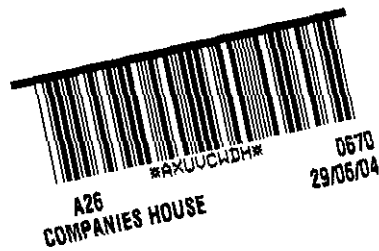


ZOO Digital Group plc

Report and financial statements

31 December 2003

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	www.zoodigitalgroup.com
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 31st December 2003 was one of significant growth and development for the Group in its key areas of activity, culminating in a restructuring of ZOO into two defined business units; ZOOtech Ltd and ZOO Digital Publishing Ltd ('ZDPL').

The successful fundraising in December 2003 allowed the Group to continue to invest in the DVD-EXTRA technology and to progress with its strategy in the video games market. All planned developments on DVD-EXTRA were successfully completed and we are pleased to report that the first version of the DVD-EXTRA STUDIO development system is ready for commercial release and was formally launched at the National Association of Broadcasters Conference (NAB) in Las Vegas, which started on 17 April 2004.

In the games publishing business turnover was significantly increased to £5.1 million through the production of the interactive DVD titles licensed to Universal Pictures UK ("Universal") and the acquisition of other titles and IPs. In the year we also acquired a portfolio of products & IPs which will form a catalogue of titles to be exploited going forward.

Financial Review

The company has increased its turnover by 171 per cent for the period to £5.1 million compared with £1.9 million for the same period in 2002. Loss before interest, tax, depreciation and amortisation was reduced to £955,000 from £1.9 million in the previous year. The retained loss for the financial year was reduced to £1.5 million (2002: loss of £2.2m) with a loss per share of 0.75p (2002: loss of 1.46p).

We continued to write off all research, development and set up expenditure for DVD-EXTRA to the Profit and Loss Account and this accounts for most of the loss in the year. The games publishing business made a small profit in the second half of the year. Following the successful fundraising of £5.75 million gross through the share placing completed in December 2003 the cash position of the Group was significantly strengthened and as at 31 December 2003 stood at £5.5 million (2002: £1.3 million).

ZOOtech Ltd

Over the last twelve months investment has continued in the development of the DVD-EXTRA technology. In the early part of the year we formed an "Early Adopter Programme" with the intention of working closely with 20 organisations covering the major market segments. The programme achieved all of its objectives with over 50 organisations joining including 'The Walt Disney Company', 'BBC Worldwide' and GDMX (a division of Warner Home Video). The culmination of all this hard work and these partnerships saw the formal release and launch of 'DVD-EXTRA STUDIO' at the National Association of Broadcasters Conference (NAB) in Las Vegas in April 2004.

ZOO applied for a further 8 patents during the year in the UK, USA and internationally under the Patent Cooperation Treaty and we have established a patent development program which will help in protecting our technologies as well as assist in commercialising our innovations.

Following the fundraising a commercial team is being established to exploit the technology. We have appointed a number of senior business development and marketing personnel in both the UK and the US to drive the commercial prospects of DVD-EXTRA moving forward. To oversee ZOOtech we created the new role of Managing Director of ZOOtech and appointed Cees Zwaard in February 2004 to fill this position.

The reaction to our technology from our early adopters has been very encouraging, many of whom are keen to licence the final release version and agree commercial terms. We now need to convert this enthusiasm into sales in what is looking like a very exciting future for the technology.

Chairman and Chief Executive's statement (continued)

ZOO Digital Publishing Ltd

The progress of ZDPL is evident in the growth of its catalogue of products, which included the purchase of a selection of back catalogue titles in October 2003 from Atari. The catalogue included 16 PlayStation games and 15 PC games with all IP rights. Other titles acquired and published included Gallop Racer, Beano Town Racing and Gadget Racer across various platforms.

The GameBoy Advance market held steady for us with 'Medal of Honour', 'Sim City' and 'Who Wants To Be A Millionaire' all performing well and indicating that the market will continue to be buoyant during 2004. The Company will therefore continue to support the platform and have already secured a number of strong titles for release including 'Pacman World', 'I- Ninja' and 'Dead to Rights' from Namco. New versions of 'Premier Manager' and 'Who Wants To Be A Millionaire' are being developed internally for this platform.

