

Epic Group plc

Directors' report and consolidated
financial statements

Registered number 3175632

31 May 2005

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Chairman's statement

Overview

Epic has maintained its position as market leader in e-learning and it is pleasing for Epic to release financial results showing its best ever profitability.

Results

For the year ended 31 May 2005, turnover increased by 11% to £8.1m (2004: £7.3m). Effective cost control this year has meant that operating profit, before interest receivable and taxation, increased by 77% to £1.6m (2004: £0.9m) and profits before tax were up by 52% to £2.1m (2004: £1.4m). After providing for corporation tax, earnings per share for the year were 6.3p (2004: 4.0p) an increase of 57%.

Cash generated from operating activities was £0.7m (2004: £0.8m) as our debtor balances increased pending payments by our customers. Returns to shareholders during the year (in the form of dividends and share buy-backs) totalled £3.0m (2004: £0.5m) and consequently cash balances decreased during the year by £2.2m (2004: increase £0.8m). At 31 May 2005 cash balances were £10.3m (2004: £12.5m).

Potential offer for Epic

As shareholders will know from our formal announcement to the London Stock Exchange on 28 June 2005 and my letter alerting them to this, Epic is in preliminary discussions with a third party that may or may not result in an offer being made for the Company. Whilst this approach was not actively sought, the talks are continuing at present and we will keep shareholders informed of developments as appropriate.

Dividends

During the year the directors doubled the interim dividend to 1.6p per share (2004: 0.8p). The Board have recommended a final dividend of 3.2p (2004: 1.0p) giving a total ordinary dividend of 4.8p (2004: 1.8p) more than double the previous year. Shareholders should only expect to receive the final dividend if the potential offer does not proceed. The dividend is, as is usual, subject to shareholders voting for its approval at the annual general meeting to be held in due course.

It is the directors' intention to follow a policy of distributing the major part of earnings each year, having due regard to the working capital and cash position of Epic.

Return of capital

During the course of the year, the directors determined that Epic, from its successful trading, had generated cash balances in excess of its requirements. Following shareholder approval at an extraordinary general meeting on 13 April 2005 and the consent of the High Court, a capital re-construction was undertaken creating further distributable reserves. Accordingly the sum of £4.1m has been transferred to the profit and loss account. It is the intention of the directors that, if the potential offer does not proceed, not less than £5m of these cash balances should be returned to shareholders.

Chairman's statement *(continued)*

Trading

The balance of work between the private and public sector remains approximately even. Margins have been healthy in both sectors and we continue to be active in both. Successful integration of Epic technology in the client base with Arena (learning management software) and Context (content management software) has resulted in stronger long term relationships with clients.

In the private sector, Epic has increased both the number of clients and those clients where it has 'approved supplier' status. We have therefore broadened our client base across finance, retail, manufacturing, pharmaceutical, oil, telecommunications and consultancies.

In the public sector, after the May 2005 election and a considerable reorganisation in the National Health Service and the central government departments, we are beginning to see a more settled landscape. We have been particularly successful in the defence and education markets.

People

Steve Rayson has today announced his resignation from the Board to pursue a career outside of e-learning. I thank Steve for his past hard work. Epic is very much a people business and the thanks of the directors and shareholders go to all our staff for their contribution to these outstanding results.

Prospects

The current year has started satisfactorily in both public and private sectors and we maintain our position as the leading e-learning company in the UK.

John Gordon
Chairman
14 July 2005

Directors and advisers

Directors

John Gordon* FCA Chairman

Ian Ritchie* CBE, FREng, FBCS, Bsc

Brian Stevens* Mphil, FRSA

Donald Clark MA, PhD Chief Executive Officer

Stephen Oliver ACA Chief Financial Officer

* non-executive director

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Shareholder enquiries: tel 0870 600 3970

Solicitors

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Brighton BN1 3YB

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 May 2005.

Principal activities

The group's principal activity is the production of online learning programmes and online government solutions delivered over the internet and corporate intranets.

Business review

The Chairman's statement on pages 1 and 2 explains the business activities of the group during the year and its future development and prospects.

Directors and directors' interests

The present directors are listed on page 3. John Gordon was appointed a director on 12 October 2004 and on that date became Chairman in place of Michael Inwards. Michael Inwards resigned as a director on 31 May 2005. Steve Rayson resigned as a director on 14 July 2005

The interests of the directors in the share capital of the company are listed on pages 8 and 9.

Share capital and reserves

During the year the company repurchased for cancellation 2,828,473 ordinary shares of 1p each at a total cost of £2,444,000. It also issued 396,500 ordinary shares of 1p each as a result of exercises under share option agreements. The proceeds from the issue of shares were £84,000.

Following the EGM on the 13 April 2005 the Companies Court of the High Court of Justice approved a cancellation of the share premium account on 18 May 2005. The balance on the account at this time was £4,168,000 and this amount has been transferred to the profit and loss reserve of the company.

Dividends

The directors propose the payment of a final dividend of 3.2p per share. This combined with the interim dividend paid of 1.6p per share gives a total dividend of 4.8p per share (2004: 1.8p) for the year. The total payment by the company is £1,117,000 (2004: £471,000).

Substantial shareholdings

At 4 July 2005 the company had been notified of the following material interests in 3% or more of the issued share capital of the company.

