	**282**	**282**	**44,055**	**44,337**
At 31 December 2001	114	114	28,143	28,257

The investment in own shares relates to shares held by the Microgen Employee Share Participation Trust ("the trust"), which was set up in March 1999 to facilitate the issue of replacement options to employees of Kaisha Technology Limited. As at 31 December 2002, the trust held 675,788 Ordinary shares of 5p each in Microgen plc, representing 1.15% of the issued share capital of the company with a market value of £135,157. 441,493 Ordinary Shares which are under option to employees and the balance are available for use by the Trustees in accordance with the terms of the Trust. The options are first exercisable from the third anniversary of the original grant and for a further seven years thereafter. 280,000 of these options were granted at nil consideration and have been written off over the three year vesting period.

9. Investments (continued)

Principal subsidiaries	Held directly	Held indirectly	Equity held	Country
Microgen UK Limited	100%	—	100%	England & Wales
Microgen Kaisha Limited	20%	80%	100%	England & Wales
Microgen Telesmart Limited	100%	—	100%	England & Wales
Microgen OST Limited	100%	—	100%	England & Wales
OST Business Rules Inc	—	100%	100%	USA
Open Software Technology Poland Sp. Z.o.o.	—	100%	100%	Poland
Wishstream Limited	—	100%	100%	England & Wales

10. Debtors

	31 Dec 2002 Group	31 Dec 2001 Group As restated	31 Dec 2002 Company	31 Dec 2001 Company
	£'000	£'000	£'000	£'000
Trade debtors	4,467	2,449	—	—
Amounts owed by Group undertakings	—	—	6,322	6,749
Corporate tax recoverable	105	125	—	2
Other debtors	132	258	—	—
Prepayments and accrued income	939	591	42	—
Deferred tax asset	796	930	—	—
	6,439	4,353	6,364	6,751

11. *Cash at Bank and in hand*

	31 Dec 2002 Group £'000	31 Dec 2001 Group £'000	31 Dec 2002 Company £'000	31 Dec 2001 Company £'000
Cash at bank and in hand	3,623	943	78	16
Term deposits	6,225	12,225	4,725	225
	9,848	13,168	4,803	241

12. Creditors: due within one year

	31 Dec 2002 Group	31 Dec 2001 Group As restated	31 Dec 2002 Company	31 Dec 2001 Company
	£'000	£'000	£'000	£'000
Trade creditors	710	642	—	—
Amounts owed to Group Undertakings	—	—	21,060	14,258
Corporation tax	—	—	11	—
Other taxes and social security costs	834	854	—	—
Other creditors	392	274	—	—
Deferred consideration on acquisition	250	150	250	150
Loan notes payable	652	225	652	225
Accruals and deferred income	5,277	3,929	256	150
	8,115	6,074	22,229	14,783

13. Creditors: due after more than one year

	31 Dec 2002 Group £'000	31 Dec 2001 Group £'000	31 Dec 2002 Company £'000	31 Dec 2001 Company £'000
Loan notes payable	650	—	650	—
	650	—	650	—

14. Provisions for liabilities and charges

	31 Dec 2002 £'000	31 Dec 2001 £'000
Provisions for liabilities and charges relate to surplus lease properties and may be analysed as follows:		
At 1 January	**1,273**	1,708
Credited to profit and loss account	**(131)**	(243)
Charged to profit and loss account	**29**	162
Charged to profit and loss account – Exceptional	**1,471**	—
Utilised in the year	**(54)**	(396)
Amortisation of discount	**40**	42
At 31 December	**2,628**	1,273

The period end balance is expected to mature during the following periods analysed as follows:

	31 Dec 2002 £'000	31 Dec 2001 £'000
Within one year	**562**	47
Between one and two years	**1,270**	260
Between two and five years	**181**	247
More than five years	**615**	719
	2,628	1,273

The provision covers costs associated with surplus and vacant properties where rent and service charges are predominantly predetermined for the life of the lease. A number of properties have been sublet and rental income has been assumed for these properties. At the end of each lease the company incurs dilapidation costs which are negotiated on a case by case basis. An assessment of these costs has been included in the provision.

