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## officers and professional advisers

IQE plc is a public limited company incorporated in England and Wales.

### Directors

Dr G H H Ainsworth (Chairman, Non-Executive Director)  
Dr A W Nelson OBE (President and Chief Executive Officer)  
P J Rasmussen (Finance Director and Company Secretary)  
Dr H R Williams (Operations Director)  
S J Gibson OBE (Non-Executive Director)

### Registered office

Pascal Close, St Mellons, Cardiff, CF3 0LW.  
Company Registered in England No.: 03745726

### Principal Bankers

*Lloyds TSB*  
25 Gresham Street, London, EC2V 7HN.

### Auditors

*PricewaterhouseCoopers LLP*  
One Kingsway, Cardiff, CF10 3PW.

### Legal advisers

*M and A Solicitors*  
Kenneth Pollard House, 5-19 Cowbridge Road East, Cardiff, CF11 9AQ.

### Nominated advisers and brokers

*Noble & Company Limited*  
120 Old Broad Street, London, EC2N 1AR.

### Registrars

*Capita IRG Plc*  
Bourne House, 34 Beckenham Road, Beckenham, BR3 4TU.

### Investor Relations

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## biographies

### **Dr Godfrey H H Ainsworth BSc, PhD, FCA**

*Age 53, Non-Executive Chairman, Chairman of the Audit Committee*

Godfrey Ainsworth qualified as a Chartered Accountant and was employed by Coopers & Lybrand before becoming an audit partner and then corporate finance partner with Spicer & Oppenheim. Following a period as Finance Director of a human resource consulting group, he founded Gambit Corporate Finance in 1992, a practice specialising in the provision of corporate finance services where he is managing partner. He has held several Non-Executive Directorship appointments, including assignments for 3i plc and the Welsh Development Agency. He has provided advice to EPI since its inception and was appointed to the Board in 1997. He was appointed to the Board of IQE Plc in April 1999, and was appointed Chairman in February 2002.

### **Dr Andrew W Nelson OBE, BSc, PhD, FEng**

*Age 54, President and Chief Executive Officer*

Drew Nelson joined BT Research Laboratories in 1981, leading the group responsible for the development of MOCVD technology for the manufacture of opto-electronic devices for optical fibre communications. He subsequently managed the technology transfer from BT to Agilent. Together with Mike Scott, he founded EPI in 1988, becoming Managing Director in 1991 and Chairman and Chief Executive Officer in 1996. Dr Nelson was appointed Chairman and Chief Executive Officer of IQE Plc in April 1999 and became Chief Executive Officer in February 2002 when he split his role and Dr Godfrey Ainsworth was appointed to the role of Chairman.

### **Phillip J Rasmussen BSc, ACA**

*Age 38, Group Finance Director and Company Secretary*

Phillip Rasmussen qualified as a Chartered Accountant in the audit practice of Coopers and Lybrand, a predecessor firm of PricewaterhouseCoopers LLP ("PwC"). During his career with PwC he spent two years in Toronto, Canada and has gained significant experience of working with and advising a broad range of companies in a variety of sectors, including multinational main market and AIM listed companies. Before joining IQE Mr Rasmussen was Director of Transaction Services with PwC in Bristol and worked with IQE on two major acquisitions during 2006. He was appointed to the Board of IQE Plc in March 2007 and as Company Secretary in January 2009.

### **Dr Howard R Williams BSc, PhD, CEng, MIMechE, MCIBSE**

*Age 54, Operations Director*

Howard Williams has held a number of positions within both Manufacturing and Service industry sectors, with roles ranging from Engineering Management to General Management. He was a member of the founding team of EPI in 1988 and was appointed Operations Director for EPI in 1996. He was appointed General Manager of IQE Inc in 2002 and General Manager of IQE (Europe) Limited in 2003. He was subsequently appointed Chief Operations Officer in 2004 and was appointed to the Board of IQE Plc as Operations Director in December 2004.

### **Simon J Gibson OBE**

*Age 51, Non-Executive Director, Chairman of the Remuneration Committee*

Simon Gibson is currently President and Chief Executive Officer of Wesley Clover Limited, a private holding company with assets in technology, the leisure sector and commercial real estate. Prior to joining Wesley Clover, Simon was co-founder, President and Chief Executive Officer of Ubiquity Software Corporation, a pioneer in the creation of SIP based telecommunications services for Global Service Providers. Mr Gibson has also been a senior member of the management teams at Newbridge Networks and Mitel, following an initial career at British Telecommunications (BT), and currently holds a number of private and public board appointments. He was appointed to the Board of IQE Plc in January 2002.

## chairman's review

Our strategy is to continue to concentrate on the high growth markets for compound semiconductors and to deliver strong expansion in revenues, profits and cashflow. In 2008, we achieved a 21% increase in revenues despite the most severe recession in the post war era. This marks our fourth consecutive year of double digit revenue growth. Over this period revenues have risen almost 400% from £15.3m to £60.5m, which has transformed an EBITDA loss of £8.4m into an EBITDA profit of £8.5m before exceptional items. This is a clear demonstration of IQE's powerful business model, and our success in delivering against our strategy.

Approximately 75% of the group's 2008 revenues were generated from the wireless market, and in particular from high speed data communication applications such as 3G mobile phones, smart phones, and WiFi. In the first three quarters of 2008 our wireless business grew very rapidly, and ahead of market expectations. However, the sharp downturn in the global economy during the fourth quarter gave rise to a reassessment of inventory levels throughout the wireless supply chain. This resulted in a sudden and severe reduction in demand for new shipments as our customers sought to reduce their inventory.

As a result, in addition to ongoing restructuring activities to streamline production, the executive management took prompt and decisive action to reduce costs. Headcount was reduced by almost 20% from 378 to 308, short time working arrangements and pay cuts were implemented. This has served to protect the 2008 results without affecting our ability to support a return to growth in 2009. Furthermore, it enabled the group to remain EBITDA positive on a monthly basis during the first quarter of 2009. The burden of this unpleasant responsibility was carried by our Chief Executive, Drew Nelson and the General Managers in the operating subsidiaries and in particular Alex Cerruzzi (IQE-RF), Steve Gergar (IQE-Inc) and LG Yeap (MBET). Their quick and decisive action has left the group in a strong position to take advantage of the upturn that we are now experiencing.

Encouragingly, industry analysts widely predict that the smart phone / 3G segment of the wireless market will continue to grow in 2009, even though the overall mobile handset market is forecast to decline by approximately 10% in 2009. Smart phones have up to five times more compound semiconductor product incorporated compared with a low end handset. Therefore, we expect the second half of 2009 to show continued improvement as the inventory correction is completed and demand for new shipments return to equilibrium with underlying consumption.

IQE is a clear leader in the wireless sector and enjoys a complete portfolio of optoelectronic products. We are also extremely well positioned to take a significant share of the emerging high growth market for GaAs multijunction concentrator photo voltaic technology used in solar power generation. This technology is expected to provide 20% of solar power generation within 10 years. We also expect to have a growing presence in the solid state lighting sector and continue to pursue research and development projects on GaN technologies which are likely to provide a number of exciting product opportunities.

This difficult economic environment also provides an opportunity for IQE to build on the leadership position that it has developed in a number of ways, including:

- the opportunity to strengthen the team as new talent becomes available, attracted by the critical mass and stability offered by IQE;
- the trend to outsourcing for epitaxy which is likely to increase as wireless chip foundries look to the benefits of outsourcing, avoiding or reducing their own capital expenditure and accessing a lower and more flexible cost base; and
- the opportunity to increase market share as wireless chip foundries look for security of supply by switching to larger, more secure companies like IQE.

This year also marked the completion of the relocation of our Singapore operation. This new facility provides our customers with access to an impressive state-of-the-art facility with significant room for future expansion. This project was completed on time and within budget much to the credit of the MBET team and to IQE's operations director, Howard Williams, and his specialist equipment group which continues to provide support throughout IQE.

The investment in our new facility in Singapore underpins the competitive advantage that IQE has developed, which includes:

- a complete range of products covering all major applications;
- global multi-site production capabilities on both primary manufacturing platforms to allow efficient capacity planning and for disaster scenario contingencies;
- broad multi-jurisdictional customer base with access to all the key global markets;

- economies of scale including purchasing power and research and development efficiencies;
- technology leadership with an impressive pool of experienced and talented individuals who are leaders in their field;
- the sharing of best practices and innovation to deliver improved operating and cost efficiencies; and
- surge capacity to meet the expected growth in demand in the mobile device sector and other high volume markets.

From a financing perspective, in early 2008 the group Finance Director, Phillip Rasmussen, oversaw a change of banking to Lloyds TSB and a significant and very successful restructuring of our banking facilities. These new facilities were designed to support the completion of our capital programme in 2008 and provide working capital for our long term growth needs. This has put the group in a strong financial position and will enable us to resume rapid growth as the industry wide inventory reduction comes to an end.

The significant progress achieved during 2008 is a product of the hard work and dedication of the management and staff across the group, some of whom have been with IQE since its foundation in 1988. I am mindful and very grateful for the sacrifices they have made to see us through this current short term hiatus; they have been exceptional. I would like to take this opportunity to thank them all for their continued support and significant individual contributions. Leslie Coventry who was Company Secretary, retired from the group in January after sixteen years in the finance function. He provided tireless support to the Board, to me personally and had the attention to detail and moral integrity so important for the proper conduct of that office. I wish him well.

**Dr Godfrey Ainsworth**  
*Chairman, Non-Executive Director*  
26 May 2009

## chief executive's review

2008 was a year that demonstrated the resilience and robustness of IQE's strategy and business model. The group delivered significant quarter on quarter revenue growth for the first three quarters of 2008, performing well ahead of market expectations until the global recession had a sudden and significant adverse impact during the final quarter. In particular, the industry began to rapidly destock in reaction to economic uncertainties, causing a temporary slump in demand throughout the supply chain.

However, as evidence of this destocking began to emerge we took swift and decisive action to downsize, restructure and consolidate our operations in order to reduce costs and increase efficiencies. We have managed this without losing the ability to ensure that we can respond quickly to an upturn in demand for our products as a return to underlying consumption levels materialises when the industry destocking is completed during the first half of 2009. These swift and effective actions protected our 2008 profitability and ensured that the business was well positioned for 2009.

Against this turmoil, I am very pleased to report that we made very significant progress in respect of our strategic, operational and financial goals.

In strategic terms, we have continued to grow the business organically and increase our market share. This was in part due to new product and new customer qualifications achieved. We are now qualified with all of the major wireless chip foundries, providing significant strategic strength to the group. We also continued to build on our technology leadership, embarking on a series of new and powerful R&D programmes during the year. In addition, we made excellent progress in developing a leadership position in the emerging high growth markets, particularly for solar power generation, but also for ultra high brightness solid state lighting.

Operationally, we successfully completed the final phase of a major capital investment programme, which, together with our competitive advantages, positions us well to continue to grow market share. The capital programme included the relocation of our Singapore business to a new state-of-the-art facility. This facility has been significant in consolidating our leadership position, and allows us to demonstrate our superior capacity and capabilities to existing and potential customers. This relocation was completed in September, on time and on budget, thanks to the skills and dedication of our in-house specialists.

Financially, we achieved our fourth successive year of significant double digit sales growth despite the economic downturn. We grew sales by 21% to £60.5m, which we translated into a 116% increase in EBITDA (before exceptional items) from £3.9m to £8.4m. This tremendous performance reflects our strategic positioning, powerful business model, and strong execution. In addition, we completed a very successful debt financing to arrange new facilities to support the completion of our capital programme and to provide working capital for our long term growth needs.

### Financial Results

Revenue of £60.5m was 21% higher than 2007 (£50.1m) despite the impact of an unprecedented global recession. Sales in our primary wireless market grew 27% year on year. This compares favourably with the 3% growth in the overall mobile handset market, and the 22% growth in the smartphone market segment, reflecting an increase in our market share.

Gross profit (before exceptional items) improved 43% from £8.2m to £11.8m, reflecting an increase in volumes and the benefit of operational efficiencies. Selling, general and administrative expenses (before exceptional items) were well controlled at £7.8m (2007: £7.6m), representing 12.9% of sales (2007: 15.1%).

As a result of this growth and the efficiency improvements achieved, EBITDA (before exceptional items) for the year was up 116% at £8.4m (2007: £3.9m), and operating profit (before exceptional items) was up almost sevenfold at £4.0m (2007: £0.6m). This excellent financial performance against a backdrop of economic turmoil clearly illustrates the group's robust strategy, its powerful business model, and a strong management team.

Exceptional charges of £3.9m (2007: £0.4m) were incurred in completing the relocation of the Singapore business to a new state-of-the-art facility (2008: £2.5m; 2007: £0.4m), and in restructuring of the group's operations in order to reduce costs and improve efficiencies. A significant portion of these exceptional charges are non-cash items, hence the exceptional cash outflow in 2008 was only £1.1m (2007: £0.2m).

