

# REGISTRARS COPY

**ZOO Digital Group plc**

Report and financial statements

31 December 2002

Registered number: 3858881



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## Company information

Directors	M John Barnes (Non-Executive Chairman) Ian C Stewart (Chief Executive Officer) Robert G Deri (Chief Financial Officer) Andrew Scrivener (Chief Operating Officer) Dr Stuart A Green (Chief Technical Officer) Dr Christopher H B Honeyborne (Non-Executive Director)
Company Secretary	Robert G Deri
Registered Office	Parkhead House, 26 Carver Street, Sheffield, S1 4FS
Website Address	<a href="http://www.zoodigitalgroup.com">www.zoodigitalgroup.com</a>
Nominated Adviser	Noble & Company Limited 1 Frederick's Place London EC2R 8AB
Nominated Broker	Noble & Company Limited 1 Frederick's Place London EC2R 8AB
Auditors	PKF Knowle House 4 Norfolk Park Road Sheffield S2 3QE
Solicitors to the Company	DLA Princes Exchange Princes Square Leeds LS1 4BY
Bankers	Royal Bank of Scotland plc Sheffield Corporate Office PO Box 52 5 Church Street Sheffield S1 1HF
Registrars	Capita Registrars plc The Registry 34 Beckenham Road Beckenham Kent BR3 4TU

## Chairman and Chief Executive's statement

### Introduction

The year to 31<sup>st</sup> December 2002 was one of significant development with the Group establishing itself in the video games market and rapidly progressing its DVD-Extra Technology.

Over the year we published seven titles on the Nintendo Gameboy Advance and PC platforms across five European countries. Furthermore in November 2002, we acquired the 'Premier Manager' brand and franchise, which has enabled the Group to enter the lucrative Sony Playstation 2 market for the first time. Further PS2 titles are currently being considered for publication. The Group has also acquired a number of Electronic Arts titles, amongst others, for publishing on the Gameboy Advance platform during 2003.

Following the completion of the feasibility studies into interactive DVD-Video discs it was evident that we believed we had a unique proposition with a huge market potential. Consequently the Group accelerated its development of DVD-Extra Studio and successfully produced two showcase interactive DVD products in October 2002, achieving significant credibility in the DVD industry.

### Results

The Group increased sales for the period to £1.9m (2001: £0.7m) with a LBITDA of £1.9m (2001: £1.9m). The retained loss for the financial year was reduced to £2.2m (2001: loss of £9.0m) with a loss per share of 1.46p (2001: loss of 8.15p).

The Group's cash position was £1.3m as at 31 December 2002 (2001: £3.3m).

This compares with cash balances of approximately £2.2m at the interim stage.

### Publishing and Licensing

The Group's strategy is to build on its own intellectual property assets such as Premier Manager and Home Creative Studio using internal development resources. These key titles will be supported by the acquisition of finished titles for localised or cross platform publishing, which generally entail lower risk opportunities.

We aim to identify niche products that have a sizeable sales opportunity in this market and we intend to publish at least three PS2 titles in 2003 in line with this strategy.

Our support for the Gameboy Advance market will continue and we intend to release twelve new titles in 2003, six of which are Electronic Arts titles including "*Need For Speed - Porsche Unleashed*" and "*Sim City 2000*".

Nintendo's commitment to this market has continued with the release of the New Gameboy Advance SP and is being targeted at males aged 18 to 35. Our portfolio of games aims to compliment this target audience focus. The Christmas sales seasons will be the key selling period for the Gameboy Advance SP and we are well positioned to take advantage of this.

## Chairman and Chief Executive's statement (continued)

Home Creative Studio Version 1.6 will be published with new features and model sets during the summer and discussions are ongoing with US publishers. Whilst this product has proved difficult to position, the digital imaging market is now opening up and we anticipate a long life expectancy for this product.

Following the acquisition of Premier Manager from Atari (formerly Infogrames), a development team has been assembled to ensure the continuation of the brand.

The Group commenced a three year development program, which will enable us to re-establish the brand in the eyes of the consumer. For 2003 we will publish the title on PS2, PC and for the first time, on Gameboy Advance, taking advantage of Nintendo's positioning and marketing of the new Gameboy Advance SP. We will also look to explore the on-line and interactive TV opportunities for which product design materials are already advanced. Premier Manager is seen as a pillar title that can generate substantial revenues in a niche but popular market in which the management team has considerable experience.

### **Who Wants To Be A Millionaire ("WWTBAM")**

Following the self publishing of the WWTBAM quiz game on DVD-Video in October 2002 this product has now been licensed to Vivendi Universal for publication in three initial territories; UK, France and Italy.

In line with our agreement with Celador, the holder of rights to WWTBAM, the agreement with Universal is for a seven year period and gives them options over all territories apart from North America.

We believe this to be a major opportunity for the Group and we look forward to extending our relationship with Universal whilst also proving the benefits of DVD-Extra.

### **DVD-Extra**

During the year the Group accelerated its development of a revolutionary authoring software for producing interactive DVD-Video discs that will play on any standard consumer DVD player. We applied for and received a SMART grant award of £188,000 from the Department of Trade and Industry to assist with the research and development. DVD-Extra unlocks the hidden interactive capabilities that exist in every player, and allows developers to produce titles that exhibit many of the properties of multimedia CD-ROM on a standard, unmodified, DVD player.

ZOO's principal offering is a product for authoring interactive DVD-Video discs called *DVD-Extra Studio*. This tool operates in a similar way to multimedia authoring products that are designed for creating CD-ROM applications for PC and Macintosh, but produces DVD-Video disc images as its output. It performs a similar function to so-called DVD authoring products that are designed specifically for creating DVD-Video discs, but due to the patent-pending authoring method it employs, it offers substantial cost savings for companies that are involved in the production of DVDs and also enables more sophisticated functionality to be developed.

## Chairman and Chief Executive's statement (continued)

ZOO will license DVD-Extra Studio to multimedia developers and Compression and Authoring facilities. Charges will be levied on a pay-per-use basis, such that customers will pay a fee to ZOO for each project that uses DVD-Extra Studio.

The Group has applied for patents to protect the core DVD-Extra technology and is continuing to further develop and protect its intellectual property worldwide.