As announced in January, a disappointment in the year was the failure to deliver Premier Manager 2003, our major release for the year, in time for the Christmas market. The reasons for this slippage have been addressed and changes have been made in the way that we develop and manage the title to ensure the product is delivered in good time for the next Christmas market. Premier Manager will continue to be one of our flagship brands with the 2004 version releasing in November on PlayStation 2, PC and GameBoy Advance.

Universal released our interactive DVD product 'Who Wants To Be A Millionaire' in the UK and France in October 2003 supported by a high-level marketing campaign including national TV advertisements. Due to strong sales of the products Universal is looking to extend the release of the game across other European territories.

Retail acceptance of the product indicates the opportunities that now exist in this new genre – 'DVD Game', as well as promoting DVD-EXTRA as the method of its development. A great deal of focus has gone into building the 2004 catalogue and we have now secured 18 GameBoy Advance titles including 'Pacman World' and 'I- Ninja', 10 PC titles including 'The Suffering' and 'Pool Shark', 6 PlayStation 2 titles including 'Dangerous Hunts' and 'Zool'. In addition ZOO will launch its first Xbox titles to be announced later in the new financial year. We will also launch at least 6 interactive DVD titles including new versions of 'Who Wants To Be A Millionaire' and other titles of a similar nature. Clearly, such diversity in the catalogue leaves ZOO less reliant on any one individual release and makes for a very busy but exciting year.

Outlook

In the year ahead we believe that ZOO can take advantage of the positions established in both ZOOtech and ZDPL. In ZOOtech we have expensed all development costs to date and are quickly building a commercial team to take the product to market. The feedback from the Early Adopters of the software has been very encouraging and the breadth of uses for the software across the different market segments gives us great confidence that we will begin to earn revenues soon after launch.

In ZDPL we have laid the foundations to build up our financial strength, increasing revenues and profitability. Our objective is to continue to build the portfolio of intellectual property and to deliver profitable growth. Our acquisition of the trade and assets of Hothouse Creations Ltd in February, for a consideration of £75,000 also brings additional development expertise for leading gaming platforms into the Group and combines it with significant experience in working with major properties. This will allow us to improve our financial performance and to take advantage of opportunities in the medium term.

We would like to take this opportunity, on behalf of the Board, to thank all ZOO's staff for their continued hard work and commitment over the past year.

Chairman and Chief Executive's statement (continued)

John Barnes

Chairman

Ian Stewart

Chief Executive Officer

2004

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 2003.

Principal activities

The principal activity of the group for the year under review is the research and development of interactive DVD technology and the publishing of games and entertainment products for digital platforms.

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 2003 are set out on pages 13 to 38. The directors do not recommend the payment of a dividend for the year.

Directors

The directors who served during the year were as follows:

Name	Position
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 2003 are disclosed in note 6. In accordance with the company's Articles of Association Ian Stewart and Andrew Scrivener retire by rotation at the next Annual General Meeting and, being eligible, offer themselves for re-election.

John Barnes – Non-Executive Chairman (aged 55)

John has over 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 Caffè 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 50)

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 41)

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 45)

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 38)

Stuart brings more than 15 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 25 patents pending in the fields of image processing and DVD authoring.

Dr Christopher H B Honeyborne – Non-Executive Director (aged 63)

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 2003 were equivalent to 41 days' (2002: 89 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 31 May 2004, 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	59,323,155	21.26%
ISIS Asset Management	21,000,000	7.53%
Herald Investment Trust plc	20,000,000	7.17%
Artemis AIM VCT plc	10,950,000	3.92%
Dr S A Green	9,641,500	3.46%
Mr W Newell	9,641,500	3.46%
Alchemy Capital Ltd	9,267,208	3.32%
Ms S Scrivener	9,267,208	3.32%
Herald Ventures Partnership Ltd	8,361,111	3.00%

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.

