

Forbidden Technologies plc

**Directors' report and financial
statements**

Registered number 3507286

31 December 2002



Directors' report

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

Principal activities

The principal activity of the Company is the development and commercial exploitation of video compression technology.

Business review

The Company has continued with the development of video compression technology. A detailed review of the Company's performance is provided within the Chairman's report. The results of the Company are shown on page 10.

Proposed dividend

The directors do not recommend the payment of a dividend (2001: Enil).

Directors and directors' interests

The directors who held office during the year were as follows:

SB Streater
VJ Steel
DD Blaikie
DP Main
GB Hirst (appointed 23 January 2002)

The directors who held office at the end of the financial year had the following interests in the shares of the Company according to the register of directors' interests:

		Interest at end of year	Interest at start of year or date of appointment if later
SB Streater	Ordinary shares of 0.8 pence	62,560,000	62,560,000
VJ Steel	Ordinary shares of 0.8 pence	237,500	237,500
DD Blaikie	Ordinary shares of 0.8 pence	28,500	41,000
DP Main	Ordinary shares of 0.8 pence	—	—
GB Hirst	Ordinary shares of 0.8 pence	10,000	10,000

According to the register of directors' interests, no rights to subscribe for shares in or debentures of the Company were granted to any of the directors or their immediate families, or exercised by them, during the financial year except as indicated below:

	Number of options during the year			Exercise price £	Date from which exercisable	Expiry Date
	At start of year	Granted	Exercised			
VJ Steel	125,000	—	—	125,000	0.030	25/01/2003 25/01/2010
VJ Steel	200,000	—	—	200,000	2.175	02/10/2003 02/10/2010
VJ Steel	50,000	—	—	50,000	0.625	30/03/2004 30/03/2011
VJ Steel	150,000	—	—	150,000	0.255	21/09/2004 21/09/2011
VJ Steel	—	100,000	—	100,000	0.475	04/04/2005 04/04/2012
VJ Steel	—	100,000	—	100,000	0.215	04/10/2005 04/10/2012
DD Blaikie	62,500	—	—	62,500	0.030	25/01/2003 25/01/2010
DD Blaikie	187,500	—	—	187,500	2.175	02/10/2003 02/10/2010
DD Blaikie	25,000	—	—	25,000	0.625	30/03/2004 30/03/2011
DD Blaikie	25,000	—	—	25,000	0.255	21/09/2004 21/09/2011
DD Blaikie	—	50,000	—	50,000	0.475	04/04/2005 04/04/2012
DP Main	50,000	—	—	50,000	0.625	19/04/2004 19/04/2011
DP Main	25,000	—	—	25,000	0.255	21/09/2004 21/09/2011
DP Main	—	25,000	—	25,000	0.215	04/10/2005 04/10/2012
GB Hirst	50,000	—	—	50,000	0.255	21/09/2004 21/09/2011
GB Hirst	—	20,000	—	20,000	0.475	04/04/2005 04/04/2012
GB Hirst	—	50,000	—	50,000	0.215	04/10/2005 04/10/2012

The market value of the shares at the year end was 40.5p. The highest market value during the year was 69.5p and the lowest market value 19.0p.

Directors' report

Policy and practice on payment of creditors

The Company does not follow any code, creditors are paid in accordance with the terms of the invoice, subject to any particular agreement between the two parties. At the year end there were no trade creditors (2001: £nil).

Substantial shareholdings

At the year end there were no shareholders, other than directors, who held an interest of 3% or more in the Company's ordinary share capital.

Share option schemes

Under the Company's Approved Share Option Scheme, options over 20,000 ordinary shares of 0.8p in the Company were granted to one director on 4 April 2002, exercisable at 47.5p per share within the period 4 April 2005 to 4 April 2012, on condition of employment with the Company. In addition, options over 20,000 ordinary shares of 0.8p in the Company were granted to four employees on 4 October 2002, exercisable at 21.5p per share within the period 4 October 2005 to 4 October 2012, on condition of employment with the Company.

The Company also has an Unapproved Share Option scheme under which options over 618,750 ordinary shares of 0.8p in the Company were granted to five directors and employees on 4 April 2002, exercisable at 47.5p per share within the period 4 April 2005 to 4 April 2012, on condition of employment with the Company. In addition, options over 628,125 ordinary shares of 0.8p in the Company were granted to six directors and employees on 4 October 2002, exercisable at 21.5p per share within the period 4 October 2005 to 4 October 2012, on condition of employment with the Company.