15. Deferred taxation

	31 Dec 2002 £'000	31 Dec 2001 As restated £'000
As at 1 January (restated)	**930**	1,638
On acquisition	**7**	—
Charged to the profit and loss account	**(141)**	(708)
At 31 December	**796**	930
Deferred tax is provided as follows:		
Accelerated Capital allowances	**665**	866
Short term timing differences	**131**	64
Provision for deferred taxation	**796**	930

National rates of corporation tax have been used to calculate the amount of deferred tax. Deferred taxation assets have not been discounted.

16. Share Capital

	Number	£
Authorised ordinary shares of 5p each at 31 December 2002	**90,000,000**	**4,500,000**
Called up, allotted and fully paid		
At 1 January 2002	51,214,953	**2,560,748**
Issued under share option schemes:		
Savings related		
Issued to vendors of Microgen – OST	**8,302,521**	**415,126**
Issued re placing to raise funds in respect of the acquisition of OST Group	**5,116,373**	**255,819**
Issued to vendors of Microgen – Wishstream	**95,238**	**4,762**
Shares bought back and cancelled	**(6,320,000)**	**(316,000)**
At 31 December 2002	**58,409,085**	**2,920,455**

17. Reserves

	Share premium account £'000	Other reserves £'000	Profit and Loss Account Revenue Reserve £'000	Goodwill Reserve £'000	Total £'000
Group					
At 1 January 2002 as previously stated	**17,594**	**300**	26,452	(11,644)	**14,808**
Prior Year Adjustment – FRS 19 Deferred Tax Asset	—	—	930	—	**930**
At 1 January 2002 (as restated)	**17,594**	**300**	27,382	(11,644)	**15,738**
Retained loss for the year	—	—	(2,580)	—	**(2,580)**
Exchange Rate Adjustments	—	—	15	—	**15**
Shares issued to the vendors of OST Group	**7,472**	—	—	—	—
Issue re placing of Shares	**4,042**	—	—	—	—
Shares issued to the vendors of Wishstream	**35**	—	—	—	—
Share buy backs	—	**316**	(1,960)	—	**(1,960)**
Expenses relating to share placing	**(132)**	—	—	—	—
At 31 December 2002	**29,011**	**616**	22,857	(11,644)	**11,213**
Company					
At 1 January 2002	**17,594**	**300**	4,946	(4,935)	**11**
Retained profit for the year	—	—	2,027	—	**2,027**
Shares issued to the vendors of OST Group	**7,472**	—	—	—	—
Issue re placing of Shares	**4,042**	—	—	—	—
Shares issued to the vendors of Wishstream	**35**	—	—	—	—
Share buy backs		**316**	(1,960)	—	**(1,960)**
Expenses relating to share placing	**(132)**	—	—	—	—
At 31 December 2002	**29,011**	**616**	5,013	(4,935)	**78**

Analysis of prior year adjustment

	Total £'000
Adjustment to opening reserve at 1 January 2001	1,638
Adjustment to profit and loss for the year ended 31 December 2001	(708)
	930

18. Reconciliation of movements in Group shareholders' funds

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000 *As restated*
(Loss)/profit for the year	**(2,580)**	741
Dividends	—	—
	(2,580)	741
Other recognised gains and losses for the period	**15**	51
Shares issued during the period	**12,092**	25
Share buy back	**(1,960)**	—
	7,567	817
Opening shareholders' funds	**36,193**	35,376
Closing shareholders' funds	**43,760**	36,193

19. Earnings per share

The basic earnings per share calculations are based on the weighted average number of shares in issue during the period of 61,308,631 (2001: 51,210,517). Diluted earnings per share calculations are based on 61,536,117 (2001: 51,579,616) ordinary shares calculated as the basic weighted average number of ordinary shares plus nil (2001: 731,099) dilutive share options.

To provide an indication of the underlying operating performance per share the adjusted profit after tax figure shown below excludes goodwill amortisation, exceptional items, prior year tax charges and credits and the impact of adopting FRS 19 Deferred Tax.