Retained profit (before exceptional charges) was £2.5m (2007: loss £0.4m), representing a milestone performance for the group and a profit of 0.59 pence per share (2007: 0.10 pence loss per share). After the impact of the exceptional items, the total retained loss was £1.4m (2007: loss £0.9m) and the loss per share was 0.32 pence (2007: 0.20 pence loss per share).

We converted £8.4m of EBITDA into £8.5m of cash from operations (both before exceptional items). This

strong conversion reflects the careful management of working capital. Furthermore, the group achieved a positive free cash flow\* of £0.7m (2007: outflow £7.1m) even after a £7.8m investment in capital expenditure (£6.4m) and capitalised development costs (£1.4m).

Capital expenditure of £6.4m (2007: £7.8m) marked the completion of the final phase of a significant investment programme, including the relocation of the Singapore business. As a result there will be a much higher conversion of operating cash flow into free cash flow in 2009 as capital expenditure falls to maintenance levels of expenditure only. The group also invested £1.4m (2007: £1.4m) in capitalised development expenditure which is expected to contribute to further growth in 2009 and beyond.

Net debt at December was £18.1m (2007: £14.2m). In early 2008 we completed the change in bankers to Lloyds TSB and a very successful restructuring of the banking facilities. The new facilities supported the completion of the capital programme and provide working capital for our long term growth needs. IQE has enjoyed a strong relationship with its new bankers, and comfortably achieved all bank covenants, even though they had been set without contemplation of the global economic turmoil that would later transpire. From a financial perspective the new facilities position the group extremely well for the coming years.

### Business Review

Below is the business review by the key markets in which we operate: wireless, optoelectronics and electronics.

#### Wireless

Our wireless wafer products are used by our customers to manufacture a variety of radio frequency (RF) devices known as pseudomorphic High Electron Mobility Transistors (pHEMTs), Heterojunction Bipolar Transistors (HBTs) and advanced integrated components combining both pHEMTs and HBTs called BiFETs or BiHEMTs. These devices and integrated circuits are used to detect, amplify and switch RF signals in all forms of wireless and satellite communication systems from handsets and base stations, to PDAs and global positioning systems (GPS) through to a range of wireless components for Wifi, WiMAX, WiBree, laptops and voice and data networks.

Approximately 80% of the group's sales in 2008 were into the wireless market, and in particular in high speed smartphone devices. Whilst the overall mobile handset market is expected to decline by up to 10% in 2009 as a result of the global recession, the smartphone segment is expected to grow by up to 25% as the penetration of these devices continues to increase. The growth in this segment is widely accepted to continue over the coming years. This is excellent news for IQE, not only because of our concentration in this market, but because the gallium arsenide content in these devices is approximately 4-5 times higher than 2G devices. These dynamics should see underlying demand for our wireless products continue to rise.

We are the largest epitaxial foundry in this global wireless market, giving us critical mass in an industry where economies of scale enable a wide range of advantages including cost and technology leadership. It is estimated that almost 50% of the global wireless market is outsourced and that IQE commands more than 25% of the outsourced business, distinguishing IQE from its nearest competitors, which have market shares of approximately 10-15%.

Following successful new product qualifications with new customers over the past year, we now supply all of the world's largest wireless chip manufacturers. Our broad customer base mitigates the risk that we lose volumes as a result of changes within the supply chain, or as a result of the level of success of particular end products. This strategy more closely aligns demand for our products with the demand for wireless devices in general.

Many of our customers are major multinational chip manufacturers for whom security of supply is essential. Our multi-site production strategy allows us to supply identical products that may be manufactured at different global locations, offering our customers the benefits of higher product yield, higher capacity, lower costs and disaster scenario mitigation. We have been successful in providing seamless production across our sites in Europe, Asia and the USA.

As mobile technologies continue to converge with high speed internet and other data streaming technologies so too does the need for advanced semiconductor devices. The addition of a range of mobile services such as cameras, music and video players, location aware facilities and near field communications for contactless payments further increases the demand for IQE's products.

\* Free cashflow represents net cash flow before financing activities, interest and exceptional items

### **Optoelectronics**

The market for optoelectronic products is a diverse multi-billion dollar market. We target the high value and high growth segments. Our products are found in a wide range of applications which includes advanced laser applications, optical data storage, fibre optic communications, solid state lighting and high efficiency solar cells. This market currently accounts for approximately 17% of group sales, although we expect this to rise in the coming years as new optoelectronic device markets grow rapidly.

IQE's foundations are rooted in the market for advanced optoelectronic products, and over our twenty year history we have developed a long standing reputation for technology leadership. We continue to push the boundaries of this technology, and are engaged in a number of cutting edge R&D programmes.

We are seeing development in the more mature segments of this market. For example, in July 2008 we announced advances in the high end laser market with world leading speeds for our vertical cavity surface lasers (VCSELs). In addition, we are experiencing a resurgence in demand for fibre optic communications, as bandwidth across the globe reaches capacity, due to increasing connectivity and the proliferation of internet applications such as you-tube, social networking, video on demand, and video conferencing. In response to this, both public and private sectors worldwide have announced major investment programmes.

Even more significantly, we are seeing very rapid progress in the emerging "green" markets for solar power generation, and ultra high brightness solid state lighting. In response to the threat of global warming, and the dwindling of the world's natural resources, governments worldwide are driving policy and legislation in the direction of renewable, and highly efficient energy devices. Consequently, this is creating a remarkable and rapidly rising demand for alternative energy sources such as solar power, and the ever more efficient use of energy such as ultra high efficiency Light Emitting Diodes (LEDs).

In respect of solar, IQE has invested a significant amount of its research and development resources into developing ultra-high efficiency terrestrial solar cells and concentrator photovoltaic materials. Early field trials in 2008 have proved successful, and we expect to see momentum build in this area as we move through the next 12 to 24 months, into pilot then full scale production. To put the growth potential of this market into context, industry analysts conservatively estimate that this market will eclipse the wireless market within the next 3 to 5 years. We believe that the work that we have done in developing this technology and our market positioning over the last 12 to 18 months will deliver a leadership position as this technology begins to ramp up over the next few years.

In respect of solid state lighting, IQE is working with its technology partners to develop cutting edge ultra high brightness LEDs which will be needed to satisfy the demand for residential and commercial lighting as legislation already enacted will phase out the incandescent light bulb over the next few years.

### **Electronics**

Our electronics business provides advanced epitaxy services on silicon, which account for approximately 3% of group sales. Part of this business is engaged in more mainstream consumer electronics markets, and accordingly suffered more significantly as a result of the global economic downturn. We restructured this business in order to mitigate lower volumes, and hence it began 2009 much leaner.

Nevertheless, this business remains of strategic importance as the silicon industry struggles to deal with the physical barriers to improving the performance of Silicon through continued miniaturisation. The natural solution to this barrier is to combine the advanced properties of compound semiconductors with the cost advantages of silicon. IQE has established a powerful position in this technology, working with some of the biggest names in the industry, which is reflected in the joint patent recently awarded in conjunction with Intel for the production of III-V materials on silicon substrates.

IQE's twenty years of experience in epitaxial wafer outsourcing positions the group extremely well to provide epitaxial services to major chip manufacturers to enable the transition to enhanced features that cannot be achieved with "plain vanilla" silicon.

### **Research & Development**

IQE has a culture of innovation which has enabled us to develop our technology leadership in the markets in which we operate. We are engaged in a number of research and development programmes with customers, research institutions and government agencies.

Current research and development programmes which support the group's technology roadmap include activities in areas including laser projection, CPV Solar Cells, Solid State Lighting, advanced microprocessors and memory devices.

In November 2008 IQE received the inaugural award as "Wales' Innovation Company of the Year"

### **Quality**

IQE's reputation for quality and excellence in products and service is second to none. A philosophy of total quality is integrated throughout the group's operations and each of the group's six manufacturing facilities worldwide is independently accredited to the international standard for Quality Management: ISO9001:2000.

### **Corporate Responsibility**

IQE is fully committed to creating business growth whilst ensuring that the impact on the environment is minimised and that all activities are conducted safely by appropriately trained and qualified employees. The group works closely with all key stakeholders to ensure that its global facilities, and those activities over which it has influence through its supply chain, operate in a way that is ethical and in accordance with best practice.

The group actively promotes a philosophy of corporate social responsibility across all of its operations and engages in a number of local, national and international initiatives working with a wide range of third party organisations and authorities in areas such as ethical employment policies, educational and community work.

IQE comprises a number of subsidiary companies which operate around the world. The IQE Board is responsible for developing corporate policies on social, ethical and environmental matters and for reviewing their effectiveness. Each of the group's six operating companies is responsible for communicating and applying group policies within their businesses taking account of local legislation and potential risks.

As an AIM listed company, IQE is not eligible to participate in the FTSE4Good programme but nevertheless, maintains standards and applies the principles of this index.

### **Environment**

The group is fully committed to protecting the environment in which we live and work, and has taken a leading role in the industry by implementing formal environmental policies and management systems.

IQE has received awards from customers and third parties for its commitment to environmental programmes and all of IQE's three UK operations as well as the Singapore facility are independently accredited to the ISO14001:2004 standard for Environmental Management.

### **Markets & Outlook**

IQE is widely recognised as the global market leader in advanced wafer outsourcing. The technical, operational and financial successes of recent years provide clear evidence of the group's forward momentum, and endorses our strategy, our management, and our execution.

The global economic turmoil impacted our business in the fourth quarter of 2008 as the supply chain began destocking, however, the decisive and pro-active steps that we took to reduce costs served to both protect 2008 results, and ensure that the business is well positioned for 2009.

The inventory destocking continued into the first quarter, but demand has continued to build in the second quarter as inventory levels have been depleted. We expect to continue to build on this progress in the second half as demand for our products begins to return to underlying consumption rates, and as our progress in other markets, including solar power generation, continues to build momentum.

Encouragingly, there is wide consensus within the industry, and amongst industry analysts that the market for smartphones will continue to grow despite the economic gloom.

In light of these factors, the Board remains confident in the group's ability to increase revenue, profitability and cash generation over the coming years.

Finally, I would like to thank my Board colleagues and all the staff of IQE for their unstinting support, through both the rapid growth earlier in 2008, and more recently what has been a very difficult few months as a result of the global economic crisis. It has only been through their hard work, innovation, skill and determination that IQE has delivered such a strong set of results for 2008, and built up such a leadership position within our industry segment. I am proud to be working with such a talented and dedicated team.

**Dr Drew Nelson OBE**  
*President & Chief Executive Officer*  
26 May 2009

## director's report

For the year ended 31 December 2008

The directors present their annual report and the audited financial statements for the year ended 31 December 2008.

### Activities

The principal activity of the group during the year was the manufacture of advanced semiconductor materials. The principal activity of the company is that of a holding company for the group.

### Business review

A review of the group's trading during the year and its position at the year end is provided in the Chief Executive's review. The review includes key performance indicators as detailed in the Five Year Financial Summary.

### Dividends

The directors do not recommend the payment of a dividend (2007 - £nil).

### Directors

The directors in office at 31 December 2008 and their beneficial interests in the company's issued ordinary share capital were as follows:

	Ordinary shares of 1p each 2008 No.	Ordinary shares of 1p each 2007 No.
Dr A W Nelson	29,412,969	27,391,303
Dr H R Williams	15,000	15,000
P J Rasmussen	-	-
Dr G H H Ainsworth	2,813,919	3,731,614
S J Gibson	57,566	-

Included in the shareholding at 31 December 2007 for Dr Ainsworth is a beneficial interest in 2,502,621 shares held in the name of Gambit Corporate Finance Ltd, of which he is a partner. On 27 March 2008 he became the sole beneficiary of 819,271 of these 'Gambit' shares and other equity partners became the sole beneficiaries of the remaining Gambit holding. This change allowed individual partners to put in to effect personal tax planning measures and was as a consequence of the changes in UK Capital Gains Tax implemented on 6 April 2008.

The following directors held share options at 31 December 2008 and 31 December 2007:

	Options 2008 No.	Options 2007 No.
Dr A W Nelson	10,412,500	8,750,000
Dr H R Williams	4,829,040	3,779,040
P J Rasmussen	2,550,000	1,500,000
Dr G H H Ainsworth	-	-
S J Gibson	-	-

**Substantial interests in shares**

As at 26 May 2008, the company had been notified under section 198 of the Companies Act of the following substantial interests in the shares of the company as defined by the Listing Rules in addition to those disclosed for the directors:

	Percentage of ordinary share capital
Axa Framlington Investment Management	9.80
Gartmore Investment Management plc	9.65
Glg Partners LLP	6.69
Dr A W Nelson	6.31
Aviva Investors	6.02
Barclays Stockbrokers Limited	4.60
Dr Michael Scott	4.59
Universities Superannuation Scheme Limited	4.56
Herald Investment Management Limited	4.37
River & Mercantile Asset Management LLP	3.79

**Research and development**

The group incurred costs in respect of research and development during the year of £1,784,000 (2007: £1,572,000) of which £1,520,000 (2007: £1,372,000) have been capitalised in accordance with IAS 38 ("Intangible assets"). The remaining research and development costs totalling £264,000 (2007: £200,000) have been charged to the profit and loss account.