On termination of employment, employees lose their share options unless the board exercises its discretion to let an employee retain their share options for a limited period.

The exercise price for the share options issued was the market value at the date the options were granted.

Corporate governance

In June 1998, the London Stock Exchange published the Principles of Good Governance and Code of Best Practice (the Combined Code) which embraces the work of the Cadbury, Greenbury and Hampel committees and became effective in respect of accounting periods ending on or after December 1998.

The listing rules require that listed companies (but not companies traded on the Alternative Investment Market "AIM") incorporated in the UK should state in the report and accounts whether they comply with the Code of Best Practice and identify and give reasons for any area of non-compliance. The Company is listed on AIM and therefore no disclosure is required.

The Company supports the principles and aims of the code and follows the code wherever it is reasonable to do so. It operates an effective board which meet on a timely basis.

The board is aware of the requirements of the code and the need for appropriate controls and systems to safeguard the Company's assets. Wherever possible appropriate controls are in place and monitored by the board. However, full compliance with the code is not possible because of the size and resource constraints of the Company and because of the relative cost benefit assessment in putting in place the additional procedures.

As the Company grows in size and resources the board intends to increase its compliance.

This is not a statement of compliance as required by the Combined Code and should therefore not be relied upon to give the disclosures that would normally be made.

Political and charitable donations

The Company made no political or charitable donations in the year (2001: £nil).

Research and development

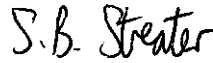
The Company have carried on research and development during the year the costs of which are written off to the profit and loss account.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming annual general meeting.

On behalf of the board

SB Streater
Director
2-4 St George's Road
London SW19 4DP
12 May 2003



Statement of directors' responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent auditors' report
to the members of Forbidden Technologies plc

We have audited the financial statements on pages 10 to 18.

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

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Directors' report and, as described on page 8, the financial statements in accordance with applicable UK law and accounting standards. Our responsibilities, as independent auditors, are established in the UK by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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 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 as at 31 December 2002 and of the loss of the Company for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
12 May 2003

KPMG Audit Plc

	Note	2002 £	2001 £
Turnover	2	9,040	2,672
Administrative expenses		(568,302)	(441,594)
Operating loss		(559,262)	(438,922)
Other interest receivable and similar income	6	128,281	188,268
Loss on ordinary activities before taxation	3-5	(430,981)	(250,654)
Tax on loss on ordinary activities	7	—	19,800
Loss for the financial year	14	(430,981)	(230,854)
Basic and diluted loss per ordinary 0.8p share	8	(0.58p)	(0.30p)

A statement of recognised gains and losses has not been included as part of these financial statements as the Company made no gains or losses in the year other than as disclosed in the profit and loss account.

A note on historical cost gains and losses has not been included as part of the financial statements as the results disclosed in the profit and loss account are prepared on an unmodified historical cost basis.

The results stated above are all derived from continuing operations.

Balance sheet
at 31 December 2002

	Note	2002	2001
		£	£
Fixed assets			
Tangible assets	9	14,264	11,441
Current assets			
Debtors	10	142,725	187,957
Cash at bank and in hand	11	2,673,503	3,021,750
		2,816,228	3,209,707
Creditors: amounts falling due within one year	12	(86,420)	(46,095)
Net current assets		2,729,808	3,163,612
Net assets		2,744,072	3,175,053
Capital and reserves			
Called up share capital	13	594,800	594,800
Share premium account	14	2,896,500	2,896,500
Capital contribution reserve	14	125,000	125,000
Profit and loss account	14	(872,228)	(441,247)
Shareholders' funds – equity		2,744,072	3,175,053

These financial statements were approved by the board of directors on 12 May 2003 and were signed on its behalf by:

SB Streater
Director

DD Blaikie
Director

S.B. Streater

DD Blaikie

	Note	2002 £	2001 £
Reconciliation of operating loss to net cash outflow from operating activities			
Operating loss		(559,262)	(438,922)
Depreciation charges		29,254	31,051
Decrease/(increase) in debtors		27,011	(3,974)
Increase/(decrease) in creditors		27,734	(8,212)
Net cash outflow from operating activities		(475,263)	(420,057)