	2002 pence	2001 pence
Basic earnings per share	**(4.2)**	1.5
Goodwill amortisation	**4.5**	2.8
Exceptional items net of tax	**1.7**	—
Prior years' tax charge/(credit)	**0.3**	(3.0)
Normalisation of Tax at 30%	**0.1**	1.0
Deferred tax charge	***0.2***	—
Adjusted earnings per share	**2.6**	2.3
Diluted earnings per share	**(4.2)**	1.5
Goodwill amortisation	**4.5**	2.8
Exceptional items net of tax	**1.7**	—
Prior years' tax credit	**0.3**	(3.0)
Normalisation of Tax at 30%	**0.1**	1.0
Deferred tax charge	**0.2**	—
Adjusted diluted earnings per share	**2.6**	2.3

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Profit/(loss) on ordinary activities before tax, goodwill amortisation and exceptional item	**2,242**	1,683
Normalised tax charge at 30%	**(673)**	(505)
Adjusted Profit on ordinary activities after tax	**1,569**	1,178
Adjustment to actual current year tax charge	**(55)**	151
Goodwill amortisation	**(2,711)**	(1,432)
Exceptional items net of tax	**(1,046)**	—
Prior years' tax charge/(credit)	**(196)**	1,544
Deferred tax charge	**(141)**	(708)
Adjusted (loss)/profit on ordinary activities after tax	**(2,580)**	733

20. Acquisitions

The group made two acquisitions during the year for a total consideration of £16,861,000. The total adjustments required to the book values of the assets and liabilities acquired in order to present the net assets of those companies acquired in accordance with group accounting principles were £270,000 details of which are set out below together with the resulting amount of goodwill arising. Both of these purchases have been accounted for as acquisitions.

From the dates of acquisition to 31 December 2002 the acquisitions have contributed £7,938,000 to turnover and £1,008,000 to Operating Profit before interest, goodwill amortisation and exceptional items. The acquisitions contributed £786,000 to the group's net operating cash flows, paid £342,000 in respect of taxation, and £82,000 in respect of interest.

(a) Acquisition of OST

On 8 February 2002 the company announced the acquisition, subject to share holder approval, of the OST Group. Shareholders' approval was obtained at the EGM on 26 February 2002 and the acquisition of the OST Group was formally completed on 27 February 2002.

The key financial details in respect of the acquisition are scheduled below.

	Notes	£'000
Consideration and cost in respect of the acquisition:		
Cash		2,118
Loan Notes		4,471
Ordinary Shares		7,265
Initial consideration		13,854
Increase in fair value of consideration	(i)	623
Deferred consideration		250
Fees and costs in respect of the acquisition		1,485
		16,212

	Provisional net assets acquired £'000	Fair Value Adjustments £'000	Provisional Fair Values £'000
Fixed Assets	503	—	503
Debtors	4,132	(245)	3,887
Cash	145	—	145
Bank Loan	(127)	—	(127)
Creditors	(2,958)	(25)	(2,983)
Taxation	(84)	—	(84)
Net Assets	1,611	(270)	1,341
Goodwill on acquisition			14,871
Total Consideration and costs			16,212

(i) The increase in the fair value of consideration represents the increase in value of the ordinary shares in Microgen plc between exchange of contracts for the transaction and completion.

(ii) The provisional fair value adjustments relate to adjustments of accounting policies to bring them in line with those of Microgen Plc.

20. *Acquisitions (continued)*

(b) Acquisition of Wishstream

On 9 September 2002 the company announced the acquisition of Wishstream Limited. The acquisition was formally completed on 11 September 2002.

The key financial details in respect of the acquisition are scheduled below.

	£'000
Consideration and cost in respect of the acquisition:	
Cash	485
Ordinary Shares	40
Initial consideration	525
Deferred consideration	65
Fees and costs in respect of the acquisition	59
	649

	Provisional net liabilities acquired £'000	Fair Value Adjustments £'000	Provisional Fair Values £'000
Fixed Assets	64	—	64
Debtors	2	—	2
Cash	104	—	104
Creditors	(211)	—	(211)
Net liabilities	(41)	—	(41)
Goodwill on acquisition			690
Total Consideration and costs			649

21. *Capital commitments*

At 31 December 2002, the Group had no contracted capital commitments for (2001: nil).

22. Operating leases

	2002 Properties £'000	2001 Properties £'000	**2002 Other £'000**	2001 Other £'000
At 31 December 2002 the Group had the following annual commitments which expire:				
Within one year	**101**	25	—	56
Between one and five years	**508**	87	—	5
After five years	**311**	288	—	—
	920	400	—	61

23. Borrowings

A composite cross guarantee exists between the various Group companies.