	Number of ordinary shares	Percentage of issued capital
Framlington Investment Management	3,791,700	16.0%
Liontrust	2,301,211	9.7%
Scottish Widows	2,232,886	9.4%
D M Clark	2,177,381	9.2%
Artemis Investment Management	1,500,000	6.3%
D C Thompson & Co Limited	815,000	3.4%

Political and charitable contributions

The group made no political or charitable contributions during the year (2004: £nil).

Directors' report *(continued)*

Policy and practice on payment of creditors

The company, Epic Group plc, has external trade creditors of £nil (*2004: £nil*). All relevant costs are met directly by the main trading subsidiary, Epic Multimedia Limited, and then re-charged. Epic Multimedia Limited has 31 days' trade creditors outstanding at 31 May 2005 (*2004: 28 days*).

The group does not follow any published code on the payment of creditors. A list of approved suppliers is maintained and it is the policy of the group to agree payment terms with each supplier before they become approved. Subject to the supplier providing the appropriate services, Epic abides by the agreed payment terms.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of Baker Tilly as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

Stephen Oliver
Company Secretary

14 July 2005

Corporate governance

Directors statement on Corporate Governance

The maintenance of effective corporate governance is a key priority of the board. Under the rules of the Alternative Investment Market (AIM) the company is not required to comply with the detailed requirements of the revised Combined Code on Corporate Governance (the Code) which was issued in 2003. The Board fully supports the principles of openness, integrity and accountability on which the Code is based and has taken the actions described below.

Board of Directors

The Board comprises three executive directors and the non-executive directors and is responsible to shareholders for the proper management of the group. The non-executive directors are John Gordon, Michael Inwards, Ian Ritchie and Brian Stevens. Until the 12 October 2004 the Chairman was Michael Inwards and following his appointment John Gordon took on this role and became the senior independent director. The company requires all directors to seek re-election at the first opportunity after joining the board and thereafter once every three years.

The Board considers all of its non-executive directors to be independent in character and judgement. Under the Code only John Gordon is considered independent due to the previous policy of granting share options to non-executive directors.

The Board meets regularly throughout the year to set and monitor group strategy, to review trading performance and to formulate policy on key issues. A schedule of specific matters is reserved for board consideration and the company provides regular information to brief the directors in advance of board meetings on financial and operational matters from both internal and external sources. During the year, the Board has formally met on 8 occasions and convened telephone conferences when appropriate for significant matters between formal meetings. The directors have attended all formal meetings of the Board and its committees held during the time of their appointment.

The Company Secretary is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are considered. Due to the relative size and complexity of the group, the role of Company Secretary is currently combined with that of the Chief Financial Officer and consequently the Board as a whole considers any changes in appointment.

The Board is implementing a process, led by the Chairman, for the annual evaluation of the performance of the Board and its individual directors.

Audit Committee

The audit committee comprises the independent non-executive directors of the company, Brian Stevens, John Gordon, Ian Ritchie and Michael Inwards. The committee was chaired by Michael Inwards to the 12 October 2004 and then by John Gordon. Both Michael Inwards and John Gordon are considered by the Board to have suitable relevant and recent financial experience. The committee has met twice during the year and provides a forum for discussion and reporting with the group's auditors. By invitation, the meetings may be attended by the Chief Executive Officer and the Chief Financial Officer.

The audit committee is responsible for a wide range of financial matters including ensuring that the financial performance of the group is adequately measured and controlled, correctly represented, reported to and understood by the board.

The audit committee advises the board on the appointment of external auditors, the independence and objectivity of the external auditors, their remuneration, both audit and non-audit, and discusses the nature and scope of their audit. Where the auditors provide non-audit services, consideration is given to the potential effect on objectivity and independence as well as cost, quality of service and efficiency.

Nomination Committee

The Board as a whole takes responsibility for the process of making Board appointments.

Corporate Governance *(continued)*

Remuneration Committee

The remuneration committee meets formally on an annual basis and comprises the independent non-executive directors, Brian Stevens, Ian Ritchie, John Gordon and Michael Inwards. Michael Inwards was the Chairman until 12 October 2004 and then John Gordon was appointed Chairman. The committee is responsible for reviewing and determining the policy of the group on executive remuneration including specific remuneration packages for each of the executive members of the board, pension rights and compensation payments. In addition the committee monitors the award of share options to all employees. The committee may use information from both inside and outside the company to assist in this process, but has not employed any consultants in this role during the year.

Internal control

The responsibility for the group's system of internal controls rests with the directors. Any internal control system is designed to manage, rather than eliminate, the risks that the company may face in achieving its business objectives. Such a system can only provide reasonable and not absolute assurance against material misstatement or loss. The Code requires that directors review the effectiveness of internal controls, including those of an operational and compliance nature, as well as internal financial controls. The principal features of the group's internal control framework are:

- There are clear lines of authority within the group requiring that only senior management in consultation with a director can commit the group to material transactions. In both financial and operational matters, the group has a policy of segregation of duties and authorisation.
- The group operates procedures to back up data on a daily basis and keeps copies of the data away from the normal business premises.
- The group operate to an approved ISO 9001:2000 Quality Assurance standard. This defines many aspects of the internal operations and is independently reviewed twice a year.
- Financial reporting consists of detailed monthly reports, which are compared to budget and supplemented by weekly reporting of key performance indicators.
- The board as a whole review and approve the budget for the financial year, discuss the strategy to be adopted by the group and the associated operating risks.
- The Board's agenda includes a regular item for consideration of risk and control, and any actions that may be considered necessary. Management is responsible for the identification and evaluation of risks applicable to their areas of