**Donations**

The group made charitable donations during the year of £1,073 (2007: £200). No political donations (2007: £nil) were made during the year.

**Payment terms**

It was the group's policy during the year ended 31 December 2008 to follow the "Better Payment Practice Code". The group agrees payment terms in advance with individual suppliers. The group's average number of days' purchases outstanding in respect of trade creditors at 31 December 2008 was 72 days (2007: 67 days).

**Employment policies**

It is the group's policy that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

The group remains committed to its policy of keeping employees fully informed about all matters which concern them. Formal communications are used to achieve this objective, including notice board announcements, e-mail and intranet. Employee involvement takes different forms in each subsidiary, ranging from formal committee meetings to less formal discussion groups. Schemes have been implemented to ensure that employees are properly rewarded for performance and loyalty.

### **Principal risks and uncertainties**

The Board considers that the principal risks and uncertainties facing the group are:

#### ***Competitor***

IQE's business model involves building close working relationships with its customers and often involves forming multilevel partnerships from the product design stages through pilot production to volume production. Such arrangements can lead to long qualification timescales but once a product range and relationship is established, it can also create significant barriers to entry for competitors.

In some cases, customers need to develop second source supply arrangements to meet their own business continuity planning policies. In such cases, there can be a threat of such competitors gaining market share at IQE's expense. IQE's strategy to provide multiple site capabilities for all leading product lines goes a significant way towards mitigating that risk.

#### ***Technological change***

Any technology based company faces a threat from technology change that has not been anticipated. IQE actively engages with customers, educational institutions and government agencies on a range of research and development programmes. The company's involvement in R&D activities coupled with its broad range of products and process technologies helps ensure a forward looking approach that positions IQE as a driver of technological change.

#### ***Supply chain***

Changes in the supply chain such as scarcity of key raw materials can have a major impact on the business. IQE builds close relationships with its key suppliers in order to keep well informed about potential supply issues. The raw materials which sustain IQE's products are not scarce resources.

#### ***Retention of key employees***

IQE's people are the heart of the business and a whole range of benefits and incentives are offered to help ensure key employees stay with the business. The group was founded over 20 years ago, and a significant proportion of senior management have been with the company since it was formed.

Whilst the impact of key personnel cannot be underestimated, IQE operates a highly effective, robust, and fully documented quality management system across all of its operations. Such systems ensure that all key data and procedures are fully documented, helping IQE adopt a "learning organisation" philosophy. The rigorous use of formal systems to maintain records, data and process documentation provide IQE and its customers with a high level of confidence in terms of process reproducibility and product traceability whilst minimising the impact of losing key personnel.

#### ***Treasury***

IQE operates a central treasury which acts in accordance with specific board policies. Speculative transactions are not permitted.

#### ***Interest rate risk***

The Board is aware of the risks associated with changes in interest rates and, where possible, the interest rates on borrowings have been fixed in order to minimise risk. The Board does not speculate on future changes in interest rates or currencies.

The group's policy is to regularly review its exposure to interest rate risk and, in particular, the mix between fixed and floating rate facilities. The percentage of bank loans on fixed rate terms at 31 December 2008 was 47% (2007: 66%). Floating rate liabilities are primarily indexed to LIBOR, and to a lesser extent SIBOR (being the Singaporean Inter-Bank Offer Rate).

The group did not enter into any interest rate swap instruments during 2008. This remains under regular review. As a guide to the sensitivity of the group's results to movements in interest rates, a 100 basis point (1%) movement in interest rates would have impacted the 2008 annual interest charge by approximately £90,000.

**Credit risk**

The majority of the group's revenues are derived from large multinational organisations. Therefore the credit risk is considered to be small.

Where the group does perceive a credit risk, this is dealt with either by up-front payment prior to the shipment of goods or by other credit risk mitigation measures. As a result the group has historically had and continues to have a very low level of payment default.

**Currency risk**

(a) Cash flow risk

The group's presentational currency is sterling. However, the vast majority of sales are denominated in US dollars. Therefore, the group's cash flows are affected by fluctuations in the rate of exchange between Sterling and the US dollar.

This exposure is managed by a natural currency hedge because a significant portion of the group's cost base is also denominated in US dollars. In particular, the vast majority of the group's raw materials are purchased in US dollars (representing c.50% of the value of sales), and two of the group's principal subsidiaries are also situated in North America.

To a much lesser extent, the group also generates sales in other currencies including Yen and Euros which are also partially hedged where possible by purchases of some raw materials in these currencies.

The management team monitor foreign currency rates as part of its ongoing evaluation of the cost versus benefit of using forward contracts to manage any residual foreign currency exposure. Any forward cover obtained would be purely for hedging purposes as speculative transactions are not permitted. The group did not enter into any forward contracts during 2008. In January 2009 the group entered into forward currency contracts to exchange US dollars into sterling throughout 2009.

(b) Fair value risk

The group has operations in the UK, North America and Asia. Translation exposures that arise on converting the results of overseas subsidiaries are not hedged. Net assets held in foreign currencies are hedged wherever practical by matching borrowings in the same currency.

As a guide to the sensitivity of the group's results to movements in foreign currency exchange rates, a one cent movement in the US dollar to Sterling rate would impact annual earnings by approximately £100,000.

**Liquidity risk**

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents and the availability of funding through committed credit facilities.

Management monitors rolling forecasts of the group's liquidity reserve on the basis of expected cash flow for the next quarter (reassessed on a weekly basis) and for at least the next 12 months (reassessed on a monthly basis).

**Capital risk**

The group's main objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

Consistent with others in the industry, the group monitors capital on the basis of the gearing ratio. This ratio is calculated as 'net debt' (see note 25) divided by 'total capital' (calculated as equity in the consolidated balance sheet plus net debt).

The gearing ratios at 31 December 2008 and 2007 were as follows:

	2008 £'000	2007 £'000
Net debt (note 25)	18,135	14,159
Total equity	30,218	22,960
Total capital	48,353	37,119
Gearing ratio	37.5%	38.1%

**Going concern**

The directors, after making enquiries, have considered the future prospects of the group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these financial statements.

**Statement of directors' responsibilities**

The directors are responsible for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB). The financial statements are required by law to 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 judgements and estimates that are reasonable and prudent.
- State that the financial statements comply with IFRSs as adopted by the European Union.
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the group will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements. The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and to enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the group web site, [www.iqep.com](http://www.iqep.com). Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

#### **Provision of information to auditors**

So far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware. The directors have taken all the steps that ought to have been taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

#### **Auditors**

A resolution to reappoint PricewaterhouseCoopers LLP will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors  
and signed on behalf of the Board



**Phillip Rasmussen**  
Finance Director & Company Secretary  
26 May 2009

# remuneration report

For the year ended 31 December 2008

## Introduction

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 which introduced new statutory requirements for the disclosure of directors' remuneration. Although not required to, the directors have decided to provide directors' remuneration disclosures similar to those that would be required of a fully listed company. In particular, the Remuneration Report describes how the Board has applied the principles of good governance relating to directors' remuneration set out in the Combined Code. A resolution to approve the report will be proposed at the forthcoming Annual General Meeting of the company.

The report has been divided into separate sections for unaudited and audited information.

### **Unaudited information**

#### **(a) Remuneration Committee**

The Board considers itself ultimately responsible for the framework and cost of executive remuneration, but has delegated responsibility for determining the remuneration levels and conditions of service for executive directors and senior executives to the remuneration committee. The committee's approach is fully consistent with the company's overall philosophy that all employees should be competitively rewarded in order to attract and retain their valued skills in the business, as well as supporting corporate strategy by directly aligning executive management with the company's strategic business goals.

The remuneration committee is comprised exclusively of independent non-executive directors of the company who have no personal financial interest, other than as shareholders, in the matters to be decided. The members of the committee throughout the year were Dr G H H Ainsworth and S J Gibson. The Chairman of the committee is S J Gibson.

The committee complies with Schedule A of the Best Practice Provisions annexed to the Listing Rules of the London Stock Exchange, and is responsible for determining the company's policy on compensation of executive directors and the basis of their service agreements with due regard to the interests of shareholders. It also approves the allocation of share options to employees.

The committee operates under clear written terms of reference and has access to and takes independent professional advice as appropriate. The committee met twice during 2008 to review the performance of the executive directors and other senior executives, and set the scale and structure of their remuneration.

#### **(b) Remuneration policy**

In establishing its remuneration policy, the committee has given full consideration to Schedule B of the Best Practices Provisions annexed to the Listing Rules of the Financial Services Authority. The remuneration packages for executive directors and senior executives, as determined by the committee, are intended to attract and retain high quality executives, induce loyalty and motivate them to achieve a high level of corporate performance in line with the best interests of shareholders, while not being excessive. The remuneration of the executive directors consists of annual salary, performance bonus, share options, taxable benefits in kind and pension contributions.

There is an annual review at which the committee approves the basic salary and profit sharing bonus scheme for each executive director. The committee receives input from the Chief Executive regarding recommended packages for executive directors and senior executives.

#### **(c) Basic salary**

Basic salary is determined by reference to individual responsibilities, performance and external market data. As reported last year, the Executive Directors' remuneration was reset from the 1 January 2008 based on independent benchmarking data. The remuneration of the executive directors was unchanged throughout 2008.

**(d) Performance bonus**

Bonus payments are linked to the executive directors achieving internal annual plan targets in respect of profit before tax and other non-financial performance criteria.

During the year, the committee did not award any bonuses to the executive directors.

The committee approved bonus arrangements for 2009 in respect of the executive directors, who will be paid bonuses up to a maximum of 100% of salary based on the level of profitability achieved by the company in 2009 and other non-financial performance criteria.

**(e) Taxable benefits in kind**

The company reimbursed all fuel and maintenance costs in respect of the executive directors' private cars, and these costs are treated as taxable benefits in kind. Other taxable benefits comprise medical health insurance.

**(f) Share incentive schemes**

The company operates a number of share incentive schemes. The IQE Plc Share Option Scheme, as adopted on 26 May 2000 and amended by shareholders at the company's Annual General Meeting on 17 May 2002, allows the company to grant options over up to 15% of the issued share capital and those options are subject to performance conditions.

During the year, the committee approved the grant of 8,813,862 share options (2007: 9,620,781 share options) including the grant to the executive directors of 3,762,500 options (2007: 1,500,000 options) at nil cost. As at 31 December 2008, 43,773,669 share options (2007: 37,808,054 share options) have been granted under the IQE Plc Share Option Scheme with exercise prices ranging from nil cost to 458p/option (2007: 1p/option to 458p/option). No share options were exercised by directors during the year. The numbers and prices of share options at 31 December 2008 and 31 December 2007 were as follows:

Option price	2008 No. of options	2007 No. of options
Share options of nil cost to 10p/option	11,176,277	10,433,142
Share options from 11p/option to 20p/option	31,351,750	26,129,270
Share options from 21p/option to 30p/option	722,000	722,000
Share options in excess of 30p/option	523,642	523,642
<b>Total</b>	<b>43,773,669</b>	<b>37,808,054</b>

The company also operates UK and US All Employee Share Ownership Plans whereby employees agree to contribute fixed amounts per month during a fixed annual period which are used to purchase shares in the company. The UK Plan commenced in November 2001 and the US Plan commenced in August 2002. No contributions were made by employees to the UK Plan after 31 March 2003 and to the US Plan after 31 July 2003.

As at 31 December 2008, there were 580,079 shares (2007: 1,090,577 shares) in the UK and Offshore Trusts, comprising 289,421 allocated shares (2007: 793,780 allocated shares) and 290,658 unencumbered shares (2007: 296,797 unencumbered shares). The company has the ability to make option and share awards from the Offshore Trust.

**(g) Pension arrangements**

The executive directors are members of the group defined contribution pension schemes and their pension contributions are based on a percentage of basic annual salary. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. There have been no changes in the terms of directors' pension entitlements during 2008, and there were no unfunded pension promises or similar arrangements for directors at 31 December 2008.

**(h) Executive Directors' service contracts**

It is the company's policy to appoint executive directors under service agreements which are terminable by either party giving between six and twelve months' notice. Each of the agreements contains post-termination restrictive covenants, which place limitations on solicitation of customers and employees of the group and on acting in competition with the business of the group. There are no predetermined provisions for compensation on termination within executive directors' service agreements. However, the company is against rewards for failure and believes that severance arrangements should be restricted to basic pay and consequential payments such as earned bonus.