### Outlook

Following the successful fundraising of £1.5m gross through the share placing which was completed on 2<sup>nd</sup> June 2003 the Group looks forward to positive progression. The portfolio of products is expanding, with a focus on the development of our own intellectual properties. The board believes that the combination of publishing low risk licensed product and in-house own brands together with the huge potential of DVD-Extra Studio places the Group in an excellent position for a move to profitability and significant future growth.

The Group plans to exploit the DVD-Extra technology internationally and has established an Early Adopter Programme consisting of around twenty companies including Technicolor, Warner and Comchoice, leading to the first commercial release of the product within twelve months. We believe that the uniqueness of DVD-Extra and the filing of international patents will allow ZOO to build and maintain significant differentiation over other authoring tool providers.

**John Barnes**

Chairman

A handwritten signature in black ink, appearing to read 'Ian Stewart', is written over the printed name.

**Ian Stewart**

Chief Executive Officer

5 June 2003

## Directors' report

The directors present their report on the affairs of the group, together with the financial statements and auditors' report, for the year ended 31 December 2002.

### Principal activities

The principal activity of the group for the year under review included the development of games and entertainment products for digital platforms and the provision of digital media solutions.

### Business review

A review of the development of the business together with an indication of future developments is included in the Chairman and Chief Executive's statement set out on pages 3 to 5.

### Results and dividends

The audited financial statements for the year ended 31 December 2002 are set out on pages 13 to 41. The directors do not recommend the payment of a dividend for the year.

### Directors

The directors who served during the year were as follows:

<b>Name</b>	<b>Position</b>
M John Barnes	Non-Executive Chairman
Ian C Stewart	Chief Executive Officer
Robert G Deri	Chief Financial Officer
Andrew Scrivener	Chief Operating Officer
Dr Stuart A Green	Chief Technical Officer
Dr Christopher H B Honeyborne	Non-Executive Director

Details of the interests in the shares of the company at the beginning (or subsequent date of appointment) and end of the financial year of those directors who held office at 31 December 2002 are disclosed in note 6. In accordance with the company's Articles of Association Stuart Green and Christopher Honeyborne retire by rotation at the next Annual General Meeting and, being eligible, offer themselves for re-election.

#### ***John Barnes – Non-Executive Chairman (aged 54)***

John has 30 years of general management experience in consumer orientated businesses within Europe and the USA. John held roles with Procter & Gamble, the International Playtex Company and PepsiCo. Previously he was Managing Director of Kentucky Fried Chicken (GB) Limited and of the UK rental and retail division of Thorn EMI plc. John joined the new start-up company which acquired the one Harry Ramsden's restaurant in 1988 as Executive Chairman and led its flotation on the London Stock Exchange in 1989 and eventual sale to Granada plc in November 1999. He is a Director of Caffe Nero plc (Non-Executive), Arena Leisure plc (Non-Executive), Marketing Judo Limited, Chairman of Galaxy 105 FM Yorkshire (part of the Chrysalis Group) and Chairman of La Tasca Restaurants Limited.

## Directors' report

### ***Ian Stewart – Chief Executive Officer (aged 49)***

Ian was the majority shareholder of The ZOO Media Corporation Limited and had responsibility for its strategic direction since founding it in October 1999. He founded Gremlin Interactive Limited, a developer and publisher of computer games for consumers, in 1984 and grew that company through organic growth and strategic acquisition until July 1997 when it floated on the London Stock Exchange as Gremlin Group plc. Infogrames SA acquired Gremlin Group plc for £25 million in May 1999.

### ***Robert Deri – Chief Financial Officer and Company Secretary (aged 40)***

Robert was appointed in May 2001 and previously worked for Grattan plc as Group Finance Director. Prior to that, he held senior positions at BT Mobile, Colorvision plc and The Burton Group plc. Robert qualified as a Chartered Accountant with KPMG in 1987.

### ***Andrew Scrivener – Chief Operating Officer (aged 43)***

Andrew was the Managing Director of The ZOO Media Corporation Limited. He was previously Technical Director at Sears plc and was responsible for retail design, surveying, engineering and procurement across 15 brands in European and Middle Eastern territories.

### ***Dr Stuart A Green – Chief Technical Officer (aged 37)***

Stuart brings more than thirteen years of experience of team building and executive management in the software industry to his role as CTO, where he is responsible for determining the technology strategy and expanding the core intellectual property of the company. Previously he founded Kazoo3D plc. and prior to that was co-founder of LightWork Design Limited where he served as Technical Director with responsibility for implementing LightWork Design Limited's technical development strategy. Stuart received a Ph.D. in Computer Science from the University of Bristol in 1989 for his research into computer systems for advanced computer graphics. He has one issued and five patents pending in the fields of image processing and DVD authoring.

### ***Dr Christopher H B Honeyborne – Non-Executive Director (aged 62)***

Dr Honeyborne spent 24 years in banking, gaining experience in a variety of roles with Lazard Brothers, Banque Paribas Group and Bank of N.T. Butterfield & Son. Since then, Dr Honeyborne has held a number of high-profile non-executive directorships, including Yorkshire Water plc and Gremlin Group plc and is now a Director of Bede plc, Birse Group plc, BWD Aim VCT plc and of a number of unquoted companies.

## Directors' report

### Supplier payment policy

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the company at 31 December 2002 were equivalent to 89 days' (2001: 36 days) purchases, based on the average daily amount invoiced by suppliers during the year.

### Charitable and political contributions

During the year the group made no charitable or political donations.

### Substantial shareholdings

On 29 May 2003, the company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests in the ordinary share capital of the company

Name of holder	Number	Percentage held
Mr I C Stewart	51,180,298	32.44%
Dr M T Dalman	9,641,500	6.11%
Mr W Newall	9,641,500	6.11%
Dr S A Green	9,641,500	6.11%
Alchemy Capital Limited	9,267,208	5.87%
Mrs S Scrivener	9,267,208	5.87%
Dr R G Oliver	8,900,500	5.64%
Mr S Bailey	8,187,948	5.19%
Mrs K Allaby	6,000,000	3.80%

### Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training is arranged. It is the policy of the group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

### Employee consultation

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through formal and informal meetings. All full-time employees, following the successful completion of their probation become entitled to share options in the company.

