

Registered Number 03745726

# **IQE PLC**

## Annual report and accounts for the year ended 31 December 2011

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# Five year financial summary

	2011	2010	2009	2008	2007
	£'000	£'000	£'000	£'000	£'000
<b>Revenue</b>	<b>75,318</b>	<b>72,650</b>	<b>52,652</b>	<b>60,485</b>	<b>50,065</b>
<b>EBITDA (see below)</b>	<b>13,955</b>	<b>13,115</b>	<b>8,051</b>	<b>8,407</b>	<b>3,891</b>
<b>Operating profit</b>					
- Before exceptional items	7,373	7,208	3,044	4,000	613
- After exceptional items	7,373	7,208	3,044	69	174
<b>Retained profit/(loss)</b>					
- Before exceptional items	8,443	7,506	2,058	2,546	(423)
- After exceptional items	8,443	7,506	2,058	(1,385)	(862)
<b>Net cash flow from operations</b>					
- Before exceptional items	10,823	10,250	8,139	8,526	2,043
- After exceptional items	10,823	10,250	7,712	7,461	1,828
<b>Free cash flow*</b>					
- Before exceptional items	(8,585)	3,315	3,906	690	(7,066)
- After exceptional items	(8,585)	3,315	3,479	(375)	(7,281)
<b>Net (debt) / funds</b>	<b>(3,921)</b>	<b>7,021</b>	<b>(14,931)</b>	<b>(18,135)</b>	<b>(14,159)</b>
<b>Shareholders' funds</b>	<b>72,750</b>	<b>62,274</b>	<b>29,837</b>	<b>30,218</b>	<b>22,960</b>
<b>EPS – adjusted**</b>	<b>1.86p</b>	<b>1.91p</b>	<b>0.68p</b>	<b>0.79p</b>	<b>0.02p</b>
<b>EPS – unadjusted</b>	<b>1.62p</b>	<b>1.63p</b>	<b>0.47p</b>	<b>(0.32p)</b>	<b>(0.14p)</b>
<b>Diluted EPS – adjusted**</b>	<b>1.74p</b>	<b>1.76p</b>	<b>0.64p</b>	<b>0.79p</b>	<b>0.02p</b>
<b>Diluted EPS – unadjusted</b>	<b>1.51p</b>	<b>1.50p</b>	<b>0.44p</b>	<b>(0.32p)</b>	<b>(0.14p)</b>

\* Free cash flow is defined as net cash flow before acquisitions, financing and net interest paid

\*\* Adjusted EPS measures exclude share based payments and exceptional items

EBITDA has been calculated as follows

	2011	2010	2009	2008	2007
	£'000	£'000	£'000	£'000	£'000
<b>Profit/(loss) after tax</b>	<b>8,443</b>	<b>7,506</b>	<b>2,058</b>	<b>(1,385)</b>	<b>(862)</b>
<b>Tax</b>	<b>(1,551)</b>	<b>(1,172)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Interest</b>	<b>481</b>	<b>874</b>	<b>986</b>	<b>1,454</b>	<b>1,036</b>
<b>Share based payments</b>	<b>1,284</b>	<b>1,302</b>	<b>898</b>	<b>884</b>	<b>571</b>
<b>Exceptional items</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,931</b>	<b>439</b>
<b>Depreciation</b>	<b>4,175</b>	<b>3,619</b>	<b>3,372</b>	<b>3,076</b>	<b>2,400</b>
<b>Amortisation of intangible assets</b>	<b>1,123</b>	<b>986</b>	<b>737</b>	<b>447</b>	<b>307</b>
<b>EBITDA</b>	<b>13,955</b>	<b>13,115</b>	<b>8,051</b>	<b>8,407</b>	<b>3,891</b>

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

## Registered office

Pascal Close, St Mellons, Cardiff, CF3 0LW

## Principal Bankers

HSBC Bank Plc  
8 Canada Square, London, E14 5HQ

## Auditors

PricewaterhouseCoopers LLP  
One Kingsway, Cardiff, CF10 3PW

## Nominated advisers and brokers

Espirito Santo Investment Bank, incorporating Execution Noble Limited  
10 Paternoster Square, London, EC4M 7AL

## Joint brokers

Canaccord Genuity Limited  
88 Wood Street, London, EC2V 7QR

## Registrars

Capita Registrars  
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## Investor relations

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# Board of directors

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

Age 56, Chairman, Non-Executive Director, 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. He founded Gambit Corporate Finance in 1992, a practice specialising in the provision of corporate finance services where he was Managing Partner until his retirement from the firm on 30 November 2009. He has held several Non-Executive Directorship appointments, including assignments for 3i plc and the Welsh Development Agency. He has provided advice to IQE (formerly 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 57, 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 optoelectronic devices for optical fibre communications. He subsequently managed the technology transfer from BT to Agilent. He co-founded EPI in 1988 (which became IQE in 1999) and was appointed Chief Executive Officer of IQE Plc in April 1999. Dr Nelson has held several Non-Executive Directorship appointments and is currently non-executive chairman of PhotonStar LED Group plc.

## **Simon J Gibson OBE**

Age 54, Non-Executive Director, Chairman of the Remuneration Committee

Simon Gibson is currently President and Chief Executive Officer of Wesley Clover Wales 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.

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

Age 41, 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 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 appointed as Company Secretary in January 2009.

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

Age 57, 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.

## **Adrian Meldrum BSc**

Age 42, Business Development Director

Adrian Meldrum joined IQE in October 2009, and has over 15 years' experience in the optoelectronics market sector having held a range of technical and commercial roles with JDSU and more recently, business development and sales & marketing roles at Bookham (now Oclaro) where he was Executive Vice President and General Manager of the Telecom Division until joining IQE.

# Chairman's review

## Dear shareholder

I am proud to be part of IQE, one of the unsung heroes of the UK technology world. From humble beginnings in 1988, the people behind IQE have worked tirelessly to create a British company at the cutting-edge of the highly competitive global technology market. As a result, IQE has built a global leadership position in the field of advanced semiconductors which enable many of the electronic devices with which we are all so familiar, and which will be at the heart of future technologies.

Although IQE is far from being a household name, it is more than likely that your home, car and office will contain a multitude of electronic devices that are enabled by the advanced semiconductor material produced by your company. From the portable devices that you rely on every day such as smartphones and tablet devices, to the GPS navigation systems which take the effort out of our journeys, through to the cellular base stations, satellites and back-haul optical-fibre links that form the infrastructure of virtually all global communications.

The subtle penetration of IQE products into many aspects of today's life is the result of our long term strategy to achieve market leadership and commercial success in targeted high growth markets where we are able to differentiate ourselves. This strategy has enabled IQE to achieve a very impressive 26% compound growth in sales over the past 7 years. This result has been achieved despite the economic gloom that has persisted since 2008, reflecting that demand for IQE's product is being driven by the need for increasing amounts of compound semiconductors to fuel the communications revolution that is underway.

Our strong growth continued during the first half of 2011, which enjoyed a 23% revenue increase in constant currency against the first half of 2010, but paused temporarily during the last quarter of 2011 as two major wireless chip customers suffered a temporary loss in market share. IQE management responded quickly to mitigate the impact on profit and cash, and in doing so demonstrated a resilient business model which delivered both half on half and year on year growth in EBITDA profit despite this inventory correction. As expected, the inventory correction persisted in to the first quarter of 2012. However, it is encouraging that customers demand forecasts reflect a return to normal for the second quarter and beyond.

Against this backdrop of strong growth, and in the anticipation of continued strong growth, the Board approved a capacity expansion programme towards the end of 2010. To the credit of our engineers, this expansion programme progressed well during 2011, with additional capacity coming on line and beginning to be qualified by customers. This investment is providing our customers with a high level of confidence that IQE is the ideal supply chain partner to meet their needs as their own businesses continue to expand.

As I look to the future, I continue to be impressed with the progress that IQE is making in advanced technologies. Working in partnership with industry giants, IQE is pushing the boundaries of semiconductor technology which will impact on the lives of generations to come. The breadth of applications which benefit from this technology is incredible, ranging from gesture recognition, cosmetic and health applications, laser projection, optical USBs, infrared sensing, advanced solar power, solid state lighting, MEMs, and advanced microprocessors.

I remain very positive on the prospects for our business. I believe that we have developed a unique offering in very attractive markets, providing a stable platform for continued growth in sales, profits and cash generation through our technology leadership, cost effectiveness, product range and multi-platform/multi-site capabilities.

Finally, I would like to take this opportunity to thank everyone who makes our business successful. The steady implementation of our strategy is a tribute to the quality, energy and dedication of the management teams and employees in our businesses around the world. Our management and staff show exemplary commitment and dedication in driving our business forward and in maintaining our leading competitive position. I would also like to extend my sincere appreciation of the continued support from our customers and suppliers with whom we enjoy close working relationships and to our shareholders for your support and confidence. Thank you.

**Dr Godfrey H H Ainsworth**  
Chairman  
20 March 2012

# Chief Executive's Review

## Overview

I am very pleased to present our annual report for 2011

IQE is the global leader in the production of advanced 'compound semiconductor' wafer products that are processed by its customers into components or "chips". These enable a diverse range of today's high technology devices and systems, from smartphones to satellites, optical-fibre systems to next generation solar platforms. Compound semiconductors have unique optoelectronic, RF wireless and electronic properties which set them apart from traditional silicon based semiconductors, allowing much greater functionality and performance than can be achieved by silicon alone. This has resulted in compound semiconductors enabling a range of new technology devices, and emerging as the 21st century semiconductor materials of choice.

IQE's strategy is focused on delivering technology and production leadership in these high-growth markets. The Group offers its customers the industry's broadest product range, access to the latest innovative technologies, unrivalled capabilities across a range of manufacturing platforms, facilities across three continents and a powerful intellectual property portfolio.

The Group has developed a unique set of competitive advantages to provide its customers with world-leading epitaxial wafer foundry services. By delivering these advantages both consistently and globally, and through its strong operational performance, IQE has become the global leader in its field. IQE offers its customers a powerful set of USPs:

- comprehensive, IP rich product portfolio covering all major applications,
- global multi-site production capabilities,
- choice of all the key manufacturing platforms,
- global presence with broad contact base and access to all the key global markets, and
- competitive pricing enabled by economies of scale including purchasing power and research and development efficiencies.

IQE has a proven track record in developing, protecting and commercialising its intellectual property in support of four technology "megatrends," which the Board believes will be the main growth drivers for IQE over the next decade, namely:

- high-speed connectivity,
- sustainable clean energy generation and the efficient use of energy,
- the explosion of personal consumer devices for enhanced lifestyle, and
- the increased sophistication and performance of security related systems.

Each of the megatrends involves a wave of technology upgrades driven by economic, environmental, consumer or regulatory pressures, and each is being enabled to a very large degree by compound semiconductor materials and technology. IQE is contributing strongly to each of these megatrends across all of its business segments by providing the key technologies that are already transforming a wide range of end user markets.

## Wireless

IQE enjoys a unique position in the RF wireless market, which accounted for around 70% of the Group's revenues in 2011. IQE provides a broad product portfolio that enables all the key radio frequency (RF) components found in wireless communications devices from handsets and smartphones through to tablets, PCs, location based systems (GPS), cellular base stations and satellite TV. The overall wireless chip market grew at around 11% during the year whilst the proportion of smartphones shipped grew from 22% of total handset shipments in 2010 to 32% in 2011, bringing the total number of smartphone subscribers worldwide to approximately 960 million, which represents around 16% of total subscribers. The trend towards smartphones looks set to continue and industry analysts forecast smartphone penetration to reach 43% by 2014 (Source: Ovum/Morgan Stanley). This is a key driver for IQE as 3G/4G smartphones use multiple numbers of compound semiconductor chips compared with earlier generations of handsets.