Directors' report

Auditors

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

By Order of the Board



Robert Deri

Director and Secretary

Parkhead House
26 Carver Street
Sheffield
South Yorkshire
S1 4FS

18 June 2004

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.

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 members of ZOO Digital Group plc

We have audited the financial statements of ZOO Digital Group plc for the year ended 31 December 2003 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' 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 2003 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

21 June 2004

Consolidated profit and loss account

For the year ended 31 December 2003

	Notes	2003 £'000	2002 £'000
Turnover		5,093	1,882
Cost of sales		(4,091)	(1,581)
Gross profit		<u>1,002</u>	<u>301</u>
Other operating income		222	40
Other operating expenses	3		
- other		(2,179)	(2,215)
Loss before interest, tax, depreciation and amortisation		<u>(955)</u>	<u>(1,874)</u>
- depreciation		(112)	(98)
- amortisation of goodwill		(451)	(403)
		<u>(2,742)</u>	<u>(2,716)</u>
Operating loss		(1,518)	(2,375)
Investment income	2	(20)	35
Loss on ordinary activities before taxation	3	<u>(1,538)</u>	<u>(2,340)</u>
Tax on loss on ordinary activities	6	84	134
Retained loss for the financial year	20	<u>(1,454)</u>	<u>(2,206)</u>
Loss per share			
Basic	9	(0.75p)	(1.46p)
Diluted	9	<u>(0.75p)</u>	<u>(1.46p)</u>

All amounts relate to continuing operations.

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 2003

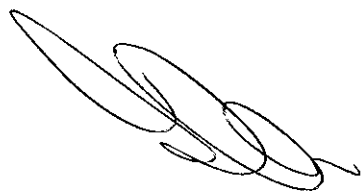
	2003 £'000	2002 £'000
Loss for the financial year	(1,454)	(2,206)
Currency loss on net overseas investment	-	(6)
Total gains and losses recognised during the year	(1,454)	(2,212)

Consolidated balance sheet

31 December 2003

	Notes	2003 £'000	2002 £'000
Fixed assets			
Intangible assets	10	3,343	3,756
Tangible assets	11	127	210
		<u>3,470</u>	<u>3,966</u>
Current assets			
Stock	13	394	363
Debtors	14	3,107	1,435
Cash at bank and in hand		5,451	1,306
		<u>8,952</u>	<u>3,104</u>
Creditors: Amounts falling due within one year	15	<u>(3,185)</u>	<u>(2,595)</u>
Net current assets		<u>5,767</u>	<u>509</u>
Total assets less current liabilities		9,237	4,475
Creditors: Amounts falling due after more than one year	16	-	(757)
Net assets		<u>9,237</u>	<u>3,718</u>
Capital and reserves			
Called-up share capital	19	558	315
Share premium account	20	18,691	11,961
Other reserves	20	8,598	8,598
Profit and loss account	20	(18,382)	(16,928)
Shareholders' funds (all equity)	21	<u>9,465</u>	<u>3,946</u>
Interest in own shares	22	(228)	(228)
		<u>9,237</u>	<u>3,718</u>

The financial statements of pages 13 to 38 were approved by the Board of Directors on *18 June* 2004 and signed on its behalf by:



Ian C Stewart

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

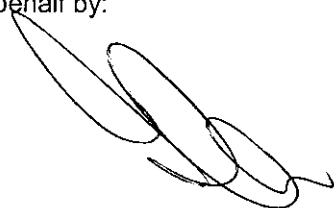
Company balance sheet

For the year ended 31 December 2003

		2003 £'000	2002 £'000
Fixed assets			
Intangible assets	10	2,409	2,711
Tangible assets	11	123	201
Investments	12	7,947	7,947
		<hr/>	<hr/>
		10,479	10,859
Current assets			
Stock	13	-	155
Debtors	14	2,213	1,496
Cash at bank and in hand		5,302	899
		<hr/>	<hr/>
		7,515	2,550
Creditors: Amounts falling due within one year	15	<hr/> (2,170)	<hr/> (2,043)
Net current assets		<hr/> 5,345	<hr/> 507
Total assets less current liabilities		<hr/> 15,824	<hr/> 11,366
Creditors: Amounts falling due after more than one year	16	<hr/> (6,785)	<hr/> (7,542)
		<hr/> 9,039	<hr/> 3,824
Capital and reserves			
Called-up share capital	19	558	315
Share premium account	20	18,691	11,961
Other reserves	20	7,394	7,394
Profit and loss account	20	<hr/> (17,376)	<hr/> (15,618)
Shareholders' funds (all equity)		<hr/> 9,267	<hr/> 4,052
Interest in own shares	22	<hr/> (228)	<hr/> (228)
		<hr/> 9,039	<hr/> 3,824

The financial statements on pages 13 to 38 were approved by the board of directors on *18 June* 2004 and signed on its behalf by:

Ian C Stewart



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

Company balance sheet

For the year ended 31 December 2003

	Notes	2003 £'000	2002 £'000
Net cash outflow from operating activities	23	(2,070)	(2,583)
Returns on investments and servicing of finance	24	(20)	66
Tax refund		84	-
Capital expenditure and financial investment	25	(67)	(45)
Acquisitions and disposals	26	-	(6)
Cash outflow before financing		<u>(2,073)</u>	<u>(2,568)</u>
Financing	27	<u>(6,218)</u>	<u>551</u>
Increase / (decrease) in cash in the year		<u>4,145</u>	<u>(2,017)</u>

Reconciliation of net cash flow to movement in net (debt)/funds (Note 28)

	Notes	2003 £'000	2002 £'000
Increase / (decrease) in cash in year		4,145	(2,017)
Cash inflow from increase in debt and lease financing		<u>755</u>	<u>(551)</u>
Change in net (debt)/funds resulting from cash flows		<u>4,900</u>	<u>(2,568)</u>
New loan notes issued on acquisition of subsidiary		-	(250)
Net (debt)/funds at 1 January 2003		<u>(307)</u>	<u>2,511</u>
Net funds/(debt) at 31 December 2003		<u>4,593</u>	<u>(307)</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

The consolidated financial statements incorporate the financial statements of the company and its subsidiary undertakings, which are drawn up to 31 December 2003. 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.

Research and development

Research and development expenditure is charged to the profit and loss account in the period in which it is incurred. Development costs that relate to clearly defined projects which are technically feasible and commercially viable, are capitalised and amortised on a straight line basis over 3 years provided that recoverability can be assessed with reasonable certainty.

Statement of accounting policies

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.

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.

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.

Statement of accounting policies

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 2003	3,242	1,545	306	5,093
31 December 2002	1,062	645	175	1,882
Net assets				
31 December 2003	9,237	-	-	9,237
31 December 2002	3,718	-	-	3,718
Operating profit/(loss)				
31 December 2003	(1,890)	311	61	(1,518)
31 December 2002	(2,485)	60	50	(2,375)

2 Investment income

	2003 £'000	2002 £'000
<i>Other interest receivable and similar income</i>		
Bank interest	38	79
	38	79
<i>Interest payable and similar charges</i>		
Finance leases and hire purchase contracts	(5)	(5)
Other loans	(53)	(39)
	(20)	35

Notes to financial statements

3 Loss on ordinary activities before taxation

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

	2003 £'000	2002 £'000
Depreciation and amounts written off tangible fixed assets		
- owned by the company	82	68
- held under finance leases	30	30
Amortisation of goodwill	451	403
Operating lease rentals		
- plant and machinery	-	-
- property rent	28	16
Auditors' remuneration for audit services	20	20
Research and development	830	603
Exchange losses	29	10
Government grants	(222)	(40)
	<hr/>	<hr/>
Other operating expenses comprise:		
- other expenses	2,179	2,215
- depreciation	112	98
- amortisation of goodwill	451	403
	<hr/>	<hr/>
Other operating expenses	2,742	2,716

Amounts payable to PKF and their associates by the company and its UK subsidiary undertakings in respect of non-audit services were £6,500 (2002: £1,800).