Cash flow statement

Cash flow from operating activities		(475,263)	(420,057)
Returns on investments and servicing of finance	16	146,502	182,647
Taxation		—	(30,211)
Capital expenditure	16	(32,077)	(22,467)
Cash outflow before management of liquid resources		(360,838)	(290,088)
Management of liquid resources	16	331,377	38,612
Decrease in cash in the year		(29,461)	(251,476)

Reconciliation of net cash flow to movement in net funds

Decrease in cash in the year	17	(29,461)	(251,476)
Cash inflow from decrease in liquid resources	17	(331,377)	(38,612)
Movement in net funds in the year		(360,838)	(290,088)
Net funds at the start of the year		3,021,750	3,311,838
Net funds at the end of the year		2,660,912	3,021,750

Reconciliation of movements in shareholders' funds
for the year ended 31 December 2002

	2002 £	2001 £
Loss for the financial year	(430,981)	(230,854)
Net reduction in shareholders' funds	(430,981)	(230,854)
Opening shareholders' funds	3,175,053	3,405,907
Closing shareholders' funds	2,744,072	3,175,053

Notes

forming part of the financial statements

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements. The Company has adopted FRS 18 'Accounting policies' and FRS 19 'Deferred tax' in these financial statements and this has not resulted in any prior year adjustment.

Basis of preparation

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

Fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows. A full years charge is provided in the year of acquisition:

Leasehold improvements	– life of lease
Fixtures and fittings	– 50% per annum
Computer equipment	– 50% per annum

Leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Employee share schemes

The cost of awards to employees that take the form of rights to shares are recognised over the period of the employee's related performance. The Company does not issue options at below market price, national insurance contributions are accrued in accordance with standard accounting practice.

Research and development expenditure

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences. Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers. Turnover is recognised at the time of invoice, which are raised upon completion of the services provided.

Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand. Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise term deposits of less than one year and a corporate bond.

2 Turnover

Turnover represents the amounts (excluding value added tax) derived from the principal activity and has been entirely earned within the UK.

Excluded from turnover and administrative expenses is £15,000 of revenue and costs which result from a barter transaction for license of the Company's software in return for corporate marketing services.

3 Loss on ordinary activities before taxation

	2002 £	2001 £
Loss on ordinary activities before taxation is stated after charging:		
Auditors' remuneration		
Audit	15,000	12,900
Other services	5,000	4,000
Depreciation and other amounts written off tangible fixed assets: Owned		
Owned	29,254	31,051
Hire of other assets – operating leases	43,077	43,045
Research and development expenditure	8,956	45,578

4 Remuneration of directors

	2002 £	2001 £
Directors' emoluments	94,625	15,666
Amounts paid to third parties in respect of directors' services	12,000	12,000
	106,625	27,666

Share options held by the directors are disclosed under directors' share interests in the Directors' report.

5 Staff numbers and costs

The average number of persons employed by the Company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2002	2001
Management	5	4
Technical	4	4
	9	8

The aggregate payroll costs of these persons were as follows:

	2002 £	2001 £
Wages and salaries	213,336	127,451
Social security costs	14,801	10,249
	228,137	137,700

6 Other interest receivable and similar income

	2002 £	2001 £
Bank interest	128,281	188,268

Notes

forming part of the financial statements

7 Taxation**Analysis of credit in the period**

	2002 £	2001 £
UK corporation tax		
Tax on loss on ordinary activities	—	19,800
Current tax reconciliation		
Loss on ordinary activities before tax	(430,981)	(250,654)
Current tax at 20% (2001: 20%)	(86,196)	(50,131)
Effects of:		
Expenses not deductible for tax purposes	590	834
Capital allowances for period (in excess)/lower than depreciation	(1,210)	1,221
Tax losses carried forward	86,816	38,960
Utilisation of tax losses	—	9,116
Research and development tax credit	—	19,800
Total current tax credit (see above)	—	19,800

Deferred tax assets of £173,807 (2001: £88,200) due to differences between capital allowances and depreciation and also tax losses carried forward have not been recognised as they are not considered recoverable in the foreseeable future.

8 Earnings per share

Diluted earnings per share has not been presented as including all potential ordinary shares in the calculation would be anti-dilutive.

Basic earnings per share

The weighted average number of shares in issue during the period is 74,350,000 (2001: 74,350,000).