IQE now supplies all 12 of the top RF wireless chip producers globally, to varying degrees. Although first half wireless revenues grew by a 23% (constant currency), second half revenues were impacted by inventory corrections at two of the Group's major customers. The impact of any future inventory corrections as a result of temporary market share shifts is being mitigated by further product qualifications across all wireless products and customers. These additional qualifications are progressing well, and when completed should result in a highly robust and risk averse strategy. The Group expects the inventory corrections to be complete by Q2 2012, and more rapid growth to resume.

## Optoelectronics

In terms of wafers for optoelectronic applications, end user applications fall into three general areas: emitters and detectors, concentrated photovoltaics (CPV) and light emitting diodes for solid state lighting (SSL)

Emitters and detectors generally relate to laser type products and optical sensors that detect light. Products include lasers, vertical cavity surface emitting lasers (VCSELs), and a range of optical sensing devices from PiN diodes to photo-detectors. End uses for these optoelectronic devices include consumer products, industrial, aerospace, defence and optical communications. Consumer optoelectronics represent the fastest growing opportunities and IQE has several technologies which address these fast growing markets which include finger navigation devices, optical interconnects, miniature laser projectors (pico projectors), cosmetic applications using laser technology, and gesture recognition for gaming applications.

The Group has also seen continued growth in demand for infrared materials for a wide range of commercial and military applications, a product range enhanced by IQE's acquisition of Galaxy Compound Semiconductors Inc ("Galaxy") in 2010. In combination with its Wafer Tech subsidiary, IQE is the global market leader for antimonide substrates used in infra-red applications such as night vision, security, search and rescue and aerospace.

IQE has developed a solid portfolio of IP in relation to concentrated photovoltaic (CPV) solar energy products and is engaged with all the major global players in the industry segment. At the start of 2012, IQE's solar business was further supplemented by a strategic investment in US-based Solar Junction Corporation, a CPV solar product manufacturer, together with an exclusive long-term manufacturing agreement. CPV is the next generation of solar power generation, utilising the advanced properties of compound semiconductors.

It is particularly well suited to sunny areas of the planet, where it is soon expected to be the lowest cost energy production technology of all, with lower generation costs than fossil fuels, nuclear and all other forms of renewable technologies. This move positions the Group to take full advantage of its technical leadership in advanced materials and to evolve CPV into a business with the current scale and profitability of the Group's wireless operation within the next few years.

The Group's strategy for solid state lighting is to develop an extensive IP portfolio to license within the multi-billion dollar global lighting market.

IQE's optoelectronics business continued to grow at a faster pace than the core wireless business, achieving year on year growth of over 25% (constant currency), including the impact of the acquisition of Galaxy in 2010 and optoelectronics now accounts for more than 20% of IQE's revenues in 2011.

## Electronics

Finally, the Group is engaged in developing highly advanced products for electronic systems which can operate at much higher speeds and much less power consumption than equivalent silicon based devices. Much of this work is sponsored by some of the world's leading electronics companies, which have partnered with IQE to develop these advanced compound semiconductor devices, covering many applications from next generation superfast microprocessors, to highly efficient power semiconductors. Several additional patents were granted during 2011 to extend the powerful IP portfolio of the Group. The Group anticipates bringing the first of these products to market within the next two years, adding further growth to the exciting markets the Group now addresses.

## Financial Review

Revenues grew from £72.7m in 2010 to £75.3m driven by increased sales volumes. Revenues in the first half grew by 23% in US dollars (16% in sterling), but the Group's strong growth momentum was temporarily impacted in the fourth quarter by inventory corrections at two major wireless customers. Despite this, full year revenues grew by 8% in constant currency (4% sterling).

Gross profit margins improved from 22.8% to 24.1%, reflecting continued strong management of costs, a beneficial product mix and further improved operating efficiencies.

Selling, general and administrative expenses increased by £1.4m to £10.8m (2010: £9.4m). The cost in 2010 benefited from a £0.5m profit on sale of a property in Singapore.

The increase in sales and the tight control of costs translated into EBITDA of £14.0m (2010: £13.1m) and an operating profit of £7.4m (2010: £7.2m). Interest expense reduced from £0.9m to £0.5m.

The strong conversion of operating profit into cash delivered an operating cash inflow of £10.8m (2010: £10.3m).

The tax credit of £1.6m (2010: £1.2m) reflects the benefit of R&D tax credits and deferred tax credits. Retained profit for the year was up 12% to £8.4m compared with £7.5m in 2010.

Adjusted EPS (which exclude the charge for share based payments) were 1.86p (2010: 1.91p), and Basic EPS were 1.62p (2010: 1.63p).

The Group invested £15.5m (2010: £5.0m) of cash in capital expenditure, which largely related to its capacity expansion programme to meet future sales growth and surge demand from customers. In addition, £3.7m (2010: £3.4m) was invested in new product development.

Net debt at 31 December 2011 was £3.9m (2010: net funds £7.0m).

## Operations

Two core aspects of IQE's operations strategy are its ability to supply customers with identical products from multiple locations to ensure a secure supply and its ability to provide the most advanced compound semiconductor materials available by virtue of its technology leadership.

### ***Security of supply as a competitive advantage***

The importance of IQE's multi-site strategy was emphasised during the first half when the Japanese nuclear disaster in Fukushima highlighted the fragility of supply chains dependent on single site operations. As a consequence, The Group has witnessed increased interest in IQE in a number of areas.

Another aspect of providing customers with confidence of a secure supply is having sufficient capacity to meet their growth needs and surges in demand. It is this confidence which builds long term partnerships and is central to winning market share. This is why IQE engaged in a capacity expansion programme throughout 2011. This expansion programme is on track and will see a significant increase in IQE's capacity during 2012 as these machines are qualified.

IQE's customers' reaction to the Group's expansion programme has been very positive and positions IQE very well to participate in the anticipated growth in the wireless market, and in gaining market share.

In a separate development, as part of the Group's constant improvement strategy, IQE has achieved increases in throughput which could add approximately 10% additional capacity from existing tools. Introducing this high throughput process requires qualification with customers and hence the Group plans to introduce this during 2012 and 2013 as production schedules permit.

### ***Technology leadership drives commercial leadership***

One of the reasons that the outsource model for compound semiconductor materials has evolved is the significant level of intellectual property that is required to participate in this market. However, IQE's strategy is to lead in its chosen markets, not just to participate. The commercial leadership that the Group has achieved stands as testament to the technology leadership that IQE has developed over its 20 year history, and is why IQE is working with industry giants at the forefront of the next generation of technologies.

IQE has made some significant advances during 2011 which continue to extend, its technology leadership. Of particular note are the advances that the Group has made with BiHEMT and PHEMT technologies.

BiHEMT technology is a semiconductor material which has very advanced wireless communication properties. IQE has been at the cutting edge of commercialising BiHEMT technology, and has the distinction of shipping more BiHEMT wafers than any other epi foundry, accounting for more than 80% of the world's BiHEMTs to date. BiHEMTs are being used increasingly to replace HBT material to make power amplifiers for mobile phones. This technology shift is very good news for IQE, and provides a clear opportunity to capture market share. Notably, IQE completed a major BiHEMT qualification in early January 2012, which is in the process of ramping into volume production. Further qualifications are underway, and are expected to begin to complete as early as the second quarter of 2012.

PHEMT technology is a semiconductor material which has historically been used to make switches for mobile phones. The market for switches is benefiting from the increasing complexity of multiple bands in smartphones but, in addition, PHEMT materials are also being increasingly adopted for certain power amplifier applications. The Group estimates that IQE has approximately a 60% share of the PHEMT market, which in part reflects the advanced technology that IQE has developed. Encouragingly, IQE has made significant advances in the properties of its PHEMT materials to levels previously not considered possible. These are in the process of being evaluated by customers, and initial feedback has been excellent. The Group believes that this positions IQE in an extremely strong position to maintain, and even extend its market leadership.

## Markets

IQE's three primary markets are wireless, optoelectronics and electronics

### Wireless

Approximately 70% of the group's sales in 2011 were into the wireless communications market

IQE manufactures advanced semiconductor wafers using epitaxial growth technology which is a form of atomic engineering requiring high specification cleanrooms, sophisticated production tools and high levels of Intellectual property. Our finished products are compound semiconductor wafers or "epiwafers" which designed in conjunction with our customers to enable a set of precise electrical and radio frequency (RF) properties that will form the critical components in a wide range of wireless communications devices including smartphones, tablets, PCs and a host of other applications.

IQE's customers in this market include the wireless chip companies, which process its wafers into RF integrated circuits or chips which enable electronic devices such as mobile phones to communicate with the outside world. These chips essentially detect, amplify, switch or emit wireless signals and are known as pHEMTs (pseudomorphic High Electron Mobility Transistors), HBTs (Heterojunction Bipolar Transistors) and advanced integrated components combining both pHEMTs and HBTs called BiHEMTs.

IQE has developed a unique market position, providing cost, technology and security of supply advantages to the chip companies. It is estimated that over 60% of wafer volume is now outsourced and the trend towards outsourcing is expected to continue as the industry continues to expand, and chip foundries constrain capital expenditure.

IQE is the largest epiwafer foundry and independent industry analysts estimate that IQE's market share is more than 30%, almost twice the size of its nearest competitor.

The introduction of new products involves complex and often long qualification processes to establish the performance and reliability of the chips made from epitaxial wafers. IQE is qualified and in production with all of the major wireless chip companies across a wide range of products. IQE's strategy is to continue to qualify more leading edge products across all customers to help provide mitigation for IQE against the potential impact of swings in market share between chip companies.

The wireless communications market has grown rapidly in recent years reflecting the increasing adoption of wireless technology, multiplied by the need for a greater content of compound semiconductor material per device, as wireless communications become more sophisticated.

Growth drivers include the following:

- More than 1.55 billion mobile handsets were sold in 2011. Handset sales are expected to show further growth in coming years, driven by new applications and functions and the adoption of wireless technology in developing economies.
- High-speed connectivity and added functionality drive the requirement for the advanced properties offered by compound semiconductor epiwafers. The global roll-out of wireless broadband networks such as 4G and LTE devices increasingly rely on higher levels of compound semiconductor content.
- Shipments of smartphone devices represented 32% of total handset shipments in 2011 compared with 22% in 2010. Globally, smartphone penetration is estimated to represent only 16% of the total handset market in terms of subscribers, indicating significant growth potential.
- Smartphone technology has been driven by the emergence of mobile "apps", social networking and location based services. Future drivers for smartphone sales include near field communications for contactless payments, and augmented reality for enhanced location based services.
- Mobile World Congress in 2012 showcased the launch of a plethora of 4G/LTE devices that will fully exploit higher communication speeds for data rich applications, video streaming and real-time gaming platforms.
- Wireless connectivity continues to gain traction: over 1.2 billion mobile web users worldwide with mobile devices accounting for 8.5% of global website hits.

Wireless chip companies are expected to show around 15% CAGR over the coming years. This growth will be driven by the need for more radio frequency functionality and greater complexity in wireless circuitry but will be partly mitigated by improved efficiencies and a drive towards reduced component footprints.