**(i) Non-Executive Directors' contracts**

The non-executive directors have entered into service agreements with the company, and these are terminable by either party on three months' notice. Non-executive directors have specific terms of engagement, and their fees are determined by the Board within the limits set by the company's Articles of Association. Non-executive directors do not take part in discussions on their own remuneration. The executive committee approved an increase in the remuneration of the non-executive directors with effect from January 2008 based on the same study which was used in the executive directors benchmarking. There were no changes to non-executive remuneration during 2008.

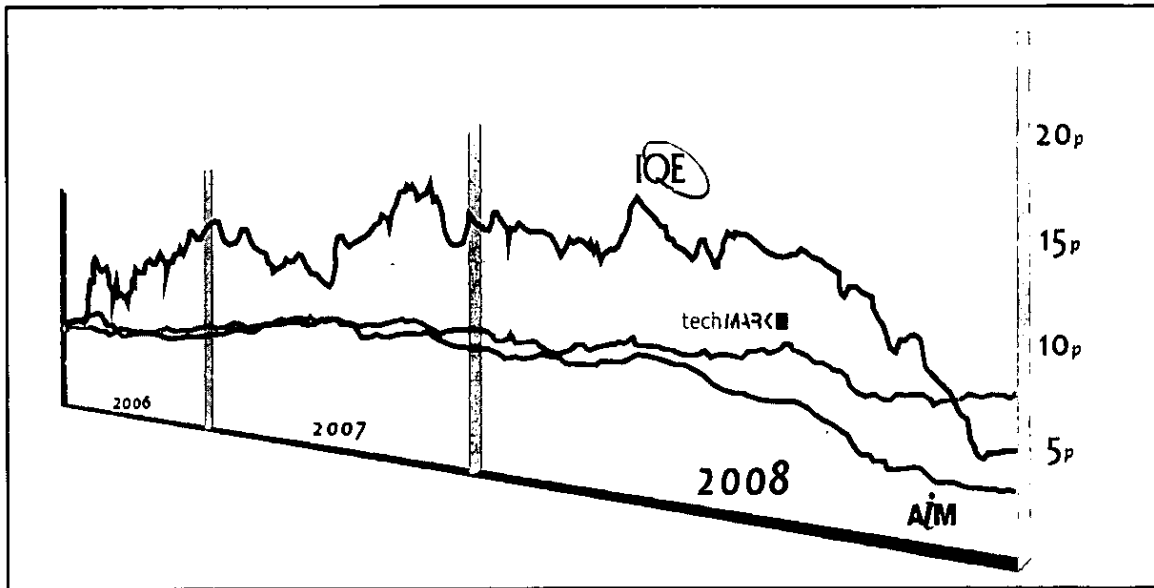
During the year, the services of Dr G H H Ainsworth were paid partly in the form of shares in the company based on the weighted average share price throughout the year and partly in cash. The shares were awarded to Gambit Corporate Finance, a firm in which Dr Ainsworth is a partner. A total of 167,790 shares (2007: 213,700 shares) were awarded to Gambit Corporate Finance for Dr Ainsworth's services, including 52,806 shares (2007: 87,274 shares) in respect of services provided in the previous year. £52,433 (2007: £18,005), not paid in the form of shares, was paid to Gambit Corporate Finance in respect of his remaining fees and expenses for 2008. VAT was charged on the invoices from Gambit Corporate Finance and this was recovered by the company.

The services of S J Gibson were paid partly in shares in the company based on the weighted average share price throughout the year and partly in cash. A total of 57,566 shares (2007: 28,831 shares) were awarded to Fishstone Limited, including no shares (2007: 28,831 shares) awarded in respect of services provided in the previous year. S J Gibson is a shareholder in Fishstone Limited. £nil (2007: £4,375) and £26,250 (2007: £8,750), not paid in the form of shares, was paid to Wesley Clover Wales Limited and Fishstone Limited respectively for his remaining fees and expenses for 2008. VAT was charged on the invoices from both companies and this was recovered by the company.

The non-executive directors receive no other pay or benefits, do not participate in the company's share schemes, and are not eligible for pension scheme membership. Neither had any share options in the company at 31 December 2008 and it is not intended that share options will be issued to them in the future in accordance with Best Practice Guidelines issued by the Association of British Insurers.

(j) Share price performance

The IQE plc share price has been compared with the AIM and TechMARK all shares indices for the years 2006 to 2008 as this was considered to be the most representative market group.



**Audited information**

(a) Aggregate directors' remuneration

The total amounts paid for directors' remuneration during 2008 were as follows:

	2008 £'000	2007 £'000
Basic salaries	526	369
Bonuses	-	305
Non-executive fees	105	61
Sub total salaries and fees	631	735
Car allowances	75	51
Benefits in kind	19	11
Money purchase pension contributions	61	37
<b>Total</b>	<b>786</b>	<b>834</b>

**(b) Directors' emoluments**

The aggregate emoluments paid to each director during 2008 were as follows:

	Salaries and fees £'000	Car allowance £'000	Benefits in kind £'000	Pensions £'000	2008 Total £'000	2007 Total £'000
<b>Executive:</b>						
Dr AW Nelson	232	33	10	27	302	336
SA Hall	-	-	-	-	-	41
Dr HR Williams	147	21	3	17	188	234
P J Rasmussen	147	21	6	17	191	162
<b>Non-Executive</b>						
Dr GHH Ainsworth	70	-	-	-	70	44
SJ Gibson	35	-	-	-	35	17
<b>Total</b>	<b>631</b>	<b>75</b>	<b>19</b>	<b>61</b>	<b>786</b>	<b>834</b>

**Notes:**

S A Hall resigned from the company with effect from 12 March 2007 and his emoluments for 2007 are to that date. P J Rasmussen was appointed a director of the company with effect from 12 March 2007 and his emoluments for 2007 are from that date.

Dr G H H Ainsworth and S J Gibson took their remuneration during 2007 and 2008 partly in the form of company shares calculated on a weighted average share price basis and partly in cash.

**(c) Directors' interests in ordinary shares of IQE Plc**

The interests in ordinary shares of IQE Plc of those directors holding office at 31 December 2008 were as follows:

Name of director	As at	
	1 January 2008	31 December 2008
<b>Executive:</b>		
Dr AW Nelson	27,391,303	29,412,969
Dr HR Williams	15,000	15,000
P J Rasmussen (appointed 12 March 2007)	-	-
<b>Non-executive:</b>		
Dr GHH Ainsworth	3,731,614	2,813,919*
SJ Gibson	-	57,566
<b>Total</b>	<b>31,137,917</b>	<b>32,299,454</b>

\* See Directors' report for explanation of movement

The interests in share options in IQE Plc of those directors who held office at 31 December 2008 were as follows:

Name of director	As at	
	1 January 2008	31 December 2008
<b>Executive:</b>		
Dr AW Nelson	8,750,000	10,412,500
Dr HR Williams	3,779,040	4,829,040
P J Rasmussen	1,500,000	2,550,000
<b>Non-Executive:</b>		
Dr GHH Ainsworth	-	-
SJ Gibson	-	-
<b>Total</b>	<b>14,029,040</b>	<b>17,791,540</b>

During the year, the following share options were granted in respect of directors:

	At 1		At 31		Exercise Price	Dates from which exercisable
	January 2008	Granted	Forfeited	December 2007		
<b>Executive:</b>						
P J Rasmussen	1,500,000	1,050,000	-	2,550,000	0p	1 Jan 2011 to 1 Jan 2018
Dr AW Nelson	8,750,000	1,662,500	-	10,412,500	0p	1 Jan 2011 to 1 Jan 2018
Dr HR Williams	3,779,040	1,050,000	-	4,829,040	0p	1 Jan 2011 to 1 Jan 2018

No other directors held share options at any point during the year.

The highest and lowest mid-market share prices in respect of the shares of IQE Plc during 2008 were 18.75p/share and 4.50p/share respectively (2007: 21.13p/share and 13.00p/share respectively). The mid-market price of IQE plc shares closed at 5.25p/share as at 31 December 2008 (2007: 17.25p/share).

#### Approval

This report was approved by the Board of Directors on 27 May 2009 and signed on its behalf by:



S J Gibson, OBE  
Remuneration Committee Chairman

## corporate governance report

For the year ended 31 December 2008

Although not required to, the directors have decided to provide corporate governance disclosures similar to those that would be required of a fully listed company.

The Board recognises that it is accountable to the group's shareholders for the standard of governance and therefore seeks to maintain high standards in its management of the affairs of the group, seeing it as a fundamental part of discharging its stewardship responsibilities. Accordingly, both the Board and the audit committee continue to keep under review the group's whole system of internal control, which comprises not only financial controls but also operational controls, compliance and risk management.

Throughout the year ended 31 December 2008, the company has been in compliance with the Code provisions set out in Section 1 of the June 2006 FRC Combined Code on Corporate Governance except for the following matter:

Provision A.4.1, Nominations Committee: The group does not have a nominations committee.

### ***The Board of Directors***

The management of the group is directed by the Board of directors, which is responsible for ensuring the development and implementation of the group's overall strategy. The Board of directors comprises the non-executive Chairman Dr G H H Ainsworth, the Chief Executive Dr A W Nelson, two executive directors and one non-executive director. There is a clear division of responsibility between the non-executive Chairman, who is responsible for the running of the Board, and the Chief Executive, who is responsible for the running of the group in accordance with the authority delegated by the Board. This ensures that there is a balance of power and authority such that no one individual has unfettered powers of decision.

The fees of the non-executive directors are paid in cash or in the form of shares in the company based on an agreed weighted average share price formula. The Board considers that the non-executive directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. The terms and conditions of appointment of the non-executive directors are available for inspection upon request to the Company Secretary.

The non-executive Chairman is recognised as the senior independent non-executive director to whom concerns by staff of any suspected impropriety can be conveyed in private and investigated as required by the Code of Best Practice.

Biographical details of the executive and non-executive directors, including their qualifications, are set out on page 5. Under the Company's Articles of Association each of the directors is required ordinarily to retire by rotation once every three years.

The Board held regular meetings during the year. The Board has a formal schedule of matters referred to it for decision, which includes the approval of interim and annual results, the annual budget, acquisitions and disposals, major items of capital expenditure, share capital issues, governance issues and executive appointments. The Board is provided with appropriate strategic and financial information prior to each meeting together with monthly reports to enable it to monitor the performance of the group. No formal performance evaluation process was undertaken during the year to evaluate the performance of the executive and non-executive directors.

All directors have direct access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures are followed, and are allowed to take independent professional advice if necessary at the company's expense.

**Board committees**

The Board has delegated specific responsibilities to the following committees:

**(a) Executive Committee**

The executive committee consists of the executive directors under the chairmanship of Dr AW Nelson and is responsible for the development of strategy, annual budgets and operating plans linked to the management and control of the day-to-day operations of the group. The executive committee is also responsible for monitoring key research and development programmes and for ensuring that the Board policies are carried out on a group-wide basis.

**(b) Audit Committee**

The audit committee consists of the non-executive directors, Dr G H H Ainsworth and S J Gibson, and meets at least twice a year under the chairmanship of Dr G H H Ainsworth.

The audit committee has specific written terms of reference which deal with its authority and responsibilities and these are available for inspection upon request to the Company Secretary. Its duties include monitoring internal controls throughout the group, approving the group's accounting policies, and reviewing the group's interim and financial statements before submission to the full Board. The audit committee also reviews and approves the scope and content of the group's annual risk assessment programme and the annual audit. There is currently no internal audit function within the group. Given the size and complexity of the business and the level of oversight exercised by group management, an internal audit function is not considered necessary at the current time. The audit committee reviews each year the need to implement an internal audit function and monitors the independence of the external auditors.

The Finance Director, other financial management and the external auditors attend meetings of the audit committee by invitation. The committee also holds separate meetings with the external auditors, as appropriate.

**(c) Remuneration and Nominations Committees**

The remuneration committee consists of the non-executive directors, Dr G H H Ainsworth and S J Gibson and meets at least twice a year under the chairmanship of S J Gibson. The Chief Executive attends meetings of the remuneration committee by invitation to respond to questions raised by the committee, but he is excluded from any matter concerning the details of his own remuneration.

The remuneration committee has specific terms of reference which deal with its authority and duties and these are available for inspection upon request to the Company Secretary. The remuneration committee is responsible for setting salaries, incentives and other benefit arrangements of executive directors and senior executives and overseeing the group's employee share schemes. The group's policy on directors' remuneration has been in line with the Code provisions throughout the year, full details of which are given in the remuneration report and in note 6 to the financial statements. Members of the remuneration committee do not participate in decisions concerning their own remuneration.

The Board has not established a separate nominations committee and has delegated responsibility for nominations to the remuneration committee. There are currently no plans for further appointments to the Board.