The Company has guaranteed loan and overdraft facilities, subject to normal financial covenants for facilities of this nature, in its subsidiaries at 31 December 2002 totalling £13,000,000 (2001: £13,000,000).

There were no amounts outstanding under these facilities as at 31 December 2002 (2001: Nil).

24. Reconciliation of operating profit to net cash flow from operating activities

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Operating loss	**(2,174)**	(320)
Depreciation	**775**	1,365
Goodwill Amortisation	**2,711**	1,432
Exceptional Item – Property Provision	**1,471**	—
Exceptional Item – Other	**24**	—
Loss on sale of fixed assets	**25**	14
Other non Cash movements	**—**	146
Decrease in Debtors	**1,300**	1,356
Decrease in Stocks	**5**	31
Decrease in Creditors	**(1,497)**	(1,027)
Net cash inflow from operating activities	**2,640**	2,997

25. Reconciliation of net cash flow to movements in net funds:

	Year ended 31 Dec 2002 £'000	Year ended 31 Dec 2001 £'000
Decrease in cash in the period	**(3,320)**	(703)
Cash Outflow from decrease in lease financing	**—**	568
Change in net funds resulting from cash flow	**(3,320)**	(135)
Redemption of loan notes	**3,394**	2,994
Issue of Loan notes	**(4,471)**	—
Movement in net funds in the period	**(4,397)**	2,859
Net funds at the beginning of the period	**12,943**	10,084
Net funds at the end of the period	**8,546**	12,943

26. Analysis of net funds

	At 1 Jan 2002 £'000	**Cash Flow £'000**	**Acquisitions £'000**	**At 31 Dec 2002 £'000**
Cash at bank and in hand	**13,168**	**(3,320)**	**—**	**9,848**
Debt due within 1 year	**(225)**	**225**	**(652)**	**(652)**
Debt due after 1 year	**—**	**—**	**(650)**	**(650)**
Total	**12,943**	**(3,095)**	**(1,302)**	**8,546**

27. Financial Instruments

The following analysis excludes debtors and creditors falling due within one year, other than cash at bank and short term deposits or borrowings.

Financial assets and liabilities

The interest rates and currency profiles of the Group's financial assets and liabilities at 31 December 2002 were:

	Cash at bank and in hand £'000	**Short term deposits £'000**	**2002 Total £'000**	2001 Total £'000
Floating rate				
Sterling	3,447	6,225	9,672	13,162
US Dollars	34	—	34	—
Polish Zloty	142	—	142	—
IR Punts	—	—	—	6
	3,623	6,225	9,848	13,168

27. Financial Instruments (continued)

Floating rate cash and short term deposits earn interest based on relevant national LIBOR equivalents or government bond rates Interest rate risk of financial liabilities, all of which are sterling.

	Loan notes £'000	Deferred consideration £'000	2002 Total £'000	2001 Total £'000
Floating rate	1,302	—	1,302	225
Non interest bearing	—	250	250	150
At 31 December	**1,302**	**250**	**1,552**	**375**

In addition to the above, the group's provision of £2,628,000 for vacant leasehold properties (note 14) meets the definition of financial liabilities. This financial liability is considered to be a floating rate financial liability as the cash flows have been discounted and the discount rate is re-appraised each year to ensure that is reflects the current market assessments of the time value of money and the risks specific to the liability.

	Loan notes £'000	Deferred consideration £'000	2002 Total £'000	2001 Total £'000
Within 1 year, or on demand	652	250	902	375
Between 1 and 2 years	650	—	650	—
At 31 December	**1,302**	**250**	**1,552**	**375**

Currency exposures:
The Group's objective in managing the currency exposures arising from its net investment overseas is to maintain a low cost of borrowing and ensure currency risk is mitigated. The Group hedges against material transactions in foreign currencies.

As at 31 December 2002 the Group had the following foreign currency intra group balances.

	Net foreign currency monetary assets (liabilities)			
Functional currency of group operation	**Sterling £'000**	**Polish Zloty £'000**	**US Dollar £'000**	**Total £'000**
Sterling	—	32	472	504
Polish Zloty	—	—	—	—
US Dollars	(472)	—	—	(472)
Total	(472)	32	472	32

At 31 December 2001 the Group had no overseas operations.