The wireless communications market continues to represent an exciting long term growth prospect for IQE due to three key factors:

- Continuing strong market growth, fuelled by unit and content growth,
- Continued trend towards epiwafer outsourcing,
- Opportunity for IQE to leverage its USP's and continue to grow market share.

## Optoelectronics

Optoelectronics represents a diverse range of products and sectors which accounted for more than 20% of IQE's sales in 2011. The diversity of optoelectronics markets coupled with the emergence of a number of high growth, mass-market applications, leads us to expect that the optoelectronics market will become increasingly significant for IQE over the coming years. IQE's revenues from optoelectronics products exhibited 25% year-on-year growth (constant currency) during 2011.

In broad terms, optoelectronics refers to devices that convert electricity into light (lasers and LEDs) or light into electricity (optical fibre communication receivers and solar power generation). It is a diverse market with a broad range of applications including LEDs, lasers for data storage (CD, DVD, BluRay), lasers for office applications (laser printers, laser mouse), medical, cosmetic and industrial lasers, and components for optical fibre communication systems covering all applications from USB cables to long haul telecommunication networks.

IQE is targeting three high growth segments, optoelectronic emitters and detectors, advanced solar power generation and solid state lighting.

### Optoelectronic emitters and detectors

This market offers a number of high growth opportunities including optical interconnects, laser projectors, optical storage, cosmetic applications, gesture recognition and finger navigation.

#### *Optical interconnects*

Higher data capacities driven by high-definition imaging and video streaming, require high-speed data transfer rates for faster communications between devices. Optical interconnects offer significantly higher-speed data transfers over much longer distances than their copper cable counterparts and are certain to replace existing cable standards such as USB and HDMI, as these traditional cables struggle to meet the increasing demands for data transfer. This is a mass market opportunity, where demand for USB cables alone is around three billion units a year.

During 2011, Sony became the first major consumer giant to adopt optical interconnects on its consumer products. The first generation of optical cables, pioneered as LightPeak by Intel, is designed to enable data transfer speeds of up to 10GBs, which is approximately twenty times faster than existing copper wire technology.

The compound semiconductor technology which enables optical interconnects are Vertical Cavity Surface Emitting Lasers (VCSELs), which is an advanced laser technology geared to mass production and low cost. IQE is the market and technology leader for VCSEL products, with world record data speeds in excess of 40GBs already demonstrated.

#### *Laser projectors*

Conventional projection technologies utilise incandescent or halogen lamps as their light sources. Such devices are power hungry, physically bulky, have relatively short lifetimes and require focusing optics which can limit the image quality and flexibility.

The emergence of lasers in each of the primary colours (red, green and blue) enables a low cost, high quality laser projection solution which can be miniaturized and does not require focusing optics. This technology is called pico projection.

Early pico projector technologies utilise LEDs for the light source but the next generation of devices will incorporate miniature laser projection units. Samsung demonstrated their entry into the picoprojector/phone market with the launch of their "BEAM" product at Mobile World Congress 2012, where it was claimed that a laser projector version of the device is at the testing and certification stage. Both the LED light source and the laser projection devices are reliant on compound semiconductor wafers.

#### *High speed, high density optical storage*

The commercialization of NanoGaN's gallium nitride technology will also give IQE access to the rapidly growing market for high-speed, high-density optical storage (Blu ray). Industry analysts are predicting growth rates in this market of c. 55-60%.

#### *Cosmetic applications*

There are exciting new applications of compound semiconductor technology in the billion dollar cosmetics market. We are working with a number of customers to develop advanced laser technology for cosmetic applications such as laser hair removal, and wrinkle treatment.

### ***Gesture recognition***

Gesture recognition represents the ability of electronic devices to recognise hand and body gestures and movements in order to control the device. The advanced properties of compound semiconductor epiwafers are a key component in gesture recognition devices which made their debut with the launch of Microsoft's Kinect gaming console.

The potential applications for this technology extend far beyond gaming, from medical applications, disability aids, remote controls, to sign language recognition, and more. In fact, the use of this technology is only limited by human imagination, and has far reaching implications for how we will interface with technology in the near future.

Gesture recognition technology is expected to penetrate a wide range of consumer electronics products over the coming years.

### ***Finger navigation***

Finger navigation is closely coupled with gesture recognition in terms of how humans will interface with machines in the future. After their emergence via RIM's Blackberry devices, the use of lasers and optical sensors for precise control of miniature track-pads is also likely to penetrate areas such as remote control units, cameras and other consumer devices over the coming years.

### ***Infrared materials***

IQE is the clear market leader in advanced gallium antimonide and indium antimonide substrates for use in infrared sensing applications.

Antimonide materials are used in a range of infrared or heat sensing applications. The sensitivity of current heat sensors enable a monochrome image so that applications such as night vision devices can only see in tones of green and black, whereas the new antimonide materials allow greater sensitivity so that different shades and colours can be distinguished, effectively producing full colour "night vision" images. The improved sensitivity is useful for search and rescue operations and the full colour night vision capability has major military potential in terms of enabling effective identification of personnel and equipment in low or zero visibility conditions.

IQE is involved in a number of key government contracts for the development and supply of infrared materials based on antimonide materials.

## **Advanced Solar Power – a highly efficient renewable energy source**

Solar cells which use compound semiconductors (called CPV or Concentrated PhotoVoltaics) provide the most efficient solution by using multiple layers of finely tuned materials to absorb sunlight across a wider range of wavelengths. As a result the efficiency of this material is already in excess of 40%, with a roadmap to increase this to 50% and beyond.

This compares with 12 to 18% efficiency from silicon solar panels, while thin film technology is typically around 10 to 15% efficient. There is very little scope to improve the efficiency of these technologies due to the fundamental properties of the materials used.

A further advantage of compound semiconductors is their tolerance of higher temperatures. This means the cost of CPV systems is also reduced by using lenses which intensify sunlight and thereby reduce the amount of semiconductor required.

CPV has now reached price parity with fossil fuels and other alternative energy sources in high sunlight regions and is considered to be at an inflection point, with industry analysts forecasting 175% compound annual growth rates for CPV installations, which are expected to grow to over 1.5GW of generating capacity by 2015, representing an epiwafer market opportunity of \$250m.

Early in 2012, IQE announced a strategic investment in Solar Junction Corporation, a US based CPV manufacturer with some key intellectual property. Solar Junction Corporation holds the world record for solar cell efficiency at 43.5%. IQE's investment in Solar Junction also gives the Group exclusive long-term manufacturing rights over its IP, which includes a technology roadmap to design solar cells with efficiencies in excess of 50%.

## **Solid state lighting – a high performance, low cost, green alternative to incandescent light bulbs.**

Global concerns about climate change and the Earth's dwindling natural resources continues to be a priority for governments worldwide. Significant new policies and legislation continue to be introduced in the direction of renewable and highly efficient energy devices.

Already, many continents have introduced wide-ranging legislation to progressively ban incandescent lighting with 2012 being a key milestone for eradicating the form of lighting altogether. Alternative low energy lighting is unpopular because of perceptions of low quality lighting and on-going issues with heavy metal content including mercury.

Solid state lighting is widely viewed as the only credible long solution to replace the incandescent light bulb. Efficient energy consumption will remain a key driver in the development and adoption of this technology, but the critical success factor is reducing cost and improving the ambience of these units.

High quality gallium nitride provides the route map to achieving this, which will revolutionise residential and commercial lighting around the planet over the coming years.

## **Advanced Electronics**

Our electronics business provides advanced epitaxy services on silicon. Although this division accounts for less than 5% of group sales, it is of long term strategic importance to the group as the silicon industry struggles to deal with the performance limitations of silicon, and looks to combine compound semiconductors with silicon as the solution. Key applications include:

### ***Power switching - a highly efficient switching technology to reduce energy losses***

It is estimated that more than 10% of all electricity is ultimately lost due to conversion inefficiencies, as energy is switched from generation, to grid, and through to consumption. The scale of this loss exceeds the world's entire supply of renewable energy generation. The transformers that we use for our electronic devices, such as laptop power supplies, provide a vivid example of this phenomenon by the virtue of the heat energy they generate as electricity is lost.

An advanced compound semiconductor called gallium nitride offers performance and efficiency which are orders of magnitude better than the silicon technology which dominates power switching technology today. Indeed, this technology has the potential to eliminate up to 90% the energy lost through switching.

### ***High performance engineered wafers***

The Group has also developed a powerful range of advanced, engineered wafers such as germanium-on-insulator (GeOI), germanium-on-silicon (GeOSi) and silicon-on-sapphire (SOS), which offer a high performance and low cost solution for next generation microprocessors, ultra-high speed/high density flash memory and MEMS devices such as motion sensors.

IQE has established a powerful position in these advanced technologies, working with some of the biggest names in the industry, which is reflected in a number of joint patents awarded in conjunction with Intel for the production of III-V materials on silicon substrates.

We believe that the intellectual property that we are developing in this field has the potential to revolutionise the semiconductor world, and in doing so create significant long term value to IQE stakeholders.

## **Research and development**

The continuous development of leading edge materials technology is paramount to IQE's success. The Group has more than twenty years of experience, and a culture of innovation, which has enabled us to develop technology and market leadership in the markets in which we operate.

We continue to push the limits of materials technology, constantly improving the quality of existing products whilst developing new and enhanced capabilities. We are engaged in a number of research and development programmes with customers, research institutions and government agencies, details of which can be viewed on the company's website at [www.iqep.com](http://www.iqep.com).

## Quality & environment

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 manufacturing facilities worldwide is independently accredited to the international standard for Quality Management ISO9001:2008.

IQE's ongoing commitment to provide the highest quality of service ensures customer satisfaction covering the entire customer relationship experience, from order inception through to delivery and after-sales support.

IQE's quality assurance program includes wafer evaluation using the most advanced measurement techniques applied specifically to its customers' structures, thereby ensuring consistent delivery of the highest-quality products. Rigorous data logging and documentation of all manufacturing processes and procedures maintain a system of full product traceability. IQE's thorough materials characterization processes ensure excellent repeatability and reproducibility.

Customers strongly value the trust and confidence they have established with IQE as a "pure play" supplier with whom they share their most confidential and proprietary device design information. The IQE strategy is to consolidate and maintain its position as the pre-eminent supplier of epiwafers rather than vertically integrate into device or component manufacturing. This philosophy protects customer interests to the fullest and facilitates excellent supply chain relationships.

Employing its extensive wafer production experience, IQE continually maintains its technological leadership through the development and implementation of new growth and characterization technologies and new materials solutions. IQE is actively involved in partnerships with its suppliers of crystal growth and characterization equipment to develop the next generations of epitaxy and metrology equipment with specific focus on increasing production efficiencies, reducing epiwafer costs, and maintaining its technological leadership.

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.

Policies relating to quality and environmental standards are available on the company's website at [www.iqep.com](http://www.iqep.com) along with access to third party accreditation certificates.

## Corporate responsibility

The IQE 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.

Detailed policy statements for quality, environmental and corporate social responsibility are contained on the company's corporate website.

Each of the Group's subsidiaries 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 London Stock Exchange FTSE4Good programme, but nevertheless maintains standards and applies the principles of this index. The group also actively engages with a number of industry groups, educational bodies and charities to promote science and technology and to help contribute to community causes.