**Attendance at meetings**

The number of meetings held during 2008 by the Board, the audit committee and the remuneration committee are as shown below. The number of meetings attended by the executive and non-executive directors is also shown below:

	Board	Audit Committee	Remuneration Committee
Number of meetings held in 2008	7	2	2
Number of meetings attended in 2008:			
<b>Executive</b>			
Dr A W Nelson	7		2
P J Rasmussen	7	2	
Dr H R Williams	7		
<b>Non-executive</b>			
Dr G H H Ainsworth	7	2	2
S J Gibson	7	2	2

**Internal control**

The Board acknowledges its responsibility for the group's system of internal control, the effectiveness of which has been reviewed by the audit committee during the year and reported on to the Board. The review has taken account of any material developments up to the date of the signing of the financial statements.

The processes to identify and manage key risks to the success of the group are an integral part of the internal control environment. Such processes are ongoing, are regularly reviewed and improved as necessary, and are in accordance with the internal control guidelines for directors in the Combined Code for Corporate Governance. They include strategic planning, the appointment of senior executives, the monitoring on a regular basis of performance, control of capital expenditure and significant revenue investment, and the setting of high standards for health, safety and environmental performance. These processes have been in place throughout the financial year and up to the date of approval of the financial statements.

The effectiveness of the control systems and procedures is monitored regularly through management self-assessment. In addition, recognition is given to the external audit findings, which inform the audit committee's views of areas of increased risk.

The system of internal control comprises those controls established in order to provide assurance that the assets of the group are safeguarded against unauthorised use or disposal and to ensure the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. Any system of internal control can only provide reasonable, but not absolute, assurance against material misstatement or loss, as it is designed to manage rather than to eliminate the risk of failing to achieve the business objectives of the group.

The key procedures that the directors have established with a view to providing effective internal control are as follows:

- a clearly defined organisational structure and limits of authority;
- corporate policies and procedures for financial reporting and control, project appraisal, human resources, quality control, health and safety, information security and corporate governance;
- the preparation of annual budgets and regular re-forecasts which require approval from both the group executive committee and the Board;
- the monitoring of performance against budget and forecasts and the reporting of any variances in a timely manner to the Board;
- regular review and self-assessment of the risks to which the group is exposed, taking steps to monitor and mitigate these wherever possible including, where appropriate, taking out insurance cover; and
- approval by the audit committee of audit plans and, on behalf of the Board, receipt of reports on the group's accounting and financial reporting practices and its internal controls together with reports from the external auditors as part of their normal audit work.

#### **Shareholder relations**

The Chief Executive and the Finance Director meet on a regular basis with representatives of institutional shareholders to discuss their views and to ensure that the strategies and objectives of the group are well understood. The Chief Executive keeps the Board fully informed of the views of institutional shareholders. Issues discussed with institutional shareholders include the group's performance and the impact of any major transactions. The Chairman has met with individual shareholders on an ad hoc basis.

The company also has a manager responsible for investor relations and operates a web site, which provides details of the group's facilities and products and includes a separate investor relations section on which financial data and other significant announcements are published. The web site can be found at [www.iqep.com](http://www.iqep.com). All shareholders receive a copy of the group's annual report and financial statements and an interim report is issued at the half year.

The Annual General Meeting allows shareholders to raise questions with the Board, although shareholder enquiries and questions are also addressed throughout the year. In accordance with the recommendation of the Hampel Code, the company will advise shareholders attending the Annual General Meeting of the number of proxy votes lodged for each resolution in the categories 'For' and 'Against', together with the numbers 'at the Chairman's discretion' and abstentions. These will be advised after the resolutions have been dealt with on a show of hands.

#### **Audit and related services**

The nature of the services provided by the auditors and the amounts paid to them are as detailed below:

a) Audit and related services	Total 2008 £'000	Total 2007 £'000
PricewaterhouseCoopers LLP (current auditors)		
- Company audit and consolidated financial statements	25	33
- Subsidiary companies audit	73	104
- Tax services	18	21
- Other services	8	8
Ernst & Young (auditors of MBE Technology Pte Limited)		
- Subsidiary company's audit	13	-
<b>Total</b>	<b>137</b>	<b>166</b>

The Board is aware of the importance of maintaining the independence of the group auditors, and does not contract for additional services from them which would compromise their audit independence. Additional services are also subject to appropriate market testing.

The Audit Committee keeps under review the nature and extent of audit and non-audit services provided to the group by the auditors in accordance with a policy which it established in 2004. Under this policy, the award to the group's auditors of audit-related services, tax consulting services or other non-audit related services in excess of £10,000 must first be approved by the Chairman of the Audit Committee. In addition, the group's auditors will be required to make a formal report to the Audit Committee annually on the safeguards that are in place to maintain their independence and the internal safeguards in place to ensure their objectivity.

# independent auditors' report

To the members of IQE plc

We have audited the group and parent company financial statements (the "financial statements") of IQE plc for the year ended 31 December 2008 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated Statement of Recognised Income and Expense and the related notes. We have also audited, at the request of the directors, the information in the part of the remuneration report that is described as having been audited. These financial statements have been prepared under the accounting policies set out therein.

## **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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 into 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 have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the Chief Executive's Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Review, the Chief Executive's Review, the Directors' Report, the unaudited part of the Remuneration Report, the Corporate Governance Report and all other information listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

We also, at the request of the directors (because the company applies the Listing Rules of the Financial Services Authority as if it were a listed company), review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's or company's corporate governance procedures or its risk and control procedures.

## **Basis of audit opinion**

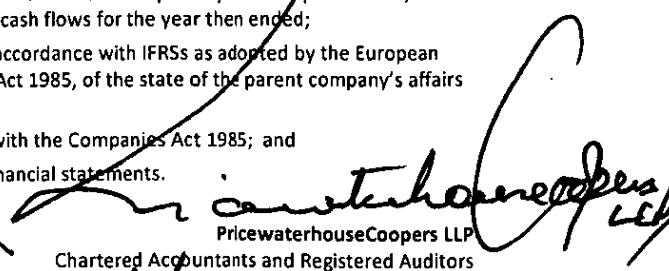
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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 group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2008 and of its loss and cash flows for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2008 and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

  
PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Cardiff  
26 May 2009

## consolidated income statement

For the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
Revenue	3	60,485	50,065
Cost of sales		(51,898)	(41,838)
<b>Gross profit</b>		<b>8,587</b>	<b>8,227</b>
Gross profit before exceptional items		11,755	8,227
Exceptional items	5	(3,168)	-
Selling, general and administrative expenses		(8,518)	(8,053)
<b>Operating profit</b>	3	<b>69</b>	<b>174</b>
Operating profit before exceptional items		4,000	613
Exceptional items	5	(3,931)	(439)
Finance income		26	58
Finance costs	7	(1,480)	(1,094)
<b>Loss for the period attributable to equity shareholders</b>		<b>(1,385)</b>	<b>(862)</b>
Pre-exceptional loss pence per ordinary 1p share		0.59	(0.10)
Basic loss pence per ordinary 1p share	11	(0.32)	(0.20)
Diluted loss pence per ordinary 1p share	11	(0.32)	(0.20)

The notes on pages 33 to 55 form part of these financial statements.

### Consolidated statement of recognised income and expense

	2008 £'000	2007 £'000
Loss for the period	(1,385)	(862)
Currency translation differences on foreign currency net investments	7,723	(743)
<b>Total recognised income/(expense) for the period</b>	<b>6,338</b>	<b>(1,605)</b>

There are no movements to be recognised through the parent company statement of recognised income and expense in 2008 or 2007.

**consolidated balance sheet**

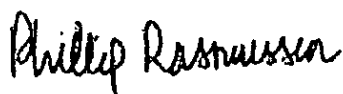
For the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
<b>Non-current assets:</b>			
Intangible assets	12	14,675	12,110
Property, plant and equipment	13	25,626	17,243
<b>Total non-current assets</b>		<b>40,301</b>	<b>29,353</b>
<b>Current assets:</b>			
Inventories	15	11,262	7,643
Trade and other receivables	16	11,671	10,599
Cash and cash equivalents		-	11
<b>Total current assets</b>		<b>22,933</b>	<b>18,253</b>
<b>Total assets</b>		<b>63,234</b>	<b>47,606</b>
<b>Current liabilities:</b>			
Borrowings	18	(8,090)	(5,911)
Trade and other payables	17	(14,798)	(10,354)
<b>Total current liabilities</b>		<b>(22,888)</b>	<b>(16,265)</b>
<b>Non-current liabilities:</b>			
Borrowings	18	(10,045)	(8,259)
Deferred income		(83)	(122)
<b>Total non-current liabilities</b>		<b>(10,128)</b>	<b>(8,381)</b>
<b>Total liabilities</b>		<b>(33,016)</b>	<b>(24,646)</b>
<b>Net assets</b>		<b>30,218</b>	<b>22,960</b>
<b>Shareholders' equity:</b>			
Ordinary shares	19,22	4,333	4,310
Share premium	22	124	172,183
Profit and loss account	22	18,455	(152,441)
Other reserves	22	7,306	(1,092)
<b>Total shareholders' equity</b>		<b>30,218</b>	<b>22,960</b>

The notes on pages 33 to 55 form part of these financial statements.

These financial statements were approved by the Board of Directors on 26 May 2009.

Signed on behalf of the Board of Directors



P J Rasmussen



Dr A W Nelson

## parent company balance sheet

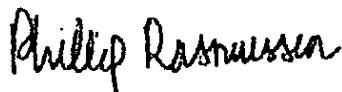
For the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
<b>Non-current assets:</b>			
Investments in subsidiaries	14	11,015	10,480
<b>Current assets:</b>			
Trade and other receivables	16	29,499	22,429
Cash and cash equivalents		-	11
<b>Total current assets</b>		<b>29,499</b>	<b>22,440</b>
<b>Total assets</b>		<b>40,514</b>	<b>32,920</b>
<b>Current liabilities:</b>			
Borrowings	18	(9,948)	(7,073)
Trade and other payables	17	(737)	(1,028)
<b>Total current liabilities</b>		<b>(10,685)</b>	<b>(8,101)</b>
<b>Non-current liabilities:</b>			
Borrowings	18	(5,609)	(2,956)
<b>Total liabilities</b>		<b>(16,294)</b>	<b>(11,057)</b>
<b>Net assets</b>		<b>24,220</b>	<b>21,863</b>
<b>Shareholders' equity:</b>			
Ordinary shares	19,22	4,333	4,310
Share premium	22	124	172,183
Profit and loss account	22	17,456	(156,262)
Other reserves	22	2,307	1,632
<b>Total shareholders' equity</b>		<b>24,220</b>	<b>21,863</b>

The notes on pages 33 to 55 form part of these financial statements.

These financial statements were approved by the Board of Directors on 26 May 2009.

Signed on behalf of the Board of Directors



P J Rasmussen



Dr A W Nelson

## consolidated cash flow statement

For the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
<b>Cash flows from operating activities:</b>			
Cash inflow from operations	23	7,461	1,828
Cash inflow from operations before exceptional items		8,526	2,043
Exceptional items	5	(1,065)	(215)
Interest received		26	58
Interest paid		(1,531)	(763)
<b>Net cash inflow from operating activities</b>		<b>5,956</b>	<b>1,123</b>
<b>Cash flows from investing activities:</b>			
Development expenditure		(1,520)	(1,372)
Investment in other intangible fixed assets		(134)	(20)
Purchase of property, plant and equipment		(6,361)	(7,814)
Proceeds from sale of property, plant and equipment		179	97
<b>Net cash used in investing activities</b>		<b>(7,836)</b>	<b>(9,109)</b>
<b>Cash flows from financing activities:</b>			
Issues of ordinary share capital		208	154
Loans and leases received		1,755	2,750
<b>Net cash generated from financing activities</b>		<b>1,963</b>	<b>2,904</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>83</b>	<b>(5,082)</b>
Cash and cash equivalents at 1 January	25	(1,011)	4,071
<b>Cash and cash equivalents at 31 December</b>	<b>25</b>	<b>(928)</b>	<b>(1,011)</b>

The notes on pages 38 to 60 form part of these financial statements.

## parent company cash flow statement

For the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
<b>Cash flows from operating activities:</b>			
Cash outflow from operations	23	(5,575)	(3,976)
Interest received		-	7
Interest paid		(1,214)	(410)
<b>Net cash outflow from operating activities</b>		<b>(6,789)</b>	<b>(4,379)</b>
<b>Cash flows from investing activities:</b>			
Purchase of investments		(100)	-
<b>Net cash used in investing activities</b>		<b>(100)</b>	<b>-</b>
<b>Cash flows from financing activities:</b>			
Issues of ordinary share capital		208	154
Loans and leases received		6,670	2,722
<b>Net cash generated from financing activities</b>		<b>6,878</b>	<b>2,876</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(11)</b>	<b>(1,503)</b>
Cash and cash equivalents at 1 January		11	1,514
<b>Cash and cash equivalents at 31 December</b>		<b>-</b>	<b>11</b>

The notes on pages 38 to 60 form part of these financial statements.