### Auditors

The directors will place a resolution before the Annual General Meeting to reappoint PKF as auditors for the ensuing year.

## Directors' report

By Order of the Board

A handwritten signature in black ink, appearing to read 'R Deri', with a small dot at the end of the signature.

**Robert Deri**  
*Director and Secretary*

Parkhead House  
26 Carver Street  
Sheffield  
South Yorkshire  
S1 4FS

5 June 2003

## Statement of Directors' responsibilities

### **Financial statements, including adoption of going concern basis**

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business. The financial statements have been prepared on a going concern basis, after considering the matters as described under basis of preparation in the statement of accounting policies. After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

### **Other matters**

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

The directors are responsible for ensuring that the directors' report and other information included in the annual report is prepared in accordance with company law in the United Kingdom.

## Independent Auditors' report

### To the shareholders of ZOO Digital Group plc

We have audited the financial statements of ZOO Digital Group plc for the year ended 31 December 2002 which comprise the Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Cash Flow Statement, Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of Directors' Responsibilities. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the Company information, Chairman and Chief Executive's statement, Directors' report and Statement of Directors' Responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Independent Auditors' report (continued)

### Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group at 31 December 2002 and of the group's loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**PKF**

**PKF**

**Registered Auditors**

Sheffield, UK

5 June 2003

## Consolidated profit and loss account

For the year ended 31 December 2002

	Notes	2002 £'000	2001 £'000
<b>Turnover</b>			
Continuing operations		618	724
Acquisitions		1,264	-
		<u>1,882</u>	<u>724</u>
Cost of sales		(1,581)	(199)
		<u>301</u>	<u>525</u>
<b>Gross profit</b>			
Other operating income		40	-
Other operating expenses	4		
- other		(2,215)	(2,426)
		<u>(1,874)</u>	<u>(1,901)</u>
<b>Loss before interest, tax, depreciation, amortisation and exceptional items</b>			
- depreciation		(98)	(238)
- amortisation of goodwill		(403)	(532)
- exceptional impairment charges		-	(5,553)
		<u>(2,716)</u>	<u>(8,749)</u>
<b>Operating loss</b>			
Continuing operations		(2,307)	(8,224)
Acquisitions		(68)	-
		<u>(2,375)</u>	<u>(8,224)</u>
Costs of fundamental reorganisation	2	-	(972)
Investment income	3	35	233
		<u>(2,340)</u>	<u>(8,963)</u>
<b>Loss on ordinary activities before taxation</b>			
Tax on loss on ordinary activities	7	134	-
		<u>(2,206)</u>	<u>(8,963)</u>
<b>Retained loss for the financial year</b>			
<b>Loss per share</b>			
Basic	10	(1.46p)	(8.15p)
Diluted		<u>(1.46p)</u>	<u>(8.15p)</u>

The accompanying notes are an integral part of this consolidated profit and loss account.

## Consolidated statement of total recognised gains and losses

For the year ended 31 December 2002

	2002 £'000	2001 £'000
Loss for the financial year	(2,206)	(8,963)
Currency (loss)/gain on net overseas investment	(6)	34
<b>Total gains and losses recognised during the year</b>	<b>(2,212)</b>	<b>(8,929)</b>

# Consolidated balance sheet

31 December 2002

	Notes	2002 £'000	2001 £'000
<b>Fixed assets</b>			
Intangible assets	11	3,756	3,043
Tangible assets	12	210	241
Other investments	13	228	228
		<u>4,194</u>	<u>3,512</u>
<b>Current assets</b>			
Stock	15	363	-
Debtors	16	1,435	144
Cash at bank and in hand		1,306	3,323
		<u>3,104</u>	<u>3,467</u>
<b>Creditors: Amounts falling due within one year</b>	17	<u>(2,595)</u>	<u>(890)</u>
<b>Net current assets</b>		<u>509</u>	<u>2,577</u>
<b>Total assets less current liabilities</b>		<u>4,703</u>	<u>6,089</u>
<b>Creditors: Amounts falling due after more than one year</b>	18	<u>(757)</u>	<u>(763)</u>
<b>Net assets</b>		<u>3,946</u>	<u>5,326</u>
<b>Capital and reserves</b>			
Called-up share capital	21	315	278
Share premium account	22	11,961	11,166
Other reserves	22	8,598	8,598
Profit and loss account	22	<u>(16,928)</u>	<u>(14,716)</u>
<b>Shareholders' funds (all equity)</b>		<u>3,946</u>	<u>5,326</u>

The financial statements of pages 13 to 41 were approved by the Board of Directors on 5 June 2003 and signed on its behalf by:



Ian C Stewart

The accompanying notes are an integral part of this consolidated balance sheet.

# Company balance sheet

31 December 2002

		2002 £'000	2001 £'000
<b>Fixed assets</b>			
Intangible assets	11	2,711	3,043
Tangible assets	12	201	241
Investments	13	8,175	7,013
		<u>11,087</u>	<u>10,297</u>
<b>Current assets</b>			
Stock	15	155	-
Debtors	16	1,496	144
Cash at bank and in hand		899	3,323
		<u>2,550</u>	<u>3,467</u>
<b>Creditors: Amounts falling due within one year</b>	17	(2,043)	(890)
		<u>507</u>	<u>2,577</u>
<b>Net current assets</b>		<u>11,594</u>	<u>12,874</u>
<b>Total assets less current liabilities</b>		<u>11,594</u>	<u>12,874</u>
<b>Creditors: Amounts falling due after more than one year</b>	18	(7,542)	(7,548)
		<u>4,052</u>	<u>5,326</u>
<b>Net assets</b>		<u>4,052</u>	<u>5,326</u>
<b>Capital and reserves</b>			
Called-up share capital	21	315	278
Share premium account	22	11,961	11,166
Other reserves	22	7,394	7,394
Profit and loss account	22	(15,618)	(13,512)
<b>Shareholders' funds (all equity)</b>		<u>4,052</u>	<u>5,326</u>

The financial statements on pages 13 to 41 were approved by the board of directors on 5 June 2003 and signed on its behalf by:

Ian C Stewart 

The accompanying notes are an integral part of this balance sheet.