## Outlook

IQE continues to make excellent progress in the qualification of additional products with its wireless customers, embedding the Group's products into a wide range of next generation devices and mitigating the impact of future swings in market share amongst the customer base

At the same time, new and emerging products for optoelectronic applications are generating increased demand across all key market segments and the Group's recent investment and long-term supply agreement with Solar Junction Corporation accelerates its CPV strategy

The inventory correction that affected the Group's wireless business during the final quarter of 2011 is concluding and we are returning to growth as expected. IQE remains uniquely placed to benefit from current and future technology trends: high-speed communications, energy efficiency, security and lifestyle – where IQE provides the key enabling technologies

The prospects for IQE's wireless markets coupled with continuing strength across the Group's other market sectors mean that the Board remains confident that IQE is well positioned to deliver strong growth in the current financial year and beyond

I would like to take this opportunity to thank my Board colleagues and all group employees for their support and dedication over the years. It is thanks to the hard work, skill and determination of our staff that IQE has become firmly established as a successful and profitable world leader in its field. I am proud to be working with such a talented and dedicated team

**Dr Drew Nelson OBE**  
President & Chief Executive Officer  
20 March 2012

# Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2011

## Activities

The principal activity of the group during the year was the development, manufacture and sale of advanced semiconductor materials. The principal activity of the company is that of a holding company for the group, the provision of services to subsidiary companies, and the research, development and provision of engineering consultancy services to the compound semiconductor industry.

## 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. The principal risks and uncertainties facing the group are set out in the Corporate Governance Report.

## Dividends

The directors do not recommend the payment of a dividend (2010: £nil).

## Directors

The directors in office at 31 December 2011 and throughout the year and their beneficial interests in the company's issued ordinary share capital and share options are set out in the remuneration report.

## Substantial interests in shares

As at 20 March 2012, the company had been notified pursuant to 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:

Blackrock Investment Management	9.70%
T Rowe Price Inc	9.14%
AXA Framlington Investment Management	7.52%
Nelson A W Dr	4.83%
Barclays Stock Brokers Limited	4.21%
Herald Investment Management Limited	4.00%
M&G Investment Management	3.99%
Four Capital Partners	3.67%
Invesco Asset Management	3.66%
T Rowe Price Associates Inc	3.26%

*shareholder analysis by Argus Vickers*

## Research and development

The group incurred costs in respect of research and development during the year of £3,773,000 (2010: £3,722,000) of which £3,666,000 (2010: £3,379,000) has been capitalised in accordance with IAS 38 ("Intangible assets"). The remaining research and development costs totalling £107,000 (2010: £343,000) have been charged to the income statement.

## Payment terms

The group seeks to agree favourable credit terms with its suppliers where possible, and adhere to the agreed terms. The group's average number of days' purchases outstanding in respect of trade creditors at 31 December 2011 was 82 days (2010 76 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 intranet, e-mail and notice board announcements. 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.

## 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.

## Principal risks and uncertainties

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

### Competition

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 seek second source supply arrangements to meet their own business continuity planning policies. As such, there is a risk that market share may be eroded. IQE's strategy to provide multiple site capabilities for all leading product lines provides an effective mitigation against this 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 could impact 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

The Board recognises that the retention and development of its workforce is critical to its long term success as a leading technology group. IQE's people are the heart of the business and in order to promote the development and retention of its staff IQE offers career progression, personal development and a range of benefits and incentives to its staff. This is reflected in low staff turnover, with many employees who have been with the company since it was formed over twenty years ago.

In addition, IQE operates a highly effective, robust, and fully documented quality management system across all of its operations. These systems ensure that all key data and procedures are fully documented, reflecting IQE's "learning organisation" philosophy. These rigorous systems provide IQE and its customers with a high level of confidence in terms of process reproducibility and product traceability, and minimise the potential 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 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 borrowings on fixed rate terms at 31 December 2011 was 1% (2010: 36%). Floating rate liabilities are indexed to LIBOR.

The group did not enter into any interest rate swap instruments during 2011. 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 2011 annual interest charge by approximately £60,000.

## 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 assess 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 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 majority of the group's raw materials are purchased in US dollars, and a significant portion of labour and overheads are also denominated in US dollars as three of the group's principal subsidiaries are situated in North America.

To a 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.

Taking into account the extent of the natural hedge within the business model, management use forward exchange contracts to mitigate the impact of the residual foreign currency exposure. As at 31 December 2011 there were contracts in place to convert fixed amounts of US dollars into sterling on a monthly basis through 2012. In total these contracts provide for the conversion of up to \$25 million into sterling. At 31 December 2011 the mark to market value of these contracts was a liability of £246,000 (see note 15).

These derivative financial instruments used for hedging are the only financial instruments of the group that are not classified as "loans and receivables" or "financial liabilities held at amortised cost".

### (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 (before the mitigating effect of forward currency contracts).

## Liquidity risk

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

Management utilises detailed rolling cash flow forecasts as part of its cash management. This includes weekly forecasts for the next quarter and monthly forecasts for the next 12 months.

## 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

The group defines total capital as equity in the consolidated balance sheet plus net debt or less net funds (note 23) Total capital at 31 December 2011 was £76,671,000 (2010 £55,253,000)

Consistent with others in the industry, the group monitors capital on the basis of the gearing ratio This ratio is calculated as net debt divided by total capital At 31 December 2011 the gearing ratio was 5% (2010 ungeared)

All covenants in relation to the group's borrowing facilities have been complied with during the year

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual 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 Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and the company and of the profit or loss of the group for that period

In preparing these financial statements, the directors are required to

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 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's website, [www.iqep.com](http://www.iqep.com) Legislation in the United Kingdom 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

## Independent 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  
20 March 2012

# Remuneration report

## Introduction

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2007 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 UK Corporate Governance 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 follows the provisions of Schedule A to the UK Corporate Governance Code, 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 four times during 2011 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.

### (d) Performance bonus

Bonus payments are linked to the executive directors achieving internal annual plan targets in respect of profitability and other non-financial performance criteria. Bonuses were awarded to certain directors in respect of 2011 in accordance with this scheme.

### (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 and life 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 5,889,277 share options to staff (2010 12,102,186 share options). No options were awarded to directors (2010 10,178,657). As at 31 December 2011, 51,043,125 share options (2010 58,617,656 share options) granted under the IQE Plc Share Option Scheme remain outstanding with exercise prices ranging from nil cost to 86p/option (2010 nil cost to 86p/option). 6,241,500 share options were exercised by directors during the year (2010 nil). The numbers and prices of share options at 31 December 2011 and 31 December 2010 were as follows:

Option price	2011 No of options	2010 No of options
Share options of nil cost to 10p/option	23,446,947	28,610,262
Share options in excess of 10p/option to 20p/option	25,377,375	28,315,752
Share options in excess of 20p/option to 30p/option	754,000	911,500
Share options in excess of 30p/option	1,464,803	780,142
<b>Total</b>	<b>51,043,125</b>	<b>58,617,656</b>

## (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 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 2011, and there were no unfunded pension promises or similar arrangements for directors at 31 December 2011.

## (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 contain 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. In circumstances where there is no conflict of interest, the company allows executive directors to serve as non-executive directors elsewhere. In such circumstances the remuneration received is retained by the director.

## (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. There were no changes to non-executive remuneration during 2011.

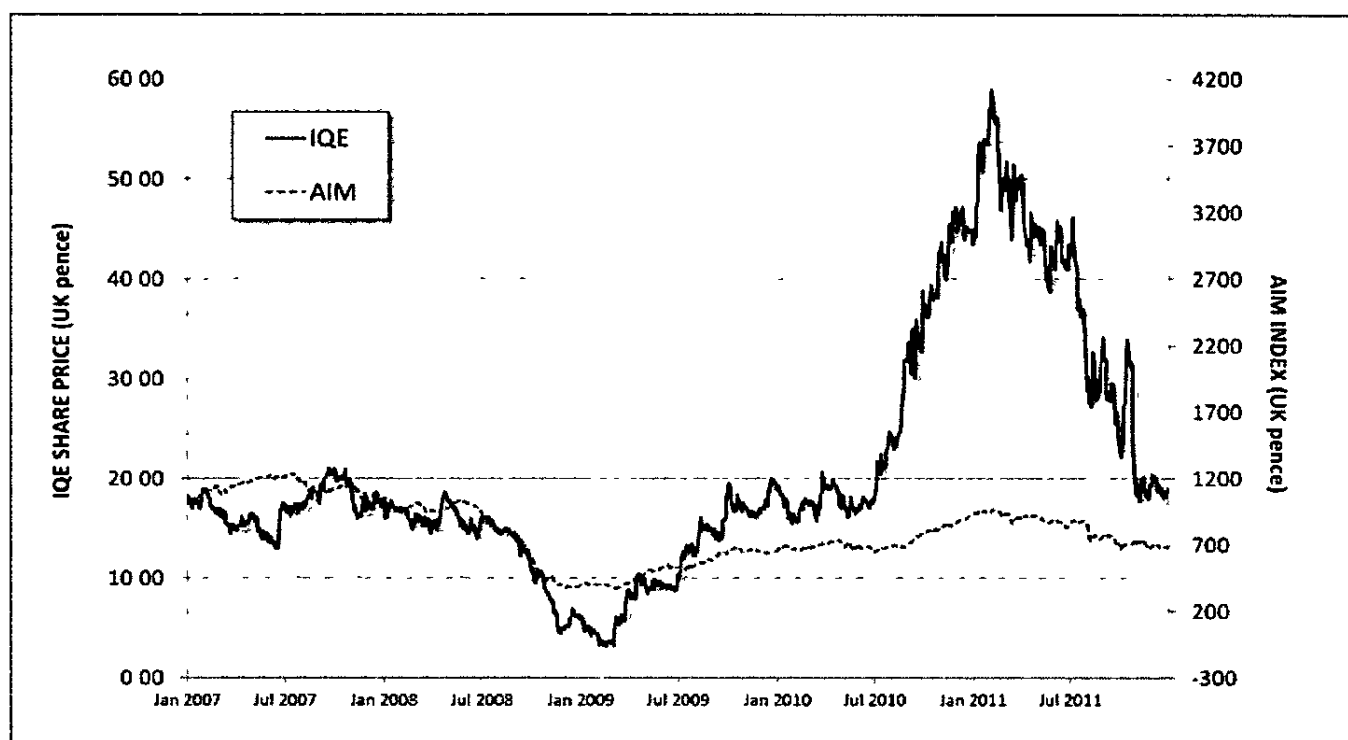
The services of Dr G H H Ainsworth were paid in cash £70,000 (2010 £70,000), was paid to Horton Corporate Finance for his fees and expenses for 2011. Dr G H H Ainsworth is a director of Horton Corporate Finance. VAT was charged on the invoices from Horton Corporate Finance and this was recovered by the company.