# notes to the financial statements

For the year ended 31 December 2008

## 1. Significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented unless otherwise stated.

### ***Basis of preparation***

This financial information has been prepared on a going concern basis under the historical cost convention and in accordance with the Companies Act 1985, International Financial Reporting Standards ("IFRS") as adopted by the European Union and IFRIC interpretations in issue at 31 December 2008. The application of these standards and interpretations necessitates the use of estimates and judgements. The main areas involving estimates are set out below in note 2.

### ***Basis of consolidation***

The consolidated financial statements incorporate the financial statements of the Company and its subsidiary undertakings. Subsidiaries are all entities over which the Group has the power to govern their financial and operating policies.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases. As permitted by Section 230 of the Companies Act 1985, the income statement of the parent company has not been presented.

### ***Business combinations***

The acquisition of subsidiaries is accounted for using the purchase method. The cost of an acquisition is measured at the fair value of the consideration plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are recognised at their fair value at the date of acquisition.

### ***Goodwill***

Goodwill arising on an acquisition is recognised as an asset and initially measured at cost, being the excess of the fair value of the consideration and directly attributable costs over the fair value of the identifiable assets, liabilities and contingent liabilities.

Goodwill is not amortised. However, it is reviewed annually for any indication of potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement. Subsequent reversals of impairment losses for goodwill are not recognised.

### ***Research and development***

Expenditure incurred on the development of new or substantially improved products or processes is capitalised, provided that the related project satisfies the criteria for capitalisation, including the project's technical feasibility and likely commercial benefit. All other research and development costs are expensed as incurred.

Capitalised development costs are amortised on a straight line basis over the period during which the economic benefits are expected to be received, which typically range between 2 and 10 years. The estimated remaining useful lives of development costs are reviewed at least on an annual basis.

The carrying value of capitalised development costs is reviewed for potential impairment at least annually. Any impairment identified is immediately charged to the Consolidated Income Statement.

**Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and any provision for impairment. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use. Depreciation is calculated to write down the cost of fixed assets to their residual values on a straight-line basis over the following estimated useful economic lives:

Freehold buildings .....	25 years
Leasehold improvements .....	5 to 27 years
Plant and machinery .....	5 to 15 years
Fixtures and fittings .....	4 to 5 years

No depreciation is provided on land or assets yet to be brought into use.

**Impairment of non-current assets**

Non-current assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value (less disposal costs) and value in use.

Value in use is based on the present value of the future cash flows relating to the asset using appropriate currency and discount rates. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (Cash Generating Units).

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and attributable overheads that have been incurred in bringing the inventories to their present location and condition.

**Financial instruments**

Financial assets and liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the financial instrument.

The only financial assets held by the group are receivables and cash and cash equivalents. Receivables do not carry interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. Cash and cash equivalents include cash in hand, short term highly liquid investments with original maturity of less than three months and bank overdrafts. Bank overdrafts are presented within borrowings in current liabilities. Trade payables are stated at their nominal value and do not bear interest.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Equity instruments issued by the company are recorded at the proceeds received net of any direct issue costs. Interest bearing loans are recorded at the proceeds received net of any direct issue costs. Finance charges are accounted for on an accrual basis using the effective interest method.

The group does not use derivative financial instruments for speculative purposes. The group did not engage in any derivative financial instruments during 2008. In January 2009 the group entered into forward currency contracts to exchange US dollars into sterling throughout 2009.

**Leases**

Leases which transfer substantially all the risks and rewards of ownership of an asset are treated as a finance lease. Assets held under finance lease are capitalised at their fair value at the inception of the lease and depreciated over the estimated useful economic life of the asset or lease term if shorter. The finance charges are allocated to the Consolidated Income Statement in proportion to the capital amount outstanding.

All other leases are classified as operating leases. Operating lease rentals are charged to the Consolidated Income Statement in equal annual amounts over the lease term.

**Provisions**

Provisions are recognised when the group has a legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are calculated based on management's best estimate of the expenditure required to settle the obligation after due consideration of the risks and uncertainties that surround the event.

**Revenue recognition**

Revenue represents the amounts receivable for goods and services provided in the ordinary course of business net of value added tax and other sales related taxes. Revenue is recognised when the risks and rewards of the underlying sale have been transferred to the customer and when collectability of the related receivable is reasonably assured, which is on the delivery of the goods or services supplied and accepted by the customer.

**Segmental reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of components operating in other economic environments.

**Exceptional items**

Exceptional items are those significant items which are separately disclosed by virtue of their size or incidence to enable a better understanding of the group's underlying financial performance.

**Pension costs**

The group operates defined contribution pension schemes. Contributions are charged in the Consolidated Income Statement as they become payable in accordance with the rules of the scheme.

**Share based payments**

Under the IQE plc Share Option Scheme, the scheme participants are eligible for the grant of share options in the Company. These have vesting periods of between one and four years and can be exercised within ten years from the date of grant, subject to performance criteria relating to profitability and share price growth. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted which is calculated using the Black-Scholes option pricing model.

Under the IQE plc All Employee Share Ownership Plans, the scheme participants are eligible for the grant of matching shares from the Company which are equivalent to the number of partnership shares that the company purchases on their behalf with their monthly contributions.

The matching shares have a three year vesting period. The Company issues its own shares in the open market in order to meet its obligations under the share incentive schemes. Shares held by the Employee Share Ownership Trust's are shown as a deduction from shareholders' funds. The cost of employee share plans is charged to Consolidated Income Statement using the quoted market price of shares at the date of grant and credited to reserves under shares to be issued. The charge is accrued over the vesting period of the shares to the extent that they are projected to vest.

#### **Government grants**

Government grants receivable in connection with expenditure on tangible fixed assets are accounted for as deferred income, which is credited to the Consolidated Income Statement by instalments over the expected useful economic life of the related assets on a basis consistent with the depreciation policy. Revenue grants for the reimbursement of costs charged to the Consolidated Income Statement are credited to the Consolidated Income Statement in the year in which the costs are incurred.

#### **Foreign currencies**

Items included in the financial statements of each subsidiary are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in sterling.

Foreign currency transactions are translated into the subsidiaries functional currency at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into the subsidiaries functional currency at the rates ruling at the balance sheet date. All exchange differences are taken to the income statement.

The balance sheets of overseas subsidiaries are translated into sterling at the closing rates of exchange at the balance sheet date, whilst the income statements are translated into sterling at the average rate for the period. The resulting translation differences are taken directly to reserves.

Foreign exchange gains and losses on the retranslation of foreign currency borrowings that are used to finance overseas operations are accounted for on the 'net investment' basis and are recorded directly in reserves provided that the hedge is 'effective' as defined in IAS 39 "Financial Instruments : recognition and measurement".

#### **Taxation**

Income tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year using rates substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of prior years.

Deferred tax is provided in full on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for taxation purposes. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be utilised.

Tax is recognised in the Consolidated Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

**Standards and Interpretations that are not yet applicable to the group**

At the date of approval of these Financial Statements, the following Standards and Interpretations, which have not been applied in these Financial Statements, were in issue but not yet effective:

IFRS 8	–	Operating segments
IFRIC 15	–	Agreements for the construction of real estate
IFRIC 16	–	Hedges of a net investment in a foreign operation
IFRIC 17	–	Distribution of non cash assets to owners
IFRIC 18	–	Transfer of assets from customers

## Revisions and amendments to existing standards:

IAS 1	–	Revised standard regarding presentation of financial statements
IAS 1 & IAS 32	–	Amendments regarding puttable financial instruments and obligations arising on liquidation
IAS 19	–	Revisions to employee benefit standard
IAS 23	–	Revised standard regarding borrowing costs
IAS 27	–	Revised standard regarding consolidated and separate financial statements
IAS 28	–	Amendment to impairment testing required for associates
IAS 36	–	Amendment to disclosures required on impairments
IAS 38	–	Amendment to timing of recognition of certain intangible assets
IFRS 2	–	Amendment regarding vesting conditions and cancellations of share based payments
IFRS 3	–	Revised standard regarding Business Combinations
IFRS 5	–	Amendment regarding classification of held for sale assets

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the Financial Statements of the group except for changes in the accounting treatment for any business combinations occurring in periods starting on or after 1 July 2009, and the amount of disclosure required for any prior period restatements or reclassifications in periods beginning on or after 1 January 2009.

**2. Critical accounting judgements and key sources of estimation uncertainty**

The group's principal accounting policies are described in note 1. The application of these policies necessitates the use of estimates and judgements in a number of areas. Accordingly, the actual amounts may differ from these estimates. The main areas involving estimation are set out below:

**(a) Impairment of intangible assets**

Goodwill on the group's balance sheet is not subject to amortisation because it is assumed to have an indefinite useful life. In accordance with IAS 36 "Impairment of assets", the carrying value of goodwill is assessed at least annually for impairment. This assessment is based on estimated cash flow forecasts. In light of these forecasts the Board has concluded that goodwill is not impaired.

The group capitalises the cost of developing new and substantially improved products and processes if there is a reasonable expectation of obtaining an appropriate economic return. This necessitates an assessment of the future technical viability and future commercial benefits of the product or process. The carrying value for each project is assessed for impairment on an on-going basis.

**(b) Impairment of receivables**

Trade and other receivables are carried at the contractual amount due less any estimated provision for non-recovery. Provision is made based a number of factors including the age of the receivable, previous collection experience and the financial circumstances of the counterparty.

**(c) Inventory provisions**

Inventories are carried at the lower of cost and net realisable value. Provision is made based on a number of factors including the age of inventories, the risk of obsolescence and the expected future usage.

**3. Segmental analysis**

2008	Wireless £'000	Opto- electronics £'000	Electronics £'000	Total £'000
<b>Income statement</b>				
Revenue	48,490	10,169	1,826	60,485
Operating profit/(loss) before exceptional items	7,356	(1,999)	(1,357)	4,000
Exceptional items	(2,975)	(646)	(310)	(3,931)
Operating profit/(loss)	4,381	(2,645)	(1,667)	69
Finance income				26
Finance costs				(1,480)
Retained loss				(1,385)
<b>Segment assets</b>				
Operating assets	52,236	9,256	1,742	63,234
Total assets				63,234
<b>Segment liabilities</b>				
Operating liabilities	(11,497)	(2,927)	(457)	(14,881)
Borrowings				(18,135)
Total liabilities				(33,016)
<b>Other segmental information</b>				
Capital expenditure - intangible assets	1,282	249	123	1,654
Capital expenditure - property, plant and equipment	5,928	585	117	6,630
Depreciation	2,263	551	262	3,076
Amortisation	401	25	21	447

The group considers its three key market areas to be its primary reporting segments. Costs not directly attributable to one of the segments above have been allocated based on the share of revenue attributable to that segment.

**3. Segmental analysis (continued)**

2007	Wireless £'000	Opto- Electronics £'000	Electronics £'000	Total £'000
<b>Income statement</b>				
Revenue	38,088	9,212	2,765	50,065
Operating profit/(loss) before exceptional items	4,022	(2,840)	(569)	613
Exceptional items	(439)	-	-	(439)
Operating profit/(loss)	3,583	(2,840)	(569)	174
Finance income				58
Finance costs				(1,094)
Retained loss				(862)
<b>Segment assets</b>				
Operating assets	35,299	9,722	2,574	47,595
Cash				11
Total assets				47,606
<b>Segment liabilities</b>				
Operating liabilities	(7,564)	(2,221)	(691)	(10,476)
Borrowings				(14,170)
Total liabilities				(24,646)
<b>Other segmental information</b>				
Capital expenditure - intangible assets	1,054	132	206	1,392
Capital expenditure - property, plant and equipment	7,486	206	122	7,814
Depreciation	1,642	515	243	2,400
Amortisation	283	19	5	307

	Sales		Net assets		Capital expenditure	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000	2008 £'000	2007 £'000
<b>By location</b>						
North America	40,029	31,638	25,955	13,306	4,384	4,519
Asia	14,531	11,317	4,055	3,799	2,192	3,320
Europe	5,925	7,110	208	5,855	1,708	1,367
	60,485	50,065	30,218	22,960	8,284	9,206

The sales analysis above is based on the location of the customer. The analysis of net assets and capital expenditure (which includes expenditure on both tangible and intangible assets) is based on the location of the operation.

#### 4. Analysis of other charges/(credits)

	2008 £'000	2007 £'000
<b>The operating result is stated after charging/(crediting):</b>		
Depreciation of property, plant and equipment	3,076	2,400
Amortisation of non-current intangible assets	447	307
Loss/(gain) on sale of property, plant and equipment	6	(5)
Services provided by auditors	137	166
Plant and machinery lease rentals	44	275
Other lease rentals	897	157
Research and development	264	200
Release of government grants	(39)	(39)
Exchange (gains)/ losses	(534)	110
Cost of inventories consumed	28,054	24,474

A schedule of services provided by the group's auditors is disclosed in the Corporate Governance Report.