Notes to financial statements

4 Staff costs

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

	2003 Number	2002 Number
Product design	30	31
Sales and marketing	6	9
Administration	9	11
	<hr/>	<hr/>
	46	51

Their aggregate remuneration comprised:

	2003 £'000	2002 £'000
Wages and salaries	1,348	1,529
Social security costs	144	154
Other pension costs (see note 30)	44	51
	<hr/>	<hr/>
	1,536	1,734

5 Directors' remuneration, interests and transactions

Aggregate remuneration

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

	2003 £'000	2002 £'000
Emoluments	353	353
Money purchase contributions	16	16
	<hr/>	<hr/>
	369	369

Notes to financial statements

5 Directors' remuneration, interests and transactions (continued)

Directors' emoluments

Name of director	Fees/basic salary £'000	Taxable benefits £'000	Pension contributions £'000	Total 2003 £'000	Total 2002 £'000
Executive:					
Ian C Stewart	75	1	4	80	80
Robert G Deri	82	1	4	87	87
Andrew Scrivener	82	1	4	87	87
Dr Stuart A Green	82	1	4	87	87
Non executive:					
M John Barnes	15	-	-	15	15
Aggregate emoluments	336	4	16	356	356
Fees to third parties	13	-	-	13	13
Total	349	4	16	369	369

Fees to third parties comprise £13,000 (2002: £13,000) paid to Brockhill Limited under agreements to provide the group with the services of Dr Christopher H B Honeyborne.

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 2003	Granted	Lapsed	31 December 2003	Exercise Price	Gains on exercise 2003
Robert G Deri	3,252,823	-	-	3,252,823	7.75p	-
Robert G Deri	-	2,252,823	-	2,252,823	2.5p	-
Robert G Deri	-	1,000,000	-	1,000,000	Nil	-
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	-
Total	3,672,823	3,252,823	-	6,925,646		-

5 Directors' remuneration, interests and transactions (continued)

The original options granted to Robert Deri 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. The subsequent options were granted to Robert Deri on 18 August 2003. These are exercisable any time after 31 December 2003 provided Robert is an employee of the Group.

The options granted to John Barnes 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 on or after 22 September 2001, lapsing no later than March 2010. 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.

The market price of the ordinary shares at 31 December 2003 was 11.75p and the range during the year was 2.5p to 18.5p.

Directors' interests

The directors who held office at 31 December 2003 had the following interests, including family interests, in the 0.2p ordinary shares of ZOO Digital Group plc:

Name of director	31 December	1 January
	2003	2003
	Beneficial	Beneficial
Ian C Stewart	59,323,155	51,180,298
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 2003 and 31 May 2004.

Directors' transactions

No other transactions have taken place with directors aside from those disclosed in this note ⁵~~6~~, note ¹⁶~~17~~ or note ~~32~~.

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Notes to financial statements

6 Tax on loss on ordinary activities

a) Analysis of credit in the year

	2003 £'000	2002 £'000
UK corporation tax		
Current tax on income for the year	-	-
Adjustments in respect of prior periods	(84)	(134)
	<u>(84)</u>	<u>(134)</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:

	2003 £'000	2002 £'000
Loss on ordinary activities before tax	<u>(1,454)</u>	<u>(2,340)</u>
Loss on ordinary activities multiplied by standard rate of corporation tax of 30%	(436)	(702)
Capital allowances in excess of depreciation	(19)	46
Disallowable items	107	126
Losses carried forward	348	530
Adjustments in respect of prior periods	<u>(84)</u>	<u>(134)</u>
Current tax credit for the year	<u>(84)</u>	<u>(134)</u>

c) Future factors affecting the tax charge

The company has tax losses carried forward of £5,878,000 (2002: £5,228,000).

7 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 £1,757,000 (2002: £2,106,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

8 Dividends

There were no dividends paid or proposed.