The services of S J Gibson were paid in cash £35,000 (2010 £35,000), was paid to Fishstone Limited for his fees and expenses for 2011. S J Gibson is a shareholder in Fishstone Limited. VAT was charged on the invoices from Fishstone Limited 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 2011 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 market all-share index for the five year period 2007 to 2011 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 2011 were as follows

	2011	2010
	£'000	£'000
Basic salaries	752	589
Bonuses	134	76
Non-executive fees	105	105
<b>Subtotal salaries and fees</b>	<b>991</b>	<b>770</b>
Car allowance	116	88
Benefits in kind	28	27
Money purchase pension contributions	45	62
<b>Total</b>	<b>1,180</b>	<b>947</b>

## (b) Directors' emoluments

The aggregate emoluments paid to each director during 2011 were as follows

Name of director	Salary fees and bonuses £'000	Car allowance £'000	Benefits in kind £'000	Pensions £'000	2011 Total £'000	2010 Total £'000
<b>Executive</b>						
Dr A W Nelson	307	41	12	7	367	298
Dr H R Williams	200	26	4	13	243	190
P J Rasmussen	200	26	10	13	249	194
A G Meldrum	179	23	2	12	216	160
<b>Non-Executive</b>						
Dr G H H Ainsworth	70	-	-	-	70	70
S J Gibson	35	-	-	-	35	35
<b>Total</b>	<b>991</b>	<b>116</b>	<b>28</b>	<b>45</b>	<b>1,180</b>	<b>947</b>

## Notes

Mr Meldrum's emoluments for 2010 are shown from the date at which he was appointed as a director (28 June 2010)

In aggregate, the executive directors made a gain of £2,465,000 on the exercise of share options during the year. The majority of the shares obtained on the exercise of these options were sold in order to satisfy the option price and tax arising on the exercise. The shares retained are included in the closing totals shown on the next page. Dr Nelson made a gain of £786,000 as part of these exercises.

## (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 2011 were as follows

Name of director	As at 1 January 2011	As at 31 December 2011
<b>Executive</b>		
Dr A W Nelson	27,391,303	27,482,913
Dr H R Williams	77,000	678,342
P J Rasmussen	60,000	495,000
A G Meldrum	-	93,800
<b>Non-Executive:</b>		
Dr G H H Ainsworth	3,234,956	3,121,999
S J Gibson	301,855	301,855
<b>Total</b>	<b>31,065,114</b>	<b>32,173,909</b>

The interests in share options in IQE Plc of those directors who held office at 31 December 2011 were as follows

Name of director	As at 1 January 2011	As at 31 December 2011	Date(s) from which exercisable
<b>Executive</b>			
Dr A W Nelson	14,507,624	12,845,124	1 Jan 2012 to 1 Jan 2013
Dr H R Williams	7,415,433	5,386,433	1 Jan 2012 to 1 Jan 2013
P J Rasmussen	5,136,393	2,586,393	1 Jan 2012 to 1 Jan 2013
A G Meldrum	910,747	910,747	1 Jan 2013
<b>Non-Executive</b>			
Dr G H H Ainsworth	-	-	
S J Gibson	-	-	
<b>Total</b>	<b>27,970,197</b>	<b>21,728,697</b>	

The directors do not hold shares or share options in any group company other than IQE plc

The highest and lowest mid-market share prices in respect of the shares of IQE Plc during 2011 were 59 00p/share and 17 75p/share respectively (2010 47 25p/share and 15 51p/share respectively) The mid-market price of IQE plc shares closed at 18 72p/share as at 31 December 2011 (2010 45 00p/share)

#### Approval

This report was approved by the Board of Directors on 20 March 2012 and signed on its behalf by



**S J Gibson, OBE**

Remuneration Committee Chairman

# Corporate governance report

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 2011, the company has been in compliance with the Code provisions set out in the UK Corporate Governance Code

## 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, three 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. 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.

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. The Chief Executive reviews the performance of the executive directors on an annual basis.

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 A W 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 results and full year 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, and monitors the independence of the external auditors.

The Group has an Internal Audit function, with a scope of evaluating and testing the group's financial control procedures. The Internal Audit function reports directly to the chairman of the audit committee, and liaises with the external auditors as appropriate.

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. 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 2011 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 2011	7	3	4
Number of meetings attended in 2011			
<b>Executive</b>			
Dr A W Nelson	7	-	4
P J Rasmussen	7	3	-
Dr H R Williams	6	-	-
Mr A G Meldrum	7	-	-
<b>Non-executive</b>			
Dr G H H Ainsworth	7	3	4
S J Gibson	7	3	4

**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 UK Corporate Governance Code. 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 and review by internal audit. 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 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
- an internal audit function, which is mandated to evaluate and test the Group's financial control procedures, reporting directly to the chairman of the audit committee

### 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). The group's annual report and financial statements, interim reports and other documentation is available online and by mail where requested.

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 Hamper 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 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.

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

	<b>Total 2011 £'000</b>	<b>Total 2010 £'000</b>
<b>PricewaterhouseCoopers LLP (group auditors)</b>		
- Company audit and consolidated financial statements	18	17
- Subsidiary companies' audit	65	72
- Tax services	5	9
- Other services	-	8
<b>Ernst and Young (auditors of MBE Technology Pte Limited)</b>		
- Subsidiary company's audit	15	15
- Tax services	10	1
<b>Total</b>	<b>113</b>	<b>122</b>

# 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 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

## Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 19, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2011 and of the group's profit and group's and parent company's cash flows for the year then ended,
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

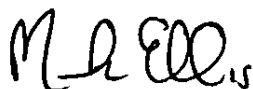
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

## IQE PLC

The directors have requested, (because the company applies Listing Rules 9.8.6R.5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Report relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority. We have nothing to report in respect of this review.

At the request of the directors, we have also audited the part of the Remuneration Report that is described as having been audited. In our opinion, the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.



Mark Ellis (Senior Statutory Auditor)  
for and on behalf of  
PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Cardiff  
20 March 2012

**Consolidated income statement  
for the year ended 31 December 2011**

	Note	2011 £'000	2010 £'000
<b>Revenue</b>	3	<b>75,318</b>	<b>72,650</b>
Cost of sales		(57,142)	(56,050)
<b>Gross profit</b>		<b>18,176</b>	<b>16,600</b>
Selling, general and administrative expenses		(10,803)	(9,392)
<b>Operating profit</b>	4	<b>7,373</b>	<b>7,208</b>
Finance costs	6	(481)	(874)
<b>Profit before tax</b>		<b>6,892</b>	<b>6,334</b>
Income tax income	7	1,551	1,172
<b>Profit for the year attributable to equity shareholders</b>		<b>8,443</b>	<b>7,506</b>
Adjusted earnings per share	9	1 86p	1 91p
Basic earnings per share	9	1 62p	1 63p
Adjusted diluted earnings per share	9	1 74p	1 76p
Diluted earnings per share	9	1 51p	1 50p

The notes on pages 36 to 62 form part of these financial statements

**Consolidated statement of comprehensive income  
for the year ended 31 December 2011**

	2011 £'000	2010 £'000
Profit for the year	8,443	7,506
Currency translation differences on foreign currency net investments	432	3,095
Foreign exchange hedges	(598)	116
<b>Total comprehensive income for the year</b>	<b>8,277</b>	<b>10,717</b>

**Consolidated balance sheet  
as at 31 December 2011**

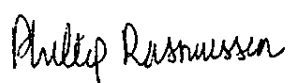
Company Number 03745726

	Note	2011 £'000	2010 £'000 <small>(restated – note 17)</small>
<b>Non-current assets</b>			
Intangible assets	10	32,706	30,401
Property, plant and equipment	11	37,348	23,804
Deferred tax asset	7	1,876	824
<b>Total non-current assets</b>		<b>71,930</b>	<b>55,029</b>
<b>Current assets</b>			
Inventories	13	15,122	11,847
Trade and other receivables	14	14,338	16,741
Cash and cash equivalents		3,233	12,507
<b>Total current assets</b>		<b>32,693</b>	<b>41,095</b>
<b>Total assets</b>		<b>104,623</b>	<b>96,124</b>
<b>Current liabilities</b>			
Borrowings	16	(49)	(4,077)
Trade and other payables	15	(23,157)	(20,073)
<b>Total current liabilities</b>		<b>(23,206)</b>	<b>(24,150)</b>
<b>Non-current liabilities</b>			
Borrowings	16	(7,105)	(1,409)
Other payables	15	(1,562)	(8,291)
<b>Total non-current liabilities</b>		<b>(8,667)</b>	<b>(9,700)</b>
<b>Total liabilities</b>		<b>(31,873)</b>	<b>(33,850)</b>
<b>Net assets</b>		<b>72,750</b>	<b>62,274</b>
<b>Shareholders' equity</b>			
Share capital	18	5,251	5,153
Share premium		22,122	21,237
Retained earnings		36,118	28,019
Other reserves		9,259	7,865
<b>Total equity</b>		<b>72,750</b>	<b>62,274</b>

The notes on pages 36 to 62 form part of these financial statements

These financial statements were approved by the Board of Directors on 20 March 2012

Signed on behalf of the Board of Directors



P J Rasmussen



Dr A W Nelson

**Consolidated statement of changes in equity  
for the year ended 31 December 2011**

	Share capital	Share premium	Retained earnings	Exchange rate reserve	Other reserves	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Balance at 1 January 2011</b>	<b>5,153</b>	<b>21,237</b>	<b>28,019</b>	<b>4,840</b>	<b>3,025</b>	<b>62,274</b>
<b>Comprehensive income</b>						
Profit for the year	-	-	8,443	-	-	8,443
Foreign exchange translation differences	-	-	-	432	-	432
Foreign exchange hedges	-	-	-	-	(598)	(598)
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>8,443</b>	<b>432</b>	<b>(598)</b>	<b>8,277</b>
<b>Transactions with owners</b>						
Employee share option scheme	-	-	(344)	-	1,284	940
Issues of ordinary shares	98	885	-	-	276	1,259
<b>Total transactions with owners</b>	<b>98</b>	<b>885</b>	<b>(344)</b>	<b>-</b>	<b>1,560</b>	<b>2,199</b>
<b>Balance at 31 December 2011</b>	<b>5,251</b>	<b>22,122</b>	<b>36,118</b>	<b>5,272</b>	<b>3,987</b>	<b>72,750</b>
<b>Balance at 1 January 2010</b>	<b>4,435</b>	<b>1,150</b>	<b>20,513</b>	<b>1,745</b>	<b>1,994</b>	<b>29,837</b>
<b>Comprehensive income</b>						
Profit for the year	-	-	7,506	-	-	7,506
Foreign exchange translation differences	-	-	-	3,095	-	3,095
Cash flow hedges	-	-	-	-	116	116
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>7,506</b>	<b>3,095</b>	<b>116</b>	<b>10,717</b>
<b>Transactions with owners</b>						
Employee share option scheme	-	-	-	-	446	446
Share placing	650	19,226	-	-	-	19,876
Other issues of ordinary shares	68	861	-	-	469	1,398
<b>Total transactions with owners</b>	<b>718</b>	<b>20,087</b>	<b>-</b>	<b>-</b>	<b>915</b>	<b>21,720</b>
<b>Balance at 31 December 2010</b>	<b>5,153</b>	<b>21,237</b>	<b>28,019</b>	<b>4,840</b>	<b>3,025</b>	<b>62,274</b>

The notes on pages 36 to 62 form part of these financial statements

**Consolidated cash flow statement  
for the year ended 31 December 2011**

	Note	2011 £'000	2010 £'000
<b>Cash flows from operating activities</b>			
Cash inflow from operations	21	10,823	10,250
Net interest paid		(515)	(904)
Income tax received		13	361
<b>Net cash generated from operating activities</b>		<b>10,321</b>	<b>9,707</b>
<b>Cash flows from investing activities.</b>			
Acquisition of Galaxy Compound Semiconductors, Inc		(1,134)	1
Development expenditure		(3,666)	(3,379)
Investment in other intangible fixed assets		(328)	(389)
Purchase of property, plant and equipment		(15,517)	(4,995)
Proceeds from sale of property, plant and equipment		90	1,467
<b>Net cash used in investing activities</b>		<b>(20,555)</b>	<b>(7,295)</b>
<b>Cash flows from financing activities:</b>			
Issues of ordinary share capital		616	20,512
Loans and leases received/(repaid)	22	334	(14,741)
<b>Net cash generated from financing activities</b>		<b>950</b>	<b>5,771</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(9,284)</b>	<b>8,183</b>
Cash and cash equivalents at 1 January	23	12,507	4,233
Exchange gains on cash and cash equivalents		10	91
<b>Cash and cash equivalents at 31 December</b>	<b>23</b>	<b>3,233</b>	<b>12,507</b>