#### 5. Exceptional items

	2008 £'000	2007 £'000
<b>Exceptional charges comprise:</b>		
Relocation costs	2,486	439
Group restructuring	1,445	-
	3,931	439

The relocation costs of £2,486,000 (2007: £439,000) relates to the one-off costs incurred in relocating the Singapore operation to a new state-of-the-art facility. The relocation was completed in November 2008. The related cash outflow in the year was £990,000 (2007: £215,000).

During the fourth quarter, the Group restructured its activities and operations to reduce its operating costs. This involved a 16% reduction in headcount in addition to a streamlining of certain manufacturing activities. This restructuring was completed by the year end. As a result the Group incurred an exceptional charge of £1,445,000 (2007: nil), the majority of which was a non-cash charge relating to the write down of assets. The related cash outflow in the year was £75,000 (2007: nil).

Of the exceptional items above £3,168,000 (2007: £nil) have been charged to cost of sales in the income statement and £763,000 (2007: £439,000) have been charged to selling, general and administrative expenses. This allocation has been determined by identifying to which classification of expenses each component of the exceptional charge most closely relates.

## 6. Employee costs

	2008 £'000	2007 £'000
<b>Employee costs (including directors' remuneration)</b>		
Wages and salaries	12,433	10,615
Social security costs	1,714	1,514
Other pension costs	715	631
Charge for share based payments	884	571
	15,746	13,331

	No.	No.
The average number of employees, including directors, during the year was as follows	367	351

Directors' emoluments and share option details are disclosed in the Remuneration Report. Key management within the group comprises the executive and non-executive directors and the general managers of the subsidiaries. Compensation to key management, including pensions and benefits, was £1,392,000 (2007: £1,468,000) and the charge for share-based payments was £490,000 (2007: £448,000).

Included above are severance costs of £409,000 (2007: £nil) relating to the group restructuring and included in exceptional costs (see note 5). As a result of the restructuring group headcount was reduced from a peak of 382 during the year to 309 at the year end.

## 7. Finance costs

	2008 £'000	2007 £'000
Bank and other loans	1,472	1,092
Finance lease interest	8	2
	1,480	1,094

## 8. Taxation

	2008 £'000	2007 £'000
United Kingdom corporation tax at 28% (2007: 30%)	-	-
Overseas taxes	-	-
	-	-

**8. Taxation (continued)****Factors affecting total tax charge**

The tax assessed for the period is different from that resulting from applying the standard rate of corporation tax in the UK: 28% (2007: 30%). The differences are explained below:

	2008 £'000	2007 £'000
Loss on ordinary activities before tax	(1,385)	(862)
Tax at 28% thereon (2007: 30%)	(388)	(259)
Effects of :		
Expenses not deductible for tax purposes	156	148
Overseas tax rate differences	(145)	(603)
Increase in tax losses	(283)	(400)
Other deferred tax movements	660	1,114
Total tax charge for the year	-	-

**Factors that may affect the future tax charge**

A deferred tax asset has not been recognised in respect of timing differences relating to trading losses carried forward and accelerated depreciation as there is currently insufficient evidence that the asset will be recovered. The amount of the asset not recognised is £28,069,000 (2007: £28,130,000); this would be recovered if sufficient profits from the same trade arise in future periods.

**9. Dividends**

No dividend has been paid or proposed in 2008 (2007: £nil).

**10. Profit of parent company**

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent company is not presented as part of these financial statements. The parent company's profit for the financial year amounted to £1,437,000 (2007: loss £3,121,000).

## 11. Loss per share

Basic loss per share is calculated by dividing the loss attributable to ordinary shareholders by the weighted average number of ordinary shares during the year. Diluted loss per share is calculated by adjusting the weighted average number of ordinary shares in issue on the assumption of conversion of all dilutive potential ordinary shares. The group incurred losses in the year and, as such, options and warrants that may be converted would be considered anti dilutive, since they would reduce the loss per share

	2008 £'000	2007 £'000
Basic and diluted loss attributable to ordinary shareholders	(1,385)	(862)

	No	No
Weighted average number of ordinary shares	432,207,766	430,601,406
Pre-exceptional loss per share	0.59	(0.10)
Loss per share	(0.32p)	(0.20p)
Diluted loss per share	(0.32p)	(0.20p)

## 12. Intangible assets

The Group	Investments £'000	Goodwill £'000	Development costs £'000	Software £'000	Total £'000
<b>Cost</b>					
At 1 January 2008	-	8,563	3,910	82	12,555
Additions	100	-	1,520	34	1,654
Exchange difference	-	1,011	1,112	41	2,164
At 31 December 2008	100	9,574	6,542	157	16,373
<b>Accumulated amortisation and impairment</b>					
At 1 January 2008	-	-	402	43	445
Charge for the year	-	-	422	25	447
Impairment	-	-	521	-	521
Exchange difference	-	-	255	30	285
At 31 December 2008	-	-	1,600	98	1,698
<b>Net book value</b>					
At 31 December 2008	100	9,574	4,942	59	14,675
At 31 December 2007	-	8,563	3,508	39	12,110

**12. Intangible assets (continued)**

The Group	Goodwill £'000	Development costs £'000	Software £'000	Total £'000
<b>Cost</b>				
At 1 January 2007	8,600	2,574	62	11,236
Additions	-	1,372	20	1,392
Exchange difference	(37)	(36)	-	(73)
<b>At 31 December 2007</b>	<b>8,563</b>	<b>3,910</b>	<b>82</b>	<b>12,555</b>
<b>Accumulated amortisation and impairment</b>				
At 1 January 2007	-	137	4	141
Charge for the year	-	268	39	307
Exchange difference	-	(3)	-	(3)
<b>At 31 December 2007</b>	<b>-</b>	<b>402</b>	<b>43</b>	<b>445</b>
<b>Net book value</b>				
At 31 December 2007	8,563	3,508	39	12,110
At 31 December 2006	8,600	2,437	58	11,095

The carrying amount of goodwill relates to the acquisition of IQE RF LLC £3,634,000 (2007: £2,623,000) and the acquisition of MBE Technology Pte Ltd £5,940,000 (2007: £5,940,000). These amounts have been reviewed for impairment by comparing their carrying value with their value in use. This confirmed that these assets have not been impaired. The value in use was determined using three year projections (based on market trends, and beyond which no growth was assumed) and a discount factor of 10%.

In light of the current economic environment the Board has decided to impair the carrying value of a small number of wireless projects, giving rise to a charge of £521,000 (2007: £nil) in the year. The carrying value of all other deferred development costs continue to be supported by forecast cashflows, also assuming a discount factor of 10%.

The investment relates to a minority equity stake in an IP rich technology start up, that is partnering with IQE to bring advanced laser products to market. This represents the only intangible asset recorded in the parent company balance sheet.

## 13. Property, plant and equipment

a) The Group	Freehold land and buildings £'000	Short leasehold improve- ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
<b>Cost</b>					
At 1 January 2008	6,727	10,550	4,568	82,108	103,953
Additions	18	65	185	6,362	6,630
Disposals	-	(930)	(561)	(928)	(2,419)
Exchange difference	1,015	1,338	257	16,764	19,374
At 31 December 2008	7,760	11,023	4,449	104,306	127,538
<b>Depreciation</b>					
At 1 January 2008	2,218	10,287	4,270	69,935	86,710
Disposals	-	(922)	(548)	(763)	(2,233)
Charge for the year	165	34	379	2,498	3,076
Exchange difference	38	1,250	277	12,794	14,359
At 31 December 2008	2,421	10,649	4,378	84,464	101,912
<b>Net book value</b>					
At 31 December 2008	5,339	374	71	19,842	25,626
At 31 December 2007	4,509	263	298	12,173	17,243

b) The Group	Freehold land and buildings £'000	Short leasehold improve- ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
<b>Cost</b>					
At 1 January 2007	4,012	10,471	4,438	77,418	96,339
Additions	2,641	88	177	4,908	7,814
Disposals	-	-	(36)	(117)	(153)
Exchange difference	74	(9)	(11)	(101)	(47)
At 31 December 2007	6,727	10,550	4,568	82,108	103,953
<b>Depreciation</b>					
At 1 January 2007	2,071	10,229	4,208	68,028	84,536
Disposals	-	-	(34)	(27)	(61)
Charge for the year	146	68	107	2,079	2,400
Exchange difference	1	(10)	(11)	(145)	(165)
At 31 December 2007	2,218	10,287	4,270	69,935	86,710
<b>Net book value</b>					
At 31 December 2007	4,509	263	298	12,173	17,243
At 31 December 2006	1,941	242	230	9,390	11,803

**13. Property, plant and equipment (continued)**

	2008 Fixtures and fittings £'000	2007 Fixtures and fittings £000
<b>c) The Company</b>		
<b>Cost</b>		
At 1 January and 31 December	140	140
<b>Depreciation</b>		
At 1 January and 31 December	140	140
<b>Net book value</b>		
At 31 December 2008	-	-
At 31 December 2007	-	-

**14. Investments in subsidiaries**

<b>The Company</b>	<b>2008 £'000</b>	<b>2007 £'000</b>
<b>Cost</b>		
At 1 January	80,918	80,491
Share based payments during the year	435	427
At 31 December	81,353	80,918
<b>Impairment</b>		
At 1 January	70,438	70,438
Impairment provision for the year	-	-
At 31 December	70,438	70,438
<b>Net book value</b>		
At 31 December 2008	10,915	10,480
At 31 December 2007	10,480	10,053

Details of subsidiary undertakings are set out in note 26.

## 15. Inventories

The Group	2008 £'000	2007 £'000
Raw materials and consumables	7,834	5,229
Work-in-progress and finished goods	3,428	2,414
	11,262	7,643

The directors are of the opinion that the replacement values of inventories are not materially different to the carrying values stated above. These carrying values are stated net of impairment provisions of £2,032,000 (2007: £1,536,000).

## 16. Trade and other receivables

	2008 Group £'000	2008 Company £'000	2007 Group £'000	2007 Company £'000
Trade receivables	4,277	-	7,625	-
Amounts owed by group undertakings	-	29,447	-	22,276
Other debtors and prepayments	7,394	52	2,974	153
	11,671	29,499	10,599	22,429

As at 31 December 2008, 69% (2007: 78%) of trade receivables were within terms. Of the other trade receivables, 84% (2007: 78%) were less than 30 days past due. An allowance has been made for estimated irrecoverable amounts from the sale of goods of £170,000 (2007: £21,000). This allowance has been determined by reference to past default experience. Included in other receivables is accrued income of £5,581,000 (2007: £1,437,000).

The carrying values of trade and other receivables also represent their estimated fair values. The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable as set out above. In terms of trade receivables, the terms of sale provide that the group has recourse to the products sold in the event of non-payment by a customer.

## 17. Trade and other payables

	2008 Group £'000	2008 Company £'000	2007 Group £'000	2007 Company £'000
Trade creditors	8,842	-	7,294	-
Other taxation and social security	223	-	695	-
Accruals and deferred income	5,733	737	2,365	1,028
	14,798	737	10,354	1,028

The carrying values of trade and other payables also represent their estimated fair values.

## 18. Borrowings

The Group	2008 £'000	2007 £'000
<b>Borrowings are analysed as follows:</b>		
Overdraft	928	1,022
Bank loans	12,351	3,646
Deferred consideration on acquisitions	1,852	4,022
Other borrowings	2,856	5,346
Finance leases	148	134
	18,135	14,170
<b>Borrowings fall due for repayment as follows:</b>		
Within one year	8,090	5,911
Between one and two years	4,084	4,194
Between two and five years	3,813	2,261
After five years	2,148	1,804
	18,135	14,170
<b>Borrowings are analysed by currency as follows:</b>		
Sterling	9,341	4,888
Euro	2,856	2,683
US dollar	3,938	1,878
Singapore dollar	2,000	4,721
	18,135	14,170

The overdraft and bank loans bear interest of between 1.95% over base and 7.95% fixed. The bank loans are repayable by monthly and quarterly instalments, and are secured by a fixed and floating charge over the assets of IQE plc and its principal subsidiaries.

The deferred consideration relates to the acquisition of MBE Technology Pte Ltd ("MBET"). This loan is secured by a charge over the issued share capital of MBET, bears interest at 6.5% and falls due for repayment in 2009.

Other borrowings are repayable by monthly instalment, and bear interest rates at 2.75% fixed. The balance of these borrowings was unsecured. Finance leases bear interest at rates between 2.83% to 3.5% (2007: 3% to 5%) and comprise amounts repayable within one year of £84,000 (2007: £45,000) and amounts repayable between one and two years of £39,000 (2007: £89,000) and amounts repayable in two to five years of £25,000 (2007: Nil).

The carrying value of loans approximates to their fair value based on the net present value of future cash flows.