## Consolidated cash flow statement

For the year ended 31 December 2002

	Notes	2002 £'000	2001 £'000
<b>Net cash outflow from operating activities</b>	24	(2,583)	(3,625)
Returns on investments and servicing of finance	25	66	233
Capital expenditure and financial investment	26	(45)	(199)
Acquisitions and disposals	27	(6)	(736)
<b>Cash outflow before financing</b>		<u>(2,568)</u>	<u>(4,327)</u>
Financing	28	<u>551</u>	<u>812</u>
<b>Decrease in cash in the year</b>		<u>(2,017)</u>	<u>(3,515)</u>

Reconciliation of net cash flow to movement in net (debt)/funds (Note 29)

	Notes	2002 £'000	2001 £'000
Decrease in cash in year		(2,017)	(3,515)
Cash inflow from increase in debt and lease financing		(551)	(812)
Loans acquired with subsidiary		-	(41)
<b>Change in net (debt)/funds resulting from cash flows</b>		<u>(2,568)</u>	<u>(4,368)</u>
New loan notes issued on acquisition of subsidiary		(250)	-
Net funds at 1 January 2002		<u>2,511</u>	<u>6,879</u>
<b>Net (debt)/funds at 31 December 2002</b>		<u>(307)</u>	<u>2,511</u>

The accompanying notes are an integral part of this consolidated cash flow statement.

## Statement of accounting policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year.

### **Basis of accounting**

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

### **Basis of preparation**

In view of the operating losses incurred during the year the directors have considered the ability of the group to continue to operate as a going concern. In this connection, financial projections have been prepared which reflect increased turnover from identified initiatives. On the basis of these projections the group can continue in operational existence for at least 12 months from the date of approval of these financial statements.

A number of alternative, and adverse, scenarios have been considered and in these cases the group still has adequate resources to continue in operation for the foreseeable future. Accordingly the financial statements have been prepared on the going concern basis.

The consolidated financial statements incorporate the financial statements of the company and its subsidiary undertakings, which are drawn up to 31 December 2002. In accordance with the exemption given under Section 230 of the Companies Act 1985 the company has not presented its own profit and loss account.

### **Intangible assets – goodwill**

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalized and written off on a straight line basis over its useful economic life, which is 10 years. Provision is made for any impairment. Following a provision for impairment the original cost less the impairment provision is written off over the remaining useful economic life of the asset.

### **Tangible fixed assets**

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all such fixed assets at rates calculated to write off the cost of each asset less estimated residual value, on a straight-line basis, over its expected useful life, as follows:

Leasehold improvements	5 years
Computers	between 2 and 3 years
Office equipment, fixtures and fittings	between 2 and 5 years
Motor vehicles	4 years

### **Investments**

Except as stated below, fixed asset investments are shown at cost less provision for impairment.

In the company balance sheet, for investments in subsidiaries acquired for consideration including the issue of shares, cost is measured by reference to the market value of the shares on the date of the transaction.

## Statement of accounting policies

### **Research and development**

All research and development expenditure is written off as incurred.

### **Taxation**

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

As required by FRS 19 "Deferred Tax", full provision is made for deferred tax assets and liabilities arising from all timing differences between the recognition of gains and losses in the financial statements and recognition in the tax computation, except for those timing differences in respect of which the standard specifies that deferred tax should not be recognised.

This represents a change in accounting policy, the previous policy being to provide deferred taxation using the liability method on all timing differences only to the extent that they are expected to reverse in the future without being replaced. However, this change in accounting policy has had no effect on the figures reported in either this year or the prior year.

### **Turnover**

Turnover represents royalty income and other sales at invoice value less trade discounts allowed and excluding VAT.

Royalties receivable on products released prior to the year-end are credited to the profit and loss account when due.

Guaranteed royalties falling due under contracts for products under development at the year-end are credited to the profit and loss account in full and attributable product development costs incurred are charged in the same year.

### **Pension costs and other post retirement benefits**

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the period and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

### **Foreign currency**

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date.

## Statement of accounting policies

The results of overseas operations are translated at the weighted average rates of exchange during the period and their balance sheets at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets and results of overseas operations are dealt with through reserves. All other exchange differences are included in the profit and loss account.

### **Finance and operating leases**

Assets acquired under finance leases or hire purchase agreements are treated as tangible fixed assets and depreciation is provided accordingly. The present value of future rentals is shown as a liability and the capital element of rental obligations is charged to the liability and the interest element of rental obligations is charged to the profit and loss account over the period of the lease in proportion to the capital balance outstanding.

Rentals under operating leases are charged to the profit and loss account on a straight-line basis over the lease term.

### **Stocks and work in progress**

Stocks and work in progress are stated at the lower of cost and net realisable value. Cost includes all direct costs incurred and attributable production overheads. Net realisable value is based on estimated selling price allowing for all further costs of completion and disposal.

Product development expenditure is carried forward to the extent that it is considered to be recoverable. The amount carried forward is written off on release over the expected sales life of each product.

### **Government grants**

Government grants in respect of capital expenditure are treated as deferred credits, a proportion of which is transferred to revenue annually over the life of the asset. Government grants in respect of revenue expenditure are recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute.