Notes to financial statements

9 Loss per share

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

	Basic and Diluted	
	2003 £'000	2002 £'000
Loss for the financial year	1,454	2,206
	2003 Number of shares	2002 Number of shares
Weighted average number of shares for basic and diluted loss per share	193,574,949	151,187,593

No adjustment has been made for 'in the money' share options as this would decrease the loss per share, which is not dilutive. No adjustment has been made for 'out of the money' share options based on the assumption that shareholders would not exercise these options.

10 Intangible fixed assets

	Group			Company		
	Goodwill £'000	Patents £'000	Total £'000	Goodwill £'000	Patents £'000	Total £'000
Cost						
At 1 January 2003	10,237	7	10,244	7,667	7	7,674
Additions	-	38	38	-	38	38
At 31 December 2003	10,237	45	10,282	7,667	45	7,712
Amortisation						
At 1 January 2003	6,487	1	6,488	4,962	1	4,963
Charge for the year	449	2	451	338	2	340
At 31 December 2003	6,936	3	6,939	5,300	3	5,303
Net book value						
At 31 December 2003	3,301	42	3,343	2,367	42	2,409
At 31 December 2003	3,750	6	3,756	2,705	6	2,711

Notes to financial statements

11 Tangible fixed assets

Group	Leasehold improvements £'000	Computers £'000	Office equipment, fixtures & fittings £'000	Motor vehicles £'000	Total £'000
Cost					
At 1 January 2003	12	491	180	11	694
Additions	-	25	4	-	29
Disposals	-	(19)	(1)	-	(20)
At 31 December 2003	12	497	183	11	703
Depreciation					
At 1 January 2003	7	345	129	3	484
Charge for the year	1	91	15	5	112
Eliminated on disposal	-	(19)	(1)	-	(20)
At 31 December 2003	8	417	143	8	576
Net book value					
At 31 December 2003	4	80	40	3	127
At 31 December 2002	5	146	51	8	210

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

At 31 December 2003	-	11	1	-	12
At 31 December 2002	-	37	4	-	41

Notes to financial statements

11 Tangible fixed assets (continued)

Company	Leasehold improvements £'000	Computers £'000	Office equipment, fixtures & fittings £'000	Motor vehicles £'000	Total £'000
Cost					
At 1 January 2003	12	487	178	-	677
Additions	-	25	4	-	29
Disposals	-	(17)	(1)	-	(18)
At 31 December 2003	12	495	181	-	688
Depreciation					
At 1 January 2003	7	341	128	-	476
Charge for the year	1	91	15	-	107
Disposal	-	(17)	(1)	-	(18)
At 31 December 2003	8	415	142	-	565
Net book value					
At 31 December 2003	4	80	39	-	123
At 31 December 2002	5	146	50	-	201

12 Fixed asset investments

	Company	
	2003 £'000	2002 £'000
Subsidiary undertakings	7,947	7,947

Notes to financial statements

12 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
ZOOTech Limited (formerly Kazoo3D Limited)	UK	Technology development	2 ordinary shares	100
<i>Subsidiary undertakings</i>				

	Company £'000
Cost	
At 1 January 2003 and 31 December 2003	9,414
Amount written off	
At 1 January 2003 and 31 December 2003	1,467
Net book value	
At 31 December 2002 and 31 December 2003	<u>7,947</u>

13 Stock

	Group		Company	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Products in the course of development	42	15	-	5
Finished goods and goods for re-sale	352	348	-	150
	<u>394</u>	<u>363</u>	<u>-</u>	<u>155</u>

Notes to financial statements

14 Debtors

Amounts falling due within one year:

	Group		Company	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Trade debtors	2,036	866	28	173
Amounts owed by subsidiary undertakings	-	-	1,434	1,034
VAT	32	26	32	26
Other debtors	342	383	22	150
Prepayments and accrued income	697	160	697	113
	<u>3,107</u>	<u>1,435</u>	<u>2,213</u>	<u>1,496</u>