The notes on pages 36 to 62 form part of these financial statements

Parent company balance sheet  
for the year ended 31 December 2011

Company Number 03745726

	Note	2011 £'000	2010 £'000
<b>Non-current assets</b>			
Investments in subsidiaries	12	13,687	14,238
<b>Total non-current assets</b>		<b>13,687</b>	<b>14,238</b>
<b>Current assets</b>			
Trade and other receivables	14	46,134	37,964
Cash and cash equivalents		240	2,502
<b>Total current assets</b>		<b>46,374</b>	<b>40,466</b>
<b>Total assets</b>		<b>60,061</b>	<b>54,704</b>
<b>Current liabilities</b>			
Trade and other payables	15	(1,737)	(2,187)
Borrowings	16	-	(3,512)
<b>Total current liabilities</b>		<b>(1,737)</b>	<b>(5,699)</b>
<b>Non-current liabilities</b>			
Trade and other payables	15	(1,562)	(2,306)
Borrowings	16	(7,087)	-
<b>Total non-current liabilities</b>		<b>(8,649)</b>	<b>(2,306)</b>
<b>Total liabilities</b>		<b>(10,386)</b>	<b>(8,005)</b>
<b>Net assets</b>		<b>49,675</b>	<b>46,699</b>
<b>Shareholders' equity</b>			
Share capital	18,20	5,251	5,153
Share premium	20	22,122	21,237
Retained earnings	20	18,129	16,886
Other reserves	20	4,173	3,423
<b>Total equity</b>		<b>49,675</b>	<b>46,699</b>

The notes on pages 36 to 62 form part of these financial statements

These financial statements were approved by the Board of Directors on 20 March 2012

Signed on behalf of the Board of Directors



P J Rasmussen



Dr A W Nelson

**Parent company cash flow statement  
for the year ended 31 December 2011**

	Note	2011 £'000	2010 £'000
<b>Cash flows from operating activities</b>			
Cash outflow from operations	21	(8,453)	(13,109)
Interest received		2,167	1,139
<b>Net cash used in operating activities</b>		<b>(6,286)</b>	<b>(11,970)</b>
<b>Cash flows from financing activities</b>			
Issues of ordinary share capital		616	20,512
Loans and leases received/(repaid)		3,408	(9,236)
<b>Net cash generated from financing activities</b>		<b>4,024</b>	<b>11,276</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(2,262)</b>	<b>(694)</b>
Cash and cash equivalents at 1 January		2,502	3,196
<b>Cash and cash equivalents at 31 December</b>		<b>240</b>	<b>2,502</b>

The notes on pages 36 to 62 form part of these financial statements

**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.

**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 2006, International Financial Reporting Standards ("IFRS") as adopted by the European Union and IFRIC interpretations expected to be in issue at 31 December 2011. 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.

**Changes in accounting policy and disclosures**

*(a) New and amended standards adopted by the group*

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2011 that would be expected to have a material impact on the group.

*(b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2011 and not early adopted*

There are no IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the group.

**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 408 of the Companies Act 2006, 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. The acquired identifiable assets, liabilities and contingent liabilities are recognised at their fair value at the date of acquisition.

Where the fair values of the net assets acquired are initially recognised on a provisional basis, these are reassessed during the 12 month period following the date of the business combination. Adjustments to the fair values as at the date of acquisition within this 'measurement period' are recorded, with any net impact being added to or deducted from the goodwill recognised. Such adjustments are recognised in both the current period and restated comparative period balance sheets as if the final fair values had been used in the initial recognition of the 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 over the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

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.

**1 Significant accounting policies (continued)**

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 5 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 is 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. 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 comprise cash in hand. 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.

**1 Significant accounting policies (continued)**

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 uses forward currency contracts as appropriate to manage foreign exchange risk

**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 leases 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

**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, which is on the delivery of the goods or services and acceptance by the customer

Accrued income is recognised for sales where, at the balance sheet date, billing has not yet taken place but contractual terms dictate that the risks and rewards have been transferred to the customer and the customer is committed to payment. Billing is deferred to a contractually defined trigger point

**Segmental reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the board of directors

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

**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

**1 Significant accounting policies (continued)**

**Share based payments**

The group operates a Share Option Scheme, under which the entity receives services from employees as consideration for equity instruments (options) of the group. 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 is determined by reference to the fair value of the options granted including any market performance conditions, (for example, an entity's share price), excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period) and including the impact of any non-vesting conditions (for example, the requirement for employees to save).

Non-market performance and service conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the group revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

When the options are exercised, the company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium. The scheme is equity settled.

The grant by the company of options over its equity instruments to the employees of subsidiary undertakings in the group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity accounts.

The social security contributions payable in connection with the grant of the share options is considered an integral part of the grant itself, and the change will be treated as a cash-settled transaction.

**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, which is the group's presentational currency.

Foreign currency transactions are translated into the subsidiaries functional currency at the rates of exchange ruling at the date of the transaction, or at the forward currency hedged rate where appropriate. 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.

**1 Significant accounting policies (continued)**

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 have been enacted or substantially enacted at the balance sheet date. Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences, unless specifically exempt.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

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.

**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 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 on 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.

**(d) Deferred tax assets**

Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

3. Segmental analysis

The board of directors considers that the wireless, optoelectronics and electronics markets are the group's primary reporting segments. The board of directors assesses the performance of these operating segments based on their earnings before interest, tax, depreciation, amortisation and share based payments (EBITDA)

Further detail on the nature of the segments is provided in the Chief Executive's Review

2011	Wireless £'000	Opto- electronics £'000	Electronics £'000	Total £'000
<b>Income statement</b>				
Revenue	55,156	18,551	1,611	75,318
EBITDA	10,718	3,409	(172)	13,955
Share based payments	(933)	(309)	(42)	(1,284)
Depreciation	(3,101)	(743)	(331)	(4,175)
Amortisation	(820)	(300)	(3)	(1,123)
Operating profit/(loss)	5,864	2,057	(548)	7,373
Finance costs				(481)
Tax				1,551
Retained profit				8,443
<b>Segment assets</b>				
Operating assets	73,108	24,930	3,352	101,390
Cash				3,233
Total assets				104,623
<b>Segment liabilities</b>				
Operating liabilities	(13,362)	(10,992)	(365)	(24,719)
Borrowings				(7,154)
Total liabilities				(31,873)
<b>Other segmental information</b>				
Capital expenditure - intangible assets	1,974	496	782	3,252
Capital expenditure - property, plant and equipment	15,604	1,549	235	17,388

Costs not directly attributable to one of the segments above have been allocated based on the share of revenue attributable to that segment

Finance costs are not allocated to the segments since this type of activity is driven by central management of the cash and borrowings of the group

3 Segmental analysis (continued)

2010	Wireless £'000	Opto- electronics £'000	Electronics £'000	Total £'000
<b>Income statement</b>				
Revenue	55,062	15,393	2,195	72,650
EBITDA	11,093	1,874	148	13,115
Share based payments	(945)	(305)	(52)	(1,302)
Depreciation	(2,687)	(651)	(281)	(3,619)
Amortisation	(713)	(269)	(4)	(986)
Operating profit/(loss)	6,748	649	(189)	7,208
Finance costs				(874)
Tax				1,172
Retained profit				7,506
<b>Segment assets</b>				
Operating assets	59,584	21,322	2,711	83,617
Cash				12,507
Total assets				96,124
<b>Segment liabilities</b>				
Operating liabilities	(14,776)	(13,147)	(441)	(28,364)
Borrowings				(5,486)
Total liabilities				(33,850)
<b>Other segmental information</b>				
Capital expenditure - intangible assets	2,035	1,318	415	3,768
Capital expenditure - property, plant and equipment	4,402	894	333	5,629

In the periods set out below, certain customers, all within the Wireless operating segment, accounted for greater than 10% of the Group's total revenues

	2011 £'000	2011 % revenue	2010 £'000	2010 % revenue
Customer 1	14,848	20%	17,964	25%
Customer 2	7,491	10%	4,083	6%
Customer 3	6,165	8%	8,869	12%

There are no customers in the optoelectronics or electronics segments that accounted for greater than 10% of the Group's total revenues

3. Segmental analysis (continued)

Geographical information

Disclosure of group revenues by location of customer

	2011 £'000	2010 £'000
<b>Americas</b>	<b>49,848</b>	<b>47,998</b>
United States of America	48,498	47,579
Rest of Americas	1,350	419
<b>Europe, Middle East &amp; Africa (EMEA)</b>	<b>7,494</b>	<b>7,866</b>
France	426	1,448
Germany	1,694	1,899
Israel	2,493	2,085
United Kingdom	821	1,318
Rest of EMEA	2,060	1,116
<b>Asia Pacific</b>	<b>17,976</b>	<b>16,786</b>
People's Republic of China	2,202	1,625
Japan	6,241	5,982
Taiwan	7,758	7,752
Rest of Asia Pacific	1,775	1,427
<b>Total revenue</b>	<b>75,318</b>	<b>72,650</b>

Disclosure of non-current assets by location of assets

	Property, plant and equipment		Intangible assets	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
<b>By location</b>				restated
USA	22,558	13,340	16,882	15,658
Singapore	9,262	6,080	8,843	8,884
UK	5,528	4,385	6,981	5,859
	<b>37,348</b>	<b>23,805</b>	<b>32,706</b>	<b>30,401</b>

4 Operating profit

	2011 £'000	2010 £'000
<b>The operating profit is stated after charging/(crediting).</b>		
Depreciation of property, plant and equipment	4,175	3,619
Amortisation of non-current intangible assets	1,123	986
Gain on sale of property, plant and equipment	(68)	(539)
Services provided by auditors	113	122
Operating lease rentals	2,158	1,845
Research and development	107	343
Deferred income (government grants)	-	(44)
Exchange losses	26	18
Cost of inventories consumed	30,822	29,900

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

5. Employee costs

	2011 £'000	2010 £'000
<b>Employee costs (including directors' remuneration)</b>		
Wages and salaries	15,541	14,769
Social security costs	1,952	1,979
Other pension costs	729	702
Charge for share based payments	1,284	1,202
	19,506	18,652

	2011 Number	2010 Number
<b>Average number of employees (including directors)</b>		
Cost of sales	311	271
Selling, general and administrative	95	81
	406	352

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 of £75,000 (2010 £90,000), was £1,987,000 (2010 £1,889,000) and the charge for share-based payments was £594,000 (2010 £1,262,000)

6 Finance costs

	2011 £'000	2010 £'000
Bank and other loans	408	839
Finance lease interest	73	35
	481	874

7. Taxation

Current tax credit	2011 £'000	2010 £'000
United Kingdom corporation tax	-	-
United Kingdom research and development tax credits receivable	568	495
Overseas taxes payable	(58)	(170)
Total current tax credit	510	325
Deferred tax credit	1,041	847
Total tax credit	1,551	1,172

Factors affecting total tax credit

The tax credit assessed for the period is different from that resulting from applying the standard rate of corporation tax in the UK 26.5% (2010 28%). The differences are explained below

	2011 £'000	2010 £'000
Profit on ordinary activities before taxation	6,892	6,334
Tax charge at 26.5% thereon (2010 28%)	(1,826)	(1,774)
Effects of		
Expenses not deductible for tax purposes	(48)	(39)
Overseas tax rate differences	530	1,362
Increase in unrecognised tax losses	(1,008)	(801)
Other deferred tax movements	3,335	1,929
United Kingdom research and development tax credits receivable	568	495
Total tax credit for the year	1,551	1,172

Deferred tax asset	2011 £'000	2010 £'000
At 1 January	824	-
Deferred tax asset recognised in the year	1,041	847
Foreign exchange differences	11	(23)
At 31 December	1,876	824

The deferred income tax asset recognised at 31 December 2011 of £1,876,000 (2010 £824,000) relates to timing differences including tax loss carry-forwards and accelerated depreciation. These are recognised to the extent that the realisation of the related tax benefit through future taxable profits from the same trade is probable. The group currently benefits from a 0% tax rate on trading income arising in Singapore.