## Notes to financial statements

### 1 Segment information

	United Kingdom £'000	Europe £'000	Other £'000	Total £'000
Turnover				
31 December 2002	1,062	645	175	1,882
31 December 2001	717	-	7	724
Net assets/(liabilities)				
31 December 2002	3,946	-	-	3,946
31 December 2001	5,326	-	-	5,326
Operating profit/(loss)				
31 December 2002	(2,485)	60	50	(2,375)
31 December 2001	(8,201)	-	(23)	(8,224)

### 2 Exceptional items

	2002 £'000	2001 £'000
Costs associated with the fundamental reorganisation of the business:		
- USA	-	769
- United Kingdom	-	203
	-	972

### 3 Investment income

	2002 £'000	2001 £'000
<i>Other interest receivable and similar income</i>		
Bank interest	79	242
	79	242
<i>Interest payable and similar charges</i>		
Finance leases and hire purchase contracts	(5)	(9)
Other loans	(39)	-
	35	233

## Notes to financial statements

### 4 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging/(crediting):

	2002 £'000	2001 £'000
Depreciation and amounts written off tangible fixed assets		
- owned by the company	68	209
- held under finance leases	30	29
Amortisation of goodwill	403	532
Exceptional impairment charges		
- goodwill	-	5,553
Operating lease rentals		
- plant and machinery	-	43
- property rent	16	9
Auditors' remuneration for audit services	20	20
Research and development	603	191
Exchange losses	10	-
Government grants	(40)	(75)
	<hr/>	<hr/>
Other operating expenses comprise:		
- other expenses	2,215	2,426
- depreciation	98	238
- amortisation of goodwill	403	532
- impairment charges	-	5,553
	<hr/>	<hr/>
Other operating expenses	2,716	8,749

Amounts payable to PKF and their associates by the company and its UK subsidiary undertakings in respect of non-audit services were £1,800 (2001: £416,000 Andersens) .

The loss on ordinary activities for the year includes cost of sales of £1,147,000 and net operating expenses of £185,000 in respect of acquisitions.

## Notes to financial statements

### 5 Staff costs

The average monthly number of employees (including executive directors) was:

	2002 Number	2001 Number
Product design	31	32
Sales and marketing	9	13
Administration	11	11
	<u>51</u>	<u>56</u>
Their aggregate remuneration comprised:	£'000	£'000
Wages and salaries	1,529	1,959
Social security costs	154	163
Other pension costs (see note 31)	51	30
	<u>1,734</u>	<u>2,152</u>

### 6 Directors' remuneration, interests and transactions

#### *Aggregate remuneration*

The total amounts for directors' remuneration and other benefits since their appointment were as follows:

	2002 £'000	2001 £'000
Emoluments	353	329
Money purchase contributions	16	17
Compensation for loss of office	-	56
	<u>369</u>	<u>402</u>

## Notes to financial statements

### 6 Directors' remuneration, interests and transactions (continued)

#### Directors' emoluments

Name of director	Fees/basic salary £'000	Taxable benefits £'000	Pension contributions £'000	Total 2002 £'000	Total 2001 £'000
<b>Executive:</b>					
Ian C Stewart	75	1	4	80	55
Robert G Deri	82	1	4	87	58
Andrew Scrivener	82	1	4	87	58
Dr Stuart A Green	82	1	4	87	101
John H Warden	-	-	-	-	33
<b>Non executive:</b>					
M John Barnes	15	-	-	15	10
Dr R Gordon Oliver	-	-	-	-	5
Aggregate emoluments	336	4	16	356	320
Fees to third parties	13	-	-	13	26
<b>Total</b>	<b>349</b>	<b>4</b>	<b>16</b>	<b>369</b>	<b>346</b>

Fees to third parties comprise £13,000 (2001: £16,000) paid to Brockhill Limited and £ Nil (2001: £10,000) paid to Hi Tech Ventures Limited under agreements to provide the group with the services of Dr Christopher H B Honeyborne and Roy Abrams respectively.

The executive directors are members of money purchase pension schemes.

#### Directors' share options

Aggregate emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the company granted to or held by the directors. Details of the options are as follows:

Name of director	1 January 2002	Granted	Lapsed	31 December 2002	Exercise Price	Gains on exercise 2002
Robert G Deri	3,252,823	-	-	3,252,823	7.75p	-
M John Barnes	200,000	-	-	200,000	7.75p	-
Dr Christopher H B Honeyborne	20,000	-	-	20,000	85p	-
Dr Christopher H B Honeyborne	200,000	-	-	200,000	7.75p	-
<b>Total</b>	<b>3,672,823</b>	<b>-</b>	<b>-</b>	<b>3,672,823</b>		<b>-</b>

## Notes to financial statements

### 6 Directors' remuneration, interests and transactions (continued)

The options granted to John Barnes and Robert Deri are exercisable on 19 July 2002 over 40% of the shares under option, on 19 July 2003 over a further 30% of the shares under option and in full on or after 19 July 2004, lapsing no later than 20 July 2011.

The original options granted, at 85p, to Dr Christopher H B Honeyborne are exercisable between 22 September 2001 and 22 September 2003. The subsequent options, at 7.75p, are exercisable on 19 July 2002 over 40% of the shares under option, on 19 July 2003 over a further 30% of the shares under option and in full on or after 19 July 2004, lapsing no later than 20 July 2011.

No director was granted or exercised the right to subscribe for shares in the company during the period.

The market price of the ordinary shares at 31 December 2002 was 3.5p and the range during the year was 3.25p to 5p.

### Directors' interests

The directors who held office at 31 December 2002 had the following interests, including family interests, in the 0.2p ordinary shares of ZOO Digital Group plc:

Name of director	31 December 2002	1 January 2002
	Beneficial	Beneficial
Ian C Stewart	51,180,298	50,176,038
Robert G Deri	132,000	132,000
Andrew Scrivener	9,267,208	9,267,208
Dr Stuart A Green	9,641,500	9,641,500
M John Barnes	660,000	660,000

Dr Stuart A Green has options to acquire 5,250,000 Ordinary Shares from fellow shareholders, at 50p per share and has an interest in a further 50,000 Ordinary Shares held by LightWork Design Limited.

No changes took place in the interests of directors between 31 December 2002 and 29 May 2003.

### Directors' transactions

No other transactions have taken place with directors aside from those disclosed in this note 6, note 18 or note 33.

## Notes to financial statements

### 7 Tax on loss on ordinary activities

#### a) Analysis of credit in the year

	2002 £'000	2001 £'000
<b>UK corporation tax</b>		
Current tax on income for the year	-	-
Adjustments in respect of prior periods	(134)	-
	<u>(134)</u>	<u>-</u>

#### b) Factors affecting tax credit for year

The tax assessed for the year can be reconciled to the standard rate of corporation tax in the UK as follows:

	2002 £'000	2001 £'000
Loss on ordinary activities before tax	<u>(2,340)</u>	<u>(8,963)</u>
Loss on ordinary activities multiplied by standard rate of corporation tax of 30%	(702)	(2,689)
Capital allowances in excess of depreciation	46	25
Disallowable items	126	2,250
Losses carried forward	530	414
Adjustments in respect of prior periods	(134)	-
Current tax credit for the year	<u>(134)</u>	<u>-</u>

#### c) Future factors affecting the tax charge

The company has tax losses carried forward of £5,228,000 (2001: 3,211,404).