15 Creditors: Amounts falling due within one year

	Group		Company	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Obligations under finance leases and hire purchase contracts	-	6	-	6
Trade creditors	790	838	382	668
Other taxation and social security	195	127	43	99
Director's loan (see note 16)	857	600	857	600
Other creditors	-	314	-	250
Accruals and deferred income	1,330	650	875	360
Accrued pension contributions	13	7	13	7
Deferred consideration	-	53	-	53
	<u>3,185</u>	<u>2,595</u>	<u>2,170</u>	<u>2,043</u>

Notes to financial statements

16 Creditors: Amounts falling due after more than one year

	Group		Company	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Obligations under finance leases and hire purchase contracts	-	-	-	-
Director's loan	-	757	-	757
Amounts owed to subsidiary undertakings	-	-	6,785	6,785
	<u>-</u>	<u>757</u>	<u>6,785</u>	<u>7,542</u>

The first Director's loan, advanced by Ian Stewart, has been repaid since the year end. The loan was interest free to 31 December 2001. From 1 January 2002 until 31 December 2003 interest accrued at 2% per annum. Thereafter interest accrued at the Royal Bank of Scotland's base rate. The original advance was £757,000 and balance on this loan account at 31 December 2003 was £557,000.

The second 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 original loan was £600,000 and the balance outstanding on this loan at 31 December 2003 was £300,000.

The total interest accrued to Ian Stewart in the year on the above loans was ⁵⁰ £~~3~~,045 (2002 £27,140).

17 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 £5,435,000 are placed in high interest bearing bank accounts.

Notes to financial statements

18 Provisions for liabilities and charges

No provision has been made for deferred tax assets.

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

	Group		Company	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Deferred tax asset:				
- Accelerated capital allowances	103	121	101	121
- Short term timing differences	-	23	-	23
- Tax losses carried forward	1,763	1,568	1,763	1,568
	<u>1,866</u>	<u>1,712</u>	<u>1,864</u>	<u>1,712</u>

19 Called-up share capital

	2003 £'000	2002 £'000
<i>Authorised</i>		
400,000,000 (2002: 250,000,000) ordinary shares of 0.2p each	<u>800</u>	<u>500</u>
<i>Allotted, called-up and fully-paid</i>		
279,030,328 (2002: 157,770,124) ordinary shares of 0.2p each	<u>558</u>	<u>315</u>

On 2 June 2003 the authorised share capital was increased from £500,000 to £650,000 by the creation of an additional 75,000,000 ordinary shares of 0.2p each.

On 2 June 2003 60,000,000 ordinary shares of 0.2p each were issued for consideration of £1,500,000.

On 18 August 2003 1,000,058 shares of 0.2p each were issued to employees under share option schemes for consideration of £1,350.

On 16 September 2003 2,752,200 shares of 0.2p each were issued to employees under share option schemes for consideration of £330.

On 22 October 2003 2,702,292 shares of 0.2p each were issued to employees under share option schemes for consideration of £2,935.

On 18 November 2003 43,750 shares of 0.2p each were issued to employees under share option schemes for consideration of £3,391.

Notes to financial statements

19 Called-up share capital (continued)

On 12 December 2003 the authorised share capital was increased from £650,000 to £800,000 by the creation of an additional 75,000,000 ordinary shares of 0.2p each.

On 12 December 2003 54,761,904 shares of 0.2p each were issued for consideration of £5,750,000.

Options have been granted under the following option schemes to subscribe for ordinary shares of the company. As at 31 December 2003 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	3,052,600	0.01199p	December 2010
ZOO Digital Group plc Enterprise Management Incentive Scheme*	2,778,860	7.75p	July 2011
ZOO Digital Group plc Enterprise Management Incentive Scheme*	454,200	Nil	July 2011
ZOO Digital Group plc Unapproved Employee Share Option Scheme*	2,362,513	7.75p	July 2011
ZOO Digital Group plc Enterprise Management Incentive Scheme*	337,500	7.75p	September 2012
ZOO Digital Group plc Enterprise Management Incentive Scheme*	300,000	7.75p	April 2013
ZOO Digital Group plc Enterprise Management Incentive Scheme*	4,037,500	2.75p	April 2013
ZOO Digital Group plc Unapproved Employee Share Option Scheme	2,252,823	2.5p	August 2013
ZOO Digital Group plc Unapproved Employee Share Option Scheme	1,000,000	Nil	August 2013
	<u>18,022,496</u>		

*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.