9 Tangible fixed assets

	Leasehold improvements £	Fixtures and fittings £	Computer equipment £	Total £
Cost				
At beginning of year	14,084	14,376	59,307	87,767
Additions	—	3,371	28,706	32,077
At end of year	14,084	17,747	88,013	119,844
Depreciation				
At beginning of year	14,084	13,850	48,392	76,326
Charge for year	—	2,434	26,820	29,254
At end of year	14,084	16,284	75,212	105,580
Net book value				
At 31 December 2002	—	1,463	12,801	14,264
At 31 December 2001	—	526	10,915	11,441

10 Debtors

	2002 £	2001 £
Trade debtors	3,562	2,079
Other debtors	47,095	60,870
Prepayments and accrued income	92,068	125,008
	142,725	187,957

11 Cash at bank and in hand

	2002 £	2001 £
Cash	—	16,870
Liquid resources	2,673,503	3,004,880
	2,673,503	3,021,750

12 Creditors: amounts falling due within one year

	2002 £	2001 £
Bank overdraft	12,591	—
Taxation and social security	36,890	24,184
Accruals and deferred income	36,939	21,911
	86,420	46,095

13 Called up share capital

	2002 £	2001 £
Authorised:		
125,000,000 Ordinary shares of 0.8p each (2001: 125,000,000 ordinary shares of 0.8p each)	1,000,000	1,000,000
Allotted, called up and fully paid:		
74,350,000 Ordinary shares of 0.8p each (2001: 74,350,000 ordinary shares of 0.8p each)	594,800	594,800

The directors held the following options to subscribe for shares in the Company:

	Class of share	At end of year	At beginning of year
VJ Steel	Ordinary shares of 0.8 pence	725,000	525,000
DD Blaikie	Ordinary shares of 0.8 pence	350,000	300,000
DP Main	Ordinary shares of 0.8 pence	100,000	75,000
GB Hirst	Ordinary shares of 0.8 pence	120,000	50,000

Details of the dates and prices at which the shares are exercisable are disclosed under directors' share interests in the Directors' report.

14 Share premium and reserves

	Share premium account £	Capital contribution reserve £	Profit and loss account £
At beginning of year	2,896,500	125,000	(441,247)
Loss for year	—	—	(430,981)
At end of year	2,896,500	125,000	(872,228)

The capital contribution reserve is distributable.

15 Commitments

Annual commitments under non-cancellable operating leases are as follows:

	2002 Land and buildings £	2001 Land and buildings £
Operating leases which expire:		
Within one year	—	21,647
In the second to fifth years inclusive	44,150	—

Notes

forming part of the financial statements

16 Analysis of cash flows

	2002 £	2001 £
Returns on investment and servicing of finance		
Interest received	146,502	182,647
Capital expenditure		
Purchase of tangible fixed assets	(32,077)	(22,467)
Management of liquid resources		
Purchase of corporate bond	—	(500,000)
Cash on term deposit	331,377	538,612
	331,377	38,612

17 Analysis of net funds

	At beginning of year £	Cash flow £	At end of year £
Cash	16,870	(29,461)	(12,591)
Current asset investments	3,004,880	(331,377)	2,673,503
	3,021,750	(360,838)	2,660,912

18 Related party transactions

Fees of £12,000 (2001: £12,000) in respect of DD Blaikie's services as a director of the Company were paid to Kittaspec Securities Limited, a company of which DD Blaikie is a director. No amounts were outstanding at the year end.

19 Financial instruments

The Company's financial instruments comprise trade debtors, trade creditors, cash, corporate bond and equity shares.

The Company has not entered into any derivative or other hedging instruments.

The Company's policy is to finance its operation and expansion through the issue of equity share capital.

Financial assets comprise cash at bank and in hand. Financial assets and financial liabilities exclude short term debtors and creditors. The fair value of the financial assets and financial liabilities are not materially different from their carrying values.

Interest rate risk

Cash balances attract a floating rate of interest. The corporate bond has a fixed interest rate of 4.475%.

The Company does not have any borrowings.

Liquidity risk

All financial liabilities fall due in one year or less. The Company has no material un-drawn committed borrowing facilities.

Foreign currency risk

The Company has no transactional exposure in respect of costs denominated in currencies other than sterling.

The Company does not currently hedge against foreign currency risk because there is no exposure at this time.

20 Ultimate controlling party

The ultimate controlling party of the Company is SB Streater by virtue of his shareholding.