### 8 Loss attributable to ZOO Digital Group plc

The loss for the year dealt with in the financial statements of the parent company, ZOO Digital Group plc, was £2,106,000 (2001: £8,929,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

### 9 Dividends

There were no dividends paid or proposed.

## Notes to financial statements

### 10 Loss per share

The calculations of loss per share are based on the following losses and numbers of shares.

	Basic and Diluted	
	2002 £'000	2001 £'000
Loss for the financial year	2,206	8,963
	2002 Number of shares	2001 Number of shares
Weighted average number of shares for basic and diluted loss per share	151,187,593	109,915,788

### 11 Intangible fixed assets – goodwill

	Group £'000	Company £'000
<b>Cost</b>		
At 1 January 2002	9,128	7,667
Purchased goodwill	1,116	7
At 31 December 2002	10,244	7,674
<b>Amortisation</b>		
At 1 January 2002	6,085	4,624
Charge for the year	403	339
At 31 December 2002	6,488	4,963
<b>Net book value</b>		
At 31 December 2002	3,756	2,711
At 31 December 2001	3,043	3,043

Notes to financial statements

12 Tangible fixed assets

Group	Leasehold improvements £'000	Computers £'000	Office equipment, fixtures & fittings £'000	Motor Vehicles £'000	Total £'000
<b>Cost</b>					
At 1 January 2002	11	504	176	-	691
Additions	1	57	4	11	73
Disposals	-	(70)	-	-	(70)
<b>At 31 December 2002</b>	<b>12</b>	<b>491</b>	<b>180</b>	<b>11</b>	<b>694</b>
<b>Depreciation</b>					
At 1 January 2002	5	331	114	-	450
Charge for the year	1	79	15	3	98
Eliminated on disposal	-	(64)	-	-	(64)
<b>At 31 December 2002</b>	<b>6</b>	<b>346</b>	<b>129</b>	<b>3</b>	<b>484</b>
<b>Net book value</b>					
<b>At 31 December 2002</b>	<b>6</b>	<b>145</b>	<b>51</b>	<b>8</b>	<b>210</b>
At 31 December 2001	6	173	62	-	241

The net book value of assets held under finance leases and hire purchase contracts comprised

<b>At 31 December 2002</b>	-	37	4	-	41
At 31 December 2001	-	62	7	-	69

## Notes to financial statements

### 12 Tangible fixed assets (continued)

Company	Leasehold improvements £'000	Computers £'000	Office equipment, fixtures & fittings £'000	Motor vehicles £'000	Total £'000
<b>Cost</b>					
At 1 January 2002	11	500	176	-	687
Additions	1	57	2	-	60
Disposals	-	(70)	-	-	(70)
<b>At 31 December 2002</b>	<u>12</u>	<u>487</u>	<u>178</u>	<u>-</u>	<u>677</u>
<b>Depreciation</b>					
At 1 January 2002	5	327	114	-	446
Charge for the year	2	78	14	-	94
Disposal	-	(64)	-	-	(64)
<b>At 31 December 2002</b>	<u>7</u>	<u>341</u>	<u>128</u>	<u>-</u>	<u>476</u>
<b>Net book value</b>					
<b>At 31 December 2002</b>	<u>5</u>	<u>146</u>	<u>50</u>	<u>-</u>	<u>201</u>
At 31 December 2001	<u>6</u>	<u>173</u>	<u>62</u>	<u>-</u>	<u>241</u>

### 13 Fixed asset investments

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Subsidiary undertakings	-	-	7,947	6,785
Own shares	228	228	228	228
	<u>228</u>	<u>228</u>	<u>8,175</u>	<u>7,013</u>

## Notes to financial statements

### 13 Fixed asset investments

The parent company has investments in the following subsidiary undertakings:

	<i>Country of incorporation</i>	<i>Principal activity</i>	<i>Holding</i>	<i>%</i>
<i>Subsidiary undertakings</i>				
ZOO Digital Publishing Limited	UK	Game publishing	100 ordinary shares	100
The ZOO Media Corporation Limited	UK	Dormant	95,714 ordinary shares	100
Kazoo3D Inc.	USA	Dormant	10,000 shares of common stock	100
ZOO Employee Share Trust Limited	UK	Employee Share Scheme	2 ordinary shares	100
Kazoo3D Limited	UK	Dormant	2 ordinary shares	100

#### *Subsidiary undertakings*

	Company £'000
<b>Cost</b>	
At 1 January 2002	8,252
Additions	1,162
<b>At 31 December 2002</b>	<u>9,414</u>
<b>Amount written off</b>	
At 1 January 2002 and 31 December 2002	<u>1,467</u>
<b>Net book value</b>	
<b>At 31 December 2002</b>	<u>7,947</u>
<b>At 31 December 2001</b>	<u>6,785</u>

## Notes to financial statements

### 13 Fixed asset investments (continued)

#### Own shares

	Group and Company £'000
<b>Cost</b>	
<b>At 31 December 2001 and 31 December 2002</b>	<u>228</u>

The company operates The ZOO Employee Share Trust Limited (the Trust) for the benefit of the employees of the group. The directors of the Trust purchase the company's shares in the open market. During the period the company had an interest in 3,587,665 of its ordinary 0.2p shares with a nominal value of £71,753. These represent 2.3% of the issued ordinary shares. The company has given financial assistance to the Trust, as permitted by Section 153(4)(b) of the Companies Act 1985, of £71,000 in prior years.

The shares are not allocated to specific employees and will be distributed in the future at the discretion of the directors.

### 14 Acquisition of subsidiary undertaking

On 8 May 2002 the company acquired the whole of the issued share capital of Digital Worldwide Limited for consideration comprising the issue of 18,461,540 ordinary shares of 0.2p each in the company, loan notes with a value of £250,000 and acquisition expenses. In addition, the company agreed to make a cash payment equal to the net assets as such assets are realised and liabilities settled. The company has recorded the cost of the investment at the fair value of the shares and loan notes issued plus the net assets at the date of acquisition and the expenses of the acquisition. The results of the subsidiary from the date of acquisition have been consolidated using the acquisition method.