Notes to financial statements

20 Reserves

Group	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2003	11,961	8,598	(16,928)	3,631
Issue of shares	6,730	-	-	6,730
Retained loss for the year	-	-	(1,454)	(1,454)
At 31 December 2003	18,691	8,598	(18,382)	8,907
Company				
At 1 January 2003	11,961	7,394	(15,618)	3,737
Shares issued	6,730	-	-	6,730
Retained loss for the year	-	-	(1,758)	(1,758)
At 31 December 2003	18,691	7,394	(17,376)	8,709

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.

21 Reconciliation of movements in group shareholders' funds

	2003 £'000	2002 £'000
Loss for the financial year	(1,454)	(2,206)
Currency (loss)/gain on net overseas investment	-	(6)
New shares issued	6,973	832
Net increase to/(deduction from) shareholders' funds	5,519	(1,380)
Opening shareholders' funds	3,946	5,326
Closing shareholders' funds	9,465	3,946
Interest in own shares	(228)	(228)
	9,237	3,718

Notes to financial statements

22 Interest in own shares

	Group and Company £'000
Cost	
At 31 December 2002 and 31 December 2003	<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 and a market value of £421,551. These represent 1.3% 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.

23 Reconciliation of operating loss to operating cash flows

	2003 £'000	2002 £'000
Operating loss	(1,518)	(2,375)
Depreciation charges	112	98
Increase in stock	(31)	(363)
Increase in debtors	(1,672)	(698)
Increase in creditors	588	352
Goodwill amortisation	451	403
Net cash outflow from operating activities	<u>(2,070)</u>	<u>(2,583)</u>

24 Returns on investment and servicing of finance

	2003 £'000	2002 £'000
Interest received	38	83
Interest paid	(53)	(12)
Finance lease interest paid	(5)	(5)
Net cash (outflow)/inflow	<u>(20)</u>	<u>66</u>

Notes to financial statements

25 Capital expenditure and financial investment

	2003 £'000	2002 £'000
Purchase of intangible fixed assets	(38)	-
Purchase of tangible fixed assets	(29)	(60)
Receipts from sales of fixed assets	-	15
Net cash outflow	(67)	(45)

26 Acquisitions and disposals

	2003 £'000	2002 £'000
Costs of acquisition	-	(28)
Cash acquired with subsidiary	-	22
Net cash outflow	-	(6)

27 Financing

	2003 £'000	2002 £'000
Capital element of finance lease rentals	(5)	(49)
Repayment of director's loan	(500)	-
New loans	-	600
Repayment of loan notes	(250)	-
Issue of share capital	6,973	-
	(6,218)	551

28 Analysis of changes in net debt

	At 1 January 2003 £'000	Cash flows £'000	Non Cash Movements £'000	At 31 December 2003 £'000
Cash at bank and in hand	1,306	4,145	-	5,451
Debt due after one year	(757)	200	557	-
Debt due within one year	(850)	550	(557)	(857)
Finance leases	(6)	5	-	(1)
	(307)	(4,900)	-	4,593

Notes to financial statements

29 Financial commitments

Commitments under non-cancellable operating leases are as follows:

	2003 £'000	2002 £'000
Group and company		
Expiry date		
- within one year	-	7
- between two and five years	28	-
	<u>28</u>	<u>7</u>

Included in commitments expiring between two and five years is an amount of £28,000 (2002: £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.

30 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 £44,000 (2002: £51,000).

31 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 £70,000 (2002: £85,000). Sales of licences were also made to LightWork Design Limited in the normal course of business amounting to £70,000 (2002: £70,000). At 31 December 2003 the balance owed to LightWork Design Limited was £nil (2002: £nil).