The net amount not recognised is an asset of £26,691,000 (2010 £36,403,000). Tax losses carried forward account for an asset of £31,651,000 (2010 £30,643,000). The remaining unrecognised amounts relating to a mix of temporary timing differences including accelerated depreciation and income tax deductions receivable on the exercise of employee share options. The asset would be recognised if sufficient profits from the same trade arise in future periods.

8. Dividends

No dividend has been paid or proposed in 2011 (2010 £nil)

9. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year

Diluted earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of shares and 'in the money' share options in issue. Share options are classified as 'in the money' if their exercise price is lower than the average share price for the year. As required by IAS 33, this calculation assumes that the proceeds receivable from the exercise of 'in the money' options would be used to purchase shares in the open market in order to reduce the number of new shares that would need to be issued.

	2011 £'000	2010 £'000
Profit attributable to ordinary shareholders	8,443	7,506
Share based payments	1,284	1,302
Adjusted profit attributable to ordinary shareholders	9,727	8,808
	2011 Number	2010 Number
Weighted average number of ordinary shares	522,386,930	461,841,899
Dilutive share options	37,008,723	39,491,923
Adjusted weighted average number of ordinary shares	559,395,653	501,333,822
Adjusted earnings per share	1 86p	1 91p
Earnings per share	1 62p	1 63p
Adjusted diluted earnings per share	1 74p	1 76p
Diluted earnings per share	1 51p	1 50p

10. Intangible assets

The Group	Goodwill £'000	Patents £'000	Development		Total £'000
			costs £'000	Software £'000	
<b>Cost</b>					
At 1 January 2011	19,674	222	13,097	697	33,690
Additions	-	83	2,924	245	3,252
Exchange difference	149	-	77	-	226
At 31 December 2011	19,823	305	16,098	942	37,168
<b>Accumulated amortisation and impairment</b>					
At 1 January 2011	-	11	3,076	202	3,289
Charge for the year	-	15	966	142	1,123
Exchange difference	-	-	50	-	50
At 31 December 2011	-	26	4,092	344	4,462
<b>Net book value</b>					
At 31 December 2011	19,823	279	12,006	598	32,706
At 31 December 2010	19,674	211	10,021	495	30,401

The Group	Goodwill £'000	Patents £'000	Development		Total £'000
			costs £'000	Software £'000	
<b>Cost</b>					
At 1 January 2010	10,802	145	9,476	372	20,795
Additions	-	77	3,379	312	3,768
Acquisitions (restated - note 17)	6,113	-	159	-	6,272
Exchange difference	2,759	-	83	13	2,855
At 31 December 2010	19,674	222	13,097	697	33,690
<b>Accumulated amortisation and impairment</b>					
At 1 January 2010	-	-	2,209	112	2,321
Charge for the year	-	11	897	78	986
Exchange difference	-	-	(30)	12	(18)
At 31 December 2010	-	11	3,076	202	3,289
<b>Net book value</b>					
At 31 December 2010	19,674	211	10,021	495	30,401
At 31 December 2009	10,802	145	7,267	260	18,474

The amortisation charge of £1,123,000 (2010 £986,000) has been charged to selling, general and administrative expenses in the Consolidated Income Statement

The carrying value of deferred development costs continue to be supported by forecast cash flows

10. Intangible assets (continued)

*Impairment tests for goodwill*

Goodwill is allocated to the group's cash generating units (CGUs) identified according to operating segment. An operating segment level summary of the goodwill allocation is presented below.

	2011 £'000	2010 £'000
<b>Allocation of goodwill by operating segment</b>		
Wireless	12,070	12,017
Optoelectronics	7,753	7,657
<b>Total Goodwill</b>	<b>19,823</b>	<b>19,674</b>

The recoverable amount of all CGUs has been determined based on value in use calculations. These calculations use pre-tax cash flow projections based on financial business plans approved by management covering a five year period. These business plans incorporate information based on past experience, external independent market forecasts and internal production and capacity modelling. No further growth has been assumed in the periods beyond those covered by these approved plans.

The discounted cash flows support the carrying value of the goodwill for each CGU. A pre-tax discount rate of 10% has been used in these calculations, which management believe is appropriate for each CGU given that they have similar risk profiles and common funding. There is a significant level of headroom in the calculations and no impairment issues would arise if a higher discount rate of 20% had been used.

11. Property, plant and equipment

a) The Group	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 2011	6,344	10,762	2,387	100,130	119,623
Additions	12	925	143	16,308	17,388
Disposals	-	(685)	(184)	(4,810)	(5,679)
Exchange difference	37	282	52	620	991
At 31 December 2011	6,393	11,284	2,398	112,248	132,323
<b>Accumulated depreciation</b>					
At 1 January 2011	2,646	10,444	2,202	80,527	95,819
Disposals	-	(685)	(184)	(4,788)	(5,657)
Charge for the year	149	168	97	3,761	4,175
Exchange difference	7	28	18	585	638
At 31 December 2011	2,802	9,955	2,133	80,085	94,975
<b>Net book value</b>					
At 31 December 2011	3,591	1,329	265	32,163	37,348
At 31 December 2010	3,698	318	185	19,603	23,804

b) The Group	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 2010	7,426	10,608	4,385	99,368	121,787
Acquisitions	-	38	13	711	762
Additions	2	6	127	5,494	5,629
Disposals	(1,223)	-	(2,164)	(7,594)	(10,981)
Exchange difference	139	110	26	2,151	2,426
At 31 December 2010	6,344	10,762	2,387	100,130	119,623
<b>Accumulated depreciation</b>					
At 1 January 2010	2,582	10,296	4,200	83,344	100,422
Disposals	(95)	-	(2,163)	(7,572)	(9,830)
Charge for the year	150	79	148	3,242	3,619
Exchange difference	9	69	17	1,513	1,608
At 31 December 2010	2,646	10,444	2,202	80,527	95,819
<b>Net book value</b>					
At 31 December 2010	3,698	318	185	19,603	23,804
At 31 December 2009	4,844	312	185	16,024	21,365

11 Property, plant and equipment (continued)

	2011 Fixtures and fittings £'000	2010 Fixtures and fittings £'000
<b>c) The Company</b>		
<b>Cost</b>		
At 1 January and 31 December	140	140
<b>Accumulated depreciation</b>		
At 1 January and 31 December	140	140
<b>Net book value</b>		
At 31 December	-	-

12. Investments in subsidiaries

	2011 £'000	2010 £'000
<b>The Company</b>		
<b>Cost</b>		
At 1 January	84,676	84,447
Adjustment to NanoGaN Limited deferred consideration	(750)	-
Subsidiaries' share option costs incurred during the year	199	229
At 31 December	84,125	84,676
<b>Impairment</b>		
At 1 January and at 31 December	70,438	70,438
<b>Net book value</b>		
At 31 December	13,687	14,238
At 1 January	14,238	14,009

Details of subsidiary undertakings are set out in note 24

13 Inventories

	2011 £'000	2010 £'000 (restated – note 17)
<b>The Group</b>		
Raw materials and consumables	12,144	9,666
Work-in-progress and finished goods	2,978	2,181
	15,122	11,847

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 £1,989,000 (2010 £1,932,000)

14 Trade and other receivables

	2011 Group £'000	2011 Company £'000	2010 Group £'000	2010 Company £'000
Trade receivables	7,244	-	9,458	-
Amounts owed by group undertakings	-	45,991	-	37,716
Forward foreign exchange contracts (cash flow hedge)	-	-	116	116
Other receivables and prepayments	7,094	143	7,167	132
	14,338	46,134	16,741	37,964

As at 31 December 2011, 82% (2010 83%) of trade receivables were within terms. Of the other trade receivables, 87% (2010 79%) were less than 30 days past due. An allowance has been made for estimated irrecoverable amounts from the sale of goods of £135,000 (2010 £6,000). This allowance has been determined by reference to past default experience.

Included in other receivables is accrued income of £4,531,000 (2010 £4,259,000).

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.

Trade receivables and accrued income are primarily denominated in US dollars, as are trade payables (note 15). The natural hedge between these financial instruments limits the exposure of the group to movements in foreign exchange rates. Based on the balances held at 31 December 2011 a 1 cent movement in the US dollar to Sterling rate would impact the net value of these instruments by £6,000 (before the mitigating impact of cash flow hedges).

15. Trade and other payables

Current	2011	2011	2010	2010
	Group £'000	Company £'000	Group £'000	Company £'000
Trade payables	11,630	-	12,521	-
Deferred consideration	6,080	-	1,134	-
Other taxation and social security	307	63	606	110
Forward foreign exchange contracts (cash flow hedge)	246	246	-	-
Accruals and deferred income	4,894	1,428	5,812	2,077
	23,157	1,737	20,073	2,187

Non-current	2011	2011	2010	2010
	Group £'000	Company £'000	Group £'000	Company £'000
Deferred consideration	1,562	1,562	8,291	2,306

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

Forward foreign currency exchange contracts are designated as cash flow hedges against highly probable forecast transactions denominated in US dollars that are expected to occur at various dates during the next 12 months. The amount recognised within payables represents the mark to market value of these contracts at each reporting date. Movements in the mark to market value are included within other comprehensive income and other reserves within equity. Gains and losses recognised in equity as at 31 December 2011 will be recognised in the income statement in the period during which the hedged forecast transaction affects the income statement.

16 Borrowings

The Group	2011 £'000	2010 £'000
<b>Borrowings are analysed as follows</b>		
Bank loans	7,087	5,363
Finance leases	67	123
	<b>7,154</b>	<b>5,486</b>
<b>Borrowings fall due for repayment as follows.</b>		
Within one year	49	4,077
Between one and two years	18	147
Between two and five years	7,087	380
After five years	-	882
	<b>7,154</b>	<b>5,486</b>

The bank loan bears interest of 1.75% over LIBOR (2010 loans bearing between 1.10% over LIBOR and 7.95% fixed). The bank loan is a multicurrency revolving facility which is repayable within two to five years, and is secured by a fixed and floating charge over certain assets of IQE plc and its principal subsidiaries. At 31 December 2011 the group had £9,553,000 undrawn within existing facilities.