On 25 June 2002 Digital Worldwide Limited change its name to ZOO Digital Publishing Limited.

## Notes to financial statements

### 14 Acquisition of subsidiary undertaking (continued)

The following table sets out the book values of the identifiable assets and liabilities acquired and their fair value to the group:

	Book value and Fair value to group £'000
<b>Fixed assets</b>	
Tangible	13
<b>Current assets</b>	
Debtors	463
Cash	22
<b>Total current assets</b>	<u>485</u>
<b>Creditors</b>	
Loans	176
Trade creditors	96
Accruals	97
Other creditors	76
<b>Total liabilities</b>	<u>445</u>
<b>Net assets</b>	<u>53</u>
Goodwill	1,109
	<u>1,162</u>
<b>Satisfied by</b>	
Shares issued	831
Loan notes issued	250
Deferred cash	53
Costs of acquisition	28
	<u>1,162</u>
Net cash outflows in respect of the acquisition comprised:	£'000
Costs of acquisition	(28)
Cash at bank and in hand acquired	22
	<u>(6)</u>

## Notes to financial statements

### 14 Acquisition of subsidiary undertaking (continued)

Digital Worldwide Limited made a profit after taxation of £112,000 in the period from 1 July 2001 to the date of acquisition and a loss of £35,000 in the period from 8 May 2000 to 30 June 2001. The summarised profit and loss account for the period from 1 July 2001 to 1 June 2002, shown on the basis of the accounting policies of Digital Worldwide Limited prior to the acquisition, is as follows:

<b>Profit and loss account</b>	£'000
Turnover	1,067
Cost of sales	(747)
<b>Gross profit</b>	<u>320</u>
Other operating expenses (net)	(194)
<b>Operating profit</b>	<u>126</u>
Interest payable	(14)
<b>Profit on ordinary activities before and after taxation</b>	<u>112</u>

There were no other gains or losses other than those shown above.

### 15 Stock

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Products in the course of development	15	-	5	-
Finished goods and goods for re-sale	348	-	150	-
	<u>363</u>	<u>-</u>	<u>155</u>	<u>-</u>

## Notes to financial statements

### 16 Debtors

#### Amounts falling due within one year:

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Trade debtors	866	71	173	71
Amounts owed by subsidiary undertakings	-	-	1,034	-
VAT	26	6	26	6
Other debtors	383	5	150	5
Prepayments and accrued income	160	62	113	62
	<u>1,435</u>	<u>144</u>	<u>1,496</u>	<u>144</u>

### 17 Creditors: Amounts falling due within one year

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Obligations under finance leases and hire purchase contracts	6	49	6	49
Trade creditors	838	254	668	254
Other taxation and social security	127	91	99	91
Director's loan	600	-	600	-
Other creditors	314	-	250	-
Accruals and deferred income	650	488	360	488
Accrued pension contributions	7	8	7	8
Deferred consideration	53	-	53	-
	<u>2,595</u>	<u>890</u>	<u>2,043</u>	<u>890</u>

## Notes to financial statements

### 18 Creditors: Amounts falling due after more than one year

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Obligations under finance leases and hire purchase contracts	-	6	-	6
Director's loan	757	757	757	757
Amounts owed to subsidiary undertakings	-	-	6,785	6,785
	<u>757</u>	<u>763</u>	<u>7,542</u>	<u>7,548</u>

The short term Director's loan advanced by Ian Stewart is due for repayment on demand. The loan accrues a rate of interest of 4% above the Royal Bank of Scotland's base rate.

The long term Director's loan, advanced by Ian Stewart, is due for repayment on 31 January 2005. The loan was interest free to 31 December 2001. From 1 January 2002 until 31 December 2003 interest accrues at 2% per annum. Thereafter interest will accrue at the Royal Bank of Scotland's base rate.

### 19 Derivatives and other financial instruments

The Group's financial instruments, other than derivatives, comprise cash and liquid resources, and various items, such as trade debtors, trade creditors etc. that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

The Group also enters into derivatives transactions (principally forward foreign currency contracts). The purpose of such transactions is to manage the currency risks arising from the Group's operations and its sources of finance.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are foreign currency risk.

The group's sterling cash deposits of £973,000 are placed in high interest bearing bank accounts.

### 20 Provisions for liabilities and charges

No provision has been made for deferred tax assets.

## Notes to financial statements

### 20 Provisions for liabilities and charges (continued)

The amounts unprovided at the year-end are as follows:

	Group		Company	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Deferred tax asset:				
- Accelerated capital allowances	121	170	121	170
- Short term timing differences	23	-	23	-
- Tax losses carried forward	1,568	963	1,568	963
	<u>1,712</u>	<u>1,133</u>	<u>1,712</u>	<u>1,133</u>

### 21 Called-up share capital

	2002 £'000	2001 £'000
<i>Authorised</i>		
250,000,000 (2000: 250,000,000) ordinary shares of 0.2p each	<u>500</u>	<u>500</u>
<i>Allotted, called-up and fully-paid</i>		
157,770,124 (2000: 139,223,584) ordinary shares of 0.2p each	<u>315</u>	<u>278</u>

On 9 May 2002 18,461,540 ordinary shares of 0.2p each were issued as consideration for the acquisition of ZOO Digital Publishing Limited (formerly Digital Worldwide Limited).

On 5 August 2002 25,000 shares of 0.2p each were issued to employees under share option schemes for consideration of £388.

On 18 September 2002 60,000 shares of 0.2p each were issued to employees under share option schemes for consideration of £930.