At 10 February 2003, the Group also held open various forward contracts that the group had taken out to hedge expected future foreign currency transactions. These are not recorded as assets or liabilities and the fair value approximates to their book value.

Borrowing facilities:
The Group's principal source of borrowing facilities is through (1) Medium term LIBOR (Revolving) - £10 million and (2) "on demand" bank overdrafts - £3 million. These facilities are subject to banking covenants and are generally reviewed on an annual or ongoing basis and hence the facilities expire within one year or less.

The £3 million "on demand" facility is due for review in August 2003 and the £10 million revolving facility expires on 21 April 2009.

Fair value of assets and liabilities:
There is no material difference between the fair value of the Group's financial assets and liabilities and their book values as shown in the financial statements.

27. Financial Instruments (continued)

Hedge of future transactions:

During the year the group has entered into forward hedge contracts in respect of transactions between the ultimate parent company in the UK and the Polish subsidiary.

The following forward contracts were completed during the year:

Date of Forward contract	PLN	Rate of Contract	Spot Rate	Gain/ (Loss) £
25 October 2002	740,000	6.4185	6.3092	(1,997)
25 November 2002	780,000	6.438	6.2216	(4,214)
16 December 2002	720,000	6.449	6.1824	(4,814)

The table below shows the extent to which the Group has off balance sheet (unrecognised) gains and losses in respect of hedges at the beginning and end of the year.

	Gains £'000	Losses £'000	Net gains/ (Losses) £'000
Gains and losses on hedges at 1 January 2002	—	—	—
Gains and losses on hedges at 31 December 2002	—	(11)	(11)
Of which:			
Gains and losses expected to be included in 2002 income	—	(11)	(11)
Gains and losses expected to be included in 2003 income or later	3	(2)	1

Shareholder
Information and Financial Calendar

Analysis of ordinary shareholders at 31 December 2002

Size of holding	Number of shareholders	%	Number of shares 000s	%
1-1,000	737	58.8	322	0.6
1,001-5,000	293	23.4	738	1.3
5,001-20,000	103	8.2	1,116	1.9
20,001-200,000	87	7.0	5,989	10.2
200,001 and above	33	2.6	50,244	86.0
	1,253	100.0	58,409	100.0

Investor type	Number of shares 000s	%
Investment and Unit Trusts	26,635	45.6
Directors' interests	11,805	20.2
Private individuals	11,959	20.5
Pension funds	4,601	7.9
Other investors	3,409	5.8
	58,409	100.0

Registered and Group Head Office
Microgen plc
11 Park Street
Windsor
Berkshire SL4 1LU
Registered number 1602662

Telephone: 01753 847100
Facsimile: 01753 847171

Registrar
Capita Registrars
Balfour House
390/398 High Road
Ilford
Essex IGI 1NQ

Telephone: 0870 162 3100
Facsimile: 0208 478 2876

Microgen plc ordinary shares are quoted on the London Stock Exchange.

Shareholders' enquiries

Enquires regarding shareholdings or dividends should in the first instance be addressed to Capita Registrars.

Annual General Meeting

The Annual General Meeting will be held at 9.00 a.m. on 17 March 2003 at 11 Park Street, Windsor, Berkshire SL4 1LU. Details are given in a separate notice to shareholders enclosed with this Annual Report.

Results announcement

Interim results	July
Final results	February

Principal Subsidiaries

PRINCIPAL SUBSIDIARIES

The Company's principal trading subsidiaries all undertake activities as described in the Directors' Report and operate in their country of incorporation or registration. Direct investments by the Company comprise Microgen UK Limited, Microgen Kaisha Limited and Microgen Telesmart Limited. The issued share capital of all subsidiaries consists solely of ordinary shares.

Company name	Country	Equity held	Nature of business
Microgen UK Limited	England and Wales	100%	Billing and Hosted Database Services
Microgen Kaisha Limited	England and Wales	100%	Consultancy
Microgen Telesmart Limited	England and Wales	100%	Electronic Payment Solutions
Microgen OST Limited	England and Wales	100%	Financial services software and consultancy
Open Software Technology Poland Sp. z.o.o.	Poland	100%	Software development and support