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 the bank loan of £7,087,000 of which £700,000 is denominated in sterling and the remainder in US dollars (2010 £3,512,000 all denominated in sterling). This amount is repayable between two and five years (2010 All repayable within 1 year).

17 Business combinations – Acquisition of Galaxy Compound Semiconductors Inc

The 2010 financial statements included details of the group's acquisition of Galaxy Compound Semiconductors Inc, and set out provisional fair values relating to the consideration and net assets acquired

As required by IFRS 3 (revised) the provisional fair values have been reassessed in light of information arising in the 12 month 'measurement period' following the acquisition. As a result the fair value of inventory acquired has been increased to £522,000 to reflect a lower risk of inventory obsolescence

As required by IFRS 3 (revised), this amendment has been restated in the prior year balance sheet (with a corresponding adjustment to goodwill). There is no impact on the current or prior year consolidated income statements

	Provisional Fair Value £'000	Measurement Period Adjustment £'000	Final Fair Value £'000
Inventories (note 13)	278	244	522
Other net assets acquired	601	-	601
Fair value of net assets acquired	879	244	1,123
Goodwill	6,357	(244)	6,113
Fair value of total purchase consideration	7,236	-	7,236

18 Share capital

Group and Company	2011 Number of shares	2011 £'000	2010 Number of shares	2010 £'000
<b>Allotted, called up and fully paid</b>				
Ordinary shares of 1p each	525,137,538	5,251	515,333,271	5,153

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

	2011 Number	2010 Number
At 1 January	515,333,271	443,500,599
Employee share based payment	9,804,267	6,730,757
Placing	-	65,000,000
Non-executive directors' fees	-	101,915
<b>At 31 December</b>	<b>525,137,538</b>	<b>515,333,271</b>

9,804,267 ordinary shares (2010 71,832,672 ordinary shares) were issued during the year for the following considerations

	2011 Number of shares	2011 Consideration	2010 Number of shares	2010 Consideration
Employee share schemes	9,804,267	Nil cost to 52 08p	6,730,757	1 00p to 24 50p
Placing	-	-	65,000,000	32 00p
Non-executive directors' fees	-	-	101,915	12 44p
	<b>9,804,267</b>		<b>71,832,672</b>	

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

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 and on page 18 of the Directors' Report

19 Share based payments

The total amount charged to the income statement in 2011 in respect of share based payments was £1,284,000 (2010 £1,302,000)

*Share option scheme*

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 (or as otherwise disclosed in the remuneration report for share options granted to executive directors). Options become exercisable between one and four years from the date of grant subject to continued employment and the achievement of performance conditions, including growth in EBITDA and earnings per share against various targets. The group has no legal or constructive obligation to repurchase or settle the options in cash.

Options are valued using the Black-Scholes option-pricing model and the total amount to be expensed is charged to income statement over the vesting period of the option. The principal assumptions used in the calculation of the fair value of share options are as follows:

Principal assumptions	2011	2010
Weighted average share price at grant date	22 35p	19 54p
Weighted average exercise price	22 88p	3 63p
Weighted average vesting period (years)	3	3
Option life (years)	10	10
Weighted average expected life (years)	3	3
Weighted average expected volatility factor	72%	69%
Weighted average risk free rate	0.90%	2.24%
Dividend yield	0%	0%

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.

Performance conditions are incorporated into the calculation of fair value by estimating the proportion of share options that will vest and be exercised based on a combination of historical trends and future expected trading performance. These are reassessed at the end of each period for each tranche of unvested options.

The fair value of options granted during the year ended 31 December 2011 was £373,263 (2010 £1,955,571).

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

	2011		2010	
	Number of options	Average exercise price (pence)	Number of options	Average exercise price (pence)
At 1 January	58,617,656	8 96	52,017,091	10 57
Granted	5,889,277	22 88	12,102,186	3 63
Exercised	(8,943,919)	6 88	(5,119,725)	12 42
Cancelled	(4,519,889)	17 95	(381,896)	12 25
At 31 December	51,043,125	10 14	58,617,656	8 96

**19 Share based payments (continued)**

The weighted average share price at the time of the options exercised during 2011 was 46.91p (2010 36.37p)

As at 31 December 2011, the total number of options held by employees was 51,043,125 (2010 58,617,656) as follows

Option price pence/share	Option period ending	2011		2010	
		Number of options	Number of options	Number of options	Number of options
1.00p – 86.20p	31 December 2012	1,475,469		2,006,447	
6.67p - 10.17p	31 December 2014	6,272,579		7,564,835	
6.87p - 10.25p	31 December 2015	934,352		1,328,351	
10.40p - 18.00p	31 December 2016	8,032,500		8,805,333	
13.58p - 19.42p	31 December 2017	5,625,175		7,585,462	
0.00p - 18.00p	31 December 2018	508,221		8,655,866	
1.00p - 17.07p	31 December 2019	10,269,732		10,569,176	
0.00p – 45.58p	31 December 2020	12,035,820		12,102,186	
9.15p – 50.25p	31 December 2021	5,889,277		-	
<b>At 31 December</b>		<b>51,043,125</b>		<b>58,617,656</b>	

20. Parent company profit and statement of changes in equity

As permitted by Section 408 of the Companies Act 2006, the income statement of the parent company is not presented as part of these financial statements. The parent company's profit for the financial year amounted to £1,243,000 (2010 loss £1,598,000)

	Share capital £'000	Share premium £'000	Retained earnings £'000	Other reserves £'000	Total equity £'000
<b>Balance at 1 January 2010</b>	<b>4,435</b>	<b>1,150</b>	<b>18,484</b>	<b>2,571</b>	<b>26,640</b>
<b>Comprehensive Income</b>					
Loss for the year	-	-	(1,598)	-	(1,598)
<b>Total comprehensive expense</b>	<b>-</b>	<b>-</b>	<b>(1,598)</b>	<b>-</b>	<b>(1,598)</b>
<b>Transactions with owners</b>					
Employee share option scheme	-	-	-	383	383
Share placing	650	19,226	-	-	19,876
Other issues of ordinary shares	68	861	-	469	1,398
<b>Total transactions with owners</b>	<b>718</b>	<b>20,087</b>	<b>-</b>	<b>852</b>	<b>21,657</b>
<b>Balance at 31 December 2010</b>	<b>5,153</b>	<b>21,237</b>	<b>16,886</b>	<b>3,423</b>	<b>46,699</b>
<b>Comprehensive Income</b>					
Profit for the year	-	-	1,243	-	1,243
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>1,243</b>	<b>-</b>	<b>1,243</b>
<b>Transactions with owners</b>					
Employee share option scheme	-	-	-	476	476
Other issues of ordinary shares	98	885	-	274	1,257
<b>Total transactions with owners</b>	<b>98</b>	<b>885</b>	<b>-</b>	<b>750</b>	<b>1,733</b>
<b>Balance at 31 December 2011</b>	<b>5,251</b>	<b>22,122</b>	<b>18,129</b>	<b>4,173</b>	<b>49,675</b>

21 Cash generated from operations

	2011 £'000	2010 £'000
<b>The Group</b>		
Operating profit	7,373	7,208
Depreciation of property, plant and equipment	4,175	3,619
Amortisation of intangible assets	1,123	986
Gain on sale of property, plant and equipment	(68)	(539)
Deferred income (government grants)	-	(44)
Cash costs related to acquisition of subsidiary	-	80
Share based payments	1,284	1,302
Cash inflow from operations before changes in working capital	13,887	12,612
Increase in inventories	(3,087)	(203)
Decrease/(increase) in trade and other receivables	2,033	(1,968)
Decrease in trade and other payables	(2,010)	(191)
Cash inflow from operations	10,823	10,250
<b>The Company</b>		
Operating loss	(924)	(3,056)
Share based payments	1,085	1,030
Cash inflow/(outflow) from operations before changes in working capital	161	(2,026)
Increase in trade and other receivables	(8,170)	(12,217)
(Decrease)/increase in trade and other payables	(444)	1,134
Cash outflow from operations	(8,453)	(13,109)

22 Reconciliation of net cash flow to movement in net debt

	2011 £'000	2010 £'000
(Decrease)/increase in cash in the year	(9,284)	8,183
Loans received	(7,253)	-
Loans repaid	5,777	13,980
Leases repaid	1,156	111
<b>Net movement resulting from cash flows</b>	<b>(9,604)</b>	<b>22,274</b>
Net funds/(debt) at 1 January	7,021	(14,931)
Net movement resulting from cash flows	(9,604)	22,274
Non-cash movements	(1,338)	(322)
<b>Net (debt)/funds at 31 December</b>	<b>(3,921)</b>	<b>7,021</b>

23 Analysis of net funds

	At 1 January 2011 £'000	Cash flow £'000	Other non-cash movements £'000	At 31 December 2011 £'000
Cash and cash equivalents	12,507	(9,284)	10	3,233
Loans due after one year	(1,331)	(5,495)	(261)	(7,087)
Loans due within one year	(4,033)	4,019	14	-
Finance leases due after one year	(78)	13	47	(18)
Finance leases due within one year	(44)	1,143	(1,148)	(49)
<b>Total borrowings</b>	<b>(5,486)</b>	<b>(320)</b>	<b>(1,348)</b>	<b>(7,154)</b>
<b>Net funds/(debt)</b>	<b>7,021</b>	<b>(9,604)</b>	<b>(1,338)</b>	<b>(3,921)</b>

Cash and cash equivalents at 31 December 2011 comprised balances held in instant access bank accounts

Non-cash movements include the drawdown of a finance lease

24 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% 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
NanoGaN Limited	Ordinary shares of £0.001	100%	Development of advanced semiconductor materials	UK
Galaxy Compound Semiconductors Inc	Common stock of \$0.00 par value	100%*	Manufacture of semiconductor compounds	USA

\* Indirect holdings

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

25. Post balance sheet event

On 8 February 2012, IQE plc entered into a strategic investment agreement and an exclusive wafer supply agreement with leading edge Concentrated PhotoVoltaic ("CPV") cell developer and manufacturer Solar Junction Corporation, a private company incorporated in the USA. The investment is expected to significantly accelerate IQE's strategy to become a leading global supplier of CPV wafers for the solar power markets.

On that date IQE plc also completed a placing of 43,750,000 new ordinary shares to raise £10,500,000 million gross. The net proceeds from this placing were used to fund a 9% equity investment in Solar Junction Corporation, the purchase of dedicated high volume molecular beam epitaxy production tools, the cost of ancillary quality control equipment and to establish initial wafer manufacturing at IQE.

**26. Related party transactions**

The group incurred professional fees and expenses during the year of £70,000 (2010 £70,000) payable to Horton Corporate Finance and £35,000 (2010 £35,000) payable to Fishstone Limited. Dr G H H Ainsworth, who is a director of IQE Plc, is a director of Horton Corporate Finance. S J Gibson, who is a director of IQE Plc, is also a director of Fishstone Limited. An amount of £26,000 (2010 £26,000) was outstanding to these parties at the year-end.

**27. Operating lease commitments**

The group was committed at 31 December 2011 and 31 December 2010 to making the following aggregate payments in respect of non-cancellable operating leases:

	2011 £'000	2010 £'000
Due within one year	2,130	1,973
Due between two and five years	6,833	6,714
Due after five years	10,337	12,123
	19,300	20,810

**28. Commitments**

The group had the following capital commitments at 31 December 2011 and 31 December 2010:

	2011 £'000	2010 £'000
Authorised and contracted for	243	3,357