## Notes to financial statements

### 21 Called-up share capital (continued)

Options have been granted under the following option schemes to subscribe for ordinary shares of the company. As at 31 December 2002 the following options were outstanding:

Scheme name	Number of shares under option	Subscription price per share	Exercise period expires
Kazoo3D plc employee share option scheme*	199,100	50p	March 2010
Kazoo3D plc unapproved employee share option scheme*	61,900	50p	March 2010
Kazoo3D plc unapproved employee share option scheme*	20,000	85p	March 2010
Kazoo3D plc cross-over share option scheme*	1,165,500	50p	March 2010
ZOO Digital Group plc roll-over share option scheme	9,257,400	0.01199p	December 2010
ZOO Digital Group plc Enterprise Management Incentive Scheme*	3,441,103	7.75p	July 2011
ZOO Digital Group plc Enterprise Management Incentive Scheme*	800,000	Nil	July 2011
ZOO Digital Group plc Unapproved Employee Share Option Scheme*	2,637,155	7.75p	July 2011
ZOO Digital Group plc Enterprise Management Incentive Scheme*	587,500	7.75p	September 2012
	<b>18,169,658</b>		

\*Under these schemes the percentage of shares that can be exercised is staggered over the exercise period with typically 40% exercisable within the first two years and a further 30% in each of the next two years.

### 22 Reserves

Group	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2002	11,166	8,598	(14,716)	5,048
Currency loss on net overseas investment	-	-	(6)	(6)
Issue of shares	795	-	-	795
Retained loss for the year	-	-	(2,206)	(2,206)
<b>At 31 December 2002</b>	<b>11,961</b>	<b>8,598</b>	<b>(16,928)</b>	<b>3,631</b>

## Notes to financial statements

### 22 Reserves (continued)

Company	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2002	11,166	7,394	(13,512)	5,048
Shares issued	795	-	-	795
Retained loss for the year	-	-	(2,106)	(2,106)
<b>At 31 December 2002</b>	<b>11,961</b>	<b>7,394</b>	<b>(15,618)</b>	<b>3,737</b>

Other reserves comprise the merger reserve arising on the acquisition of The ZOO Media Corporation Limited and market value of options granted in connection with that acquisition.

### 23 Reconciliation of movements in group shareholders' funds

	2002 £'000	2001 £'000
Loss for the financial year	(2,206)	(8,963)
Currency (loss)/gain on net overseas investment	(6)	34
New shares issued	832	6,785
Shares to be issued	-	768
Net deduction from shareholders' funds	(1,380)	(1,376)
Opening shareholders' funds	5,326	6,702
Closing shareholders' funds	3,946	5,326

### 24 Reconciliation of operating loss to operating cash flows

	Continuing £'000	Acquisitions £'000	2002 £'000	2001 £'000
Operating loss	(2,307)	(68)	(2,375)	(8,224)
Depreciation charges	94	4	98	238
(Increase)/decrease in stock	(155)	(208)	(363)	-
(Increase)/decrease in debtors	(189)	(509)	(698)	413
Increase/(decrease) in creditors	246	106	352	(1,349)
Cash impact of fundamental restructuring	-	-	-	(788)
Goodwill amortisation	403	-	403	532
Goodwill impairment	-	-	-	5,553
<b>Net cash outflow from operating activities</b>	<b>(1,908)</b>	<b>(675)</b>	<b>(2,583)</b>	<b>(3,625)</b>

## Notes to financial statements

### 25 Returns on investment and servicing of finance

	2002 £'000	2001 £'000
Interest received	83	242
Interest paid	(12)	-
Finance lease interest paid	(5)	(9)
<b>Net cash inflow</b>	<u>66</u>	<u>233</u>

### 26 Capital expenditure and financial investment

	2002 £'000	2001 £'000
Purchase of tangible fixed assets	(60)	(167)
Receipts from sales of fixed assets	15	38
Purchase of investment	-	(70)
<b>Net cash outflow</b>	<u>(45)</u>	<u>(199)</u>

### 27 Acquisitions and disposals

	2002 £'000	2001 £'000
Costs of acquisition	(28)	(676)
Purchase of business	-	(60)
Cash acquired with subsidiary	22	-
<b>Net cash outflow</b>	<u>(6)</u>	<u>(736)</u>

### 28 Financing

	2002 £'000	2001 £'000
Capital element of finance lease rentals	(49)	55
New loans	600	757
	<u>551</u>	<u>812</u>

## Notes to financial statements

### 29 Analysis of changes in net debt

	At 1 January 2002 £'000	Cash flows £'000	Other changes £'000	At 31 December 2002 £'000
Cash at bank and in hand	3,323	(2,017)	-	1,306
Debt due after one year	(757)	-	-	(757)
Debt due within one year	-	(600)	(250)	(850)
Finance leases	(55)	49	-	(6)
	<u>2,511</u>	<u>(2,568)</u>	<u>(250)</u>	<u>(307)</u>

### 30 Major non-cash transactions

Part of the consideration for the purchase of a subsidiary undertaking that occurred during the year comprised shares and loan notes. Further details of the acquisition are set out in Note 14.

### 31 Financial commitments

Commitments under non-cancellable operating leases are as follows:

	2002 £'000	2001 £'000
<b>Group</b>		
Expiry date		
- within one year	7	-
- between two and five years	-	16
	<u>7</u>	<u>16</u>
<b>Company</b>		
Expiry date		
- within one year	7	-
- between two and five years	-	16
	<u>7</u>	<u>16</u>

Included in commitments expiring within one year is an amount of £7,000 due within the next year in respect of a lease for land and buildings. Leases of land and buildings are typically subject to rent reviews at specified intervals and provide for the lessee to pay all insurance, maintenance and repair costs.

### 32 Pension arrangements

The company makes payment of contributions into certain employees' personal pension schemes for which the pension cost charge for the year amounted to £51,000 (2001: £30,000).

## Notes to financial statements

### **33 Related party transactions**

During the year the group purchased goods and services in the ordinary course of business from LightWork Design Limited, of which Dr Stuart A Green is a director, at a cost of £85,000 (2001: £178,000). Sales of licences were also made to LightWork Design Limited in the normal course of business amounting to £70,000 (2001: £53,000). At 31 December 2002 the balance owed to LightWork Design Limited was £nil (2001: £nil).

During the year the company made sales to Kunick Limited, of which Dr Christopher H B Honeybourne was a director until July 2002, amounting to £53,000 (2001: Nil). At 31 December 2002 the balance owed by Kunick Limited was £Nil (2001: £Nil).