The borrowings of the parent company comprise bank loans and overdraft of £13,705,000 (2007: £6,007,000) and deferred consideration of £1,852,000 (2007: £4,022,000). The amount payable between one and two years is £2,805,000 (2007: £2,710,000), and the amount payable between two and five years is £2,804,000 (2007: £246,000). The balance is repayable within one year. Bank loans are denominated in sterling and the deferred consideration is denominated in Singapore dollars.

**19. Called up share capital**

Group and Company	2008 Number of shares	2008 £'000	2007 Number of shares	2007 £'000
<b>Authorised</b>				
Ordinary shares of 1p each	650,000,000	6,500	650,000,000	6,500
<b>Allotted, called up and fully paid</b>				
Ordinary shares of 1p each	433,263,558	4,333	430,952,266	4,310

The movement in the number of ordinary shares during the year was:

	2008 No	2007 No
At 1 January	430,952,266	429,886,382
Employee share options	2,085,936	156,686
Executive directors	-	666,667
Non-executive directors	225,356	242,531
At 31 December	433,263,558	430,952,266

2,311,292 ordinary shares (2007: 1,065,884 ordinary shares) were issued during the year for the following considerations:

	2008 No. of shares	2008 Consideration	2007 No. of shares	2007 Consideration
Employee share options	2,085,936	1.00p to 10.11p	156,686	5.63p to 9.20p
Executive directors	-	-	666,667	15.00p
Non-executive directors	225,356	15.17p to 19.47p	242,531	15.11p to 17.83p
	2,311,292		1,065,884	

The group's objectives when managing capital are to safeguard the entity's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders, and provide an adequate return for shareholders.

The group sets the amount of capital in proportion to risk. The group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the characteristic of the underlying assets. The group monitors capital by reviewing net debt against shareholders' funds. The position of these indicators and the movement during the period is shown in the Five Year Financial Summary.

## 20. Share based payments

The IQE Plc Share Option Scheme was adopted on 26 May 2000 and amended by shareholders at the Annual General Meeting on 17 May 2002. Under the scheme, the Remuneration Committee can grant options over shares in the company to employees of the group.

Options are granted with a contractual life of ten years and with a fixed exercise price equal to the market value of the shares under option at the date of grant, and they become exercisable between one and three years from date of grant subject to performance conditions, including achievement of positive EBITDA and growth in earnings per share in excess of the retail price index over the same period.

Options are valued using the Black-Scholes option-pricing model and the total amount to be expensed is charged to profit and loss account over the vesting period of the option. No performance conditions are included in the fair value calculations. The principal assumptions used in the calculation of the fair value of share options are as follows:

Principal assumptions	2008	2007
Weighted share price at grant date	17.46p	14.43p
Weighted exercise price	10.16p	14.05p
Weighted number of options granted	2,190,271	1,881,133
Weighted vesting period (years)	3	3
Weighted expected volatility factor	48%	73%
Option life (years)	10	10
Weighted expected life (years)	3	3
Weighted risk free rate	4.35%	5.68%
Dividend yield	0%	0%
Weighted fair value per option	7.66p	7.60p

The expected volatility factor is based on historical share price volatility over the three years immediately preceding the grant of the option. The expected life is the average expected period to exercise. The risk free rate of return is the yield of zero-coupon UK government bonds of a term consistent with the assumed option life. The fair value of options granted during the year ended 31 December 2008 was £1,139,863 (2007: £715,000). The total amount charged to the income statement in 2008 in respect of share based payments was £884,000 (2007: £571,000). As at 31 December 2008, the total number of options held by employees was 43,773,669 (2007: 37,808,054) as follows:

Option price pence/share	Option period ending	2008 No. of options	2007 No. of options
1.00p - 86.20p	31 December 2009	649,324	748,824
75.00p - 458.36p	31 December 2010	10,500	10,500
72.92p - 147.40p	31 December 2011	7,000	7,000
5.63p - 24.50p	31 December 2012	2,406,252	2,949,609
6.67p - 10.17p	31 December 2014	9,026,127	10,325,233
6.87p - 10.25p	31 December 2015	2,296,958	2,609,724
10.40p - 18.00p	31 December 2016	11,490,000	11,751,500
13.58p - 19.42p	31 December 2017	9,126,425	9,405,664
0.00p - 18.00p	31 December 2018	8,761,083	-
At 31 December		43,773,669	37,808,054

**20. Share based payments (continued)**

The movements on share options during the year were as follows:

	2008	2007
	No. of options	No. of options
At 1 January	37,808,054	32,710,094
Granted	8,813,862	9,620,781
Exercised	(2,085,936)	(156,686)
Cancelled	(762,311)	(4,366,135)
At 31 December	43,773,669	37,808,054

**21. Investments in own shares**

The IQE Plc Employee Benefit Trust and the IQE Plc General Benefit Trust were established to manage the IQE Plc All Employee Share Ownership Plans (the Plans) for UK and US employees respectively. The IQE Plc General Benefit Trust was also established to manage a Deferred Share Bonus Plan for UK and US employees by granting shares to employees in lieu of salary and bonus sacrifices. The Trustees of the Plans purchase the company's ordinary shares in the open market with financing provided by the employees. The Trusts contribute matching shares at no cost to the employees which are generated from new issues made by the company to the Trusts. As at 31 December 2008, the company had issued 1,863,079 ordinary shares (2007: 1,863,079 ordinary shares) of 1p each to the Trusts to establish the Plans and allocated 1,806,718 matching shares (2007: 1,927,368 matching shares).

The market value of shares awarded under the Plans is amortised evenly over the period from the original grant of the particular award to the time of vesting, which is normally a period of three years, and charged to the income statement. Other administrative costs are also charged to the income statement as incurred. As at 31 December 2008, 901,088 shares (2007: 772,503 shares) had been issued to employees including 249,967 shares (2007: 249,967 shares) under the Deferred Share Bonus Plan.

The market value of IQE Plc ordinary shares at 31 December 2008 was 5.25p (2007: 17.25p) per share.

Group and Company	Shares held in trust No.	Nominal value £'000	Cost £'000	Issued £'000	Net book value £'000
At 1 January 2008	1,090,576	12	12	(1)	11
Issued to staff	(129,184)	-	-	(1)	(1)
At 31 December 2008	961,392	12	12	(2)	10

**22. Statement of changes in equity**

	At 1 January 2008 £'000	Shares issued £'000	Reserve for options issued £'000	Foreign exchange translation differences £'000	Profit/(Loss) attributable to members of the group £'000	Capital Reduction £'000	At 31 December 2008 £'000
<b>The Group</b>							
Issued share capital	4,310	23	-	-	-	-	4,333
Share premium	172,183	222	-	-	-	(172,281)	124
Shares to be issued	213	(73)	-	-	-	-	140
Investment in own shares	(11)	1	-	-	-	-	(10)
Merger reserve	(605)	-	-	-	-	-	(605)
Profit and loss account	(152,441)	-	-	-	(1,385)	172,281	18,455
Exchange rate reserve	(2,119)	-	-	7,723	-	-	5,604
Share option reserve	1,430	-	747	-	-	-	2,177
Equity shareholders funds						-	
2008	22,960	173	747	7,723	(1,385)	-	30,218
2007	23,840	155	571	(745)	(861)	-	22,960
<b>The Company</b>							
Issued share capital	4,310	23	-	-	-	-	4,333
Share premium	172,183	222	-	-	-	(172,281)	124
Shares to be issued	213	(73)	-	-	-	-	140
Investment in own shares	(11)	1	-	-	-	-	(10)
Profit and loss account	(156,262)	-	-	-	1,437	172,281	17,456
Share option reserve	1,430	-	747	-	-	-	2,177
Equity shareholders funds						-	
2008	21,863	173	747	-	1,437	-	24,220
2007	24,258	155	571	-	(3,121)	-	21,863

During the year the Group took action to eliminate the accumulated deficit in its profit and loss reserve. This was achieved by obtaining a court order, permitting the Group to eliminate the share premium as at 30 June 2008 and transfer its value at this date of £172,280,655 to the profit and loss reserve.

**23. Cash generated from operations**

	2008	2007
The Group	£'000	£'000
Operating profit	69	174
Depreciation of tangible assets	3,076	2,400
Amortisation of intangible assets	447	307
Loss/(gain) on sale of tangible assets	6	(5)
Government grants released	(39)	(39)
Non cash exceptional costs – impairment of development costs	521	-
Non cash exceptional costs – other costs	2,345	224
Non-cash share option costs	884	571
Operating profit before changes in working capital	7,309	3,632
(Increase)/decrease in inventories	(1,426)	937
Decrease/(increase) in trade and other receivables	1,618	(4,118)
(Decrease)/increase in trade and other payables	(40)	1,377
Net cash inflow from operations	7,461	1,828

	2008	2007
The Company	£'000	£'000
Operating profit/(loss)	1,437	(3,764)
Non-cash share option costs	349	144
Operating profit/(loss) before changes in working capital	1,786	(3,620)
Increase in trade and other receivables	(7,070)	(533)
(Decrease)/increase in trade and other payables	(291)	177
Net cash outflow from operations	(5,575)	(3,976)

**24. Reconciliation of net cash flow to movement in net debt**

	2008	2007
	£'000	£'000
Decrease in cash in the year	-	(3,085)
Decrease in highly liquid investments in the year	(11)	(975)
Decrease/(increase) in overdraft in the year	94	(1,022)
Loans received	(9,862)	(5,432)
Loans repaid	8,174	2,777
Leases received	(24)	(117)
Leases repaid	53	22
Increase in net debt resulting from cash flows	(1,576)	(7,832)
Net debt at 1 January	(14,159)	(5,917)
Net movement for year	(1,576)	(7,832)
Exchange differences	(2,400)	(410)
Net debt at 31 December	(18,135)	(14,159)

Highly liquid investments represent cash balances placed on deposit terms which are not accessible within one day.

## 25. Analysis of net debt

	At 1 January 2008 £'000	Cash flow £'000	Other non-cash movements £'000	At 31 December 2008 £'000
Cash and cash equivalents	11	(11)	-	-
Bank overdraft	(1,022)	94	-	(928)
Loans due after one year	(8,214)	(9,862)	8,115	(9,961)
Loans due within one year	(4,800)	8,174	(10,472)	(7,098)
Finance leases due after one year	(90)	(24)	30	(84)
Finance leases due within one year	(44)	53	(73)	(64)
<b>Total borrowings</b>	<b>(14,170)</b>	<b>(1,565)</b>	<b>(2,400)</b>	<b>(18,135)</b>
<b>Net debt</b>	<b>(14,159)</b>	<b>(1,576)</b>	<b>(2,400)</b>	<b>(18,135)</b>

Cash and cash equivalents at 1 January 2008 comprised highly liquid investments of £11,000.

## 26. Principal subsidiary undertakings

Name of company	Class of capital	Proportion of shares held	Activity	Country of incorporation
IQE (Europe) Limited	Ordinary shares of £1	100%*	Manufacture of advanced semiconductor materials	UK
IQE Inc	Common stock of \$0.001	100%*	Manufacture of advanced semiconductor materials	USA
IQE RF LLC	Limited liability company	100%	Manufacture of advanced semiconductor materials	USA
IQE Silicon Compounds Limited	Ordinary shares of £1	100%	Manufacture of silicon epitaxy	UK
MBE Technology Pte Ltd	Preferred shares of S\$1 Ordinary shares of S\$1	100%	Manufacture of advanced semiconductor materials	Singapore
Wafer Technology Limited	Ordinary shares of £1	100%*	Manufacture of semiconductor compounds and ultra high purity materials	UK

\* Indirect holdings

The proportion of voting rights of subsidiaries held by the group is the same as the proportion of shares held.

## 27. Related party transactions

The group incurred professional fees and expenses during the year of £69,910 (2007: £44,256) payable to Gambit Corporate Finance, Enil (2007: £8,750) payable to Wesley Clover Wales Limited, and £39,375 (2007: £8,750) payable to Fishstone Limited. Dr G H H Ainsworth, who is a director of IQE Plc, is a partner in Gambit Corporate Finance. S J Gibson, who is a director of IQE Plc, is also a director of Wesley Clover Wales Limited and Fishstone Limited. An amount of £30,162 (2007: £13,125) was outstanding to these parties at the year-end. During the year fees were paid to M and A solicitors of £11,566. Alan Whitely, a partner in Gambit Corporate Finance is also a partner in M and A solicitors.

## 28. Operating lease commitments

The group was committed at 31 December 2008 and 31 December 2007 to making the following aggregate payments in respect of non-cancellable operating leases:

	2008 £'000	2007 £'000
Due within one year	1,474	1,292
Due between two and five years	6,525	4,509
Due after five years	13,910	10,787
	21,909	16,589

## 29. Commitments

The group had the following capital commitments at 31 December 2008 and 31 December 2007:

	2008 £'000	2007 £'000
Authorised and contracted for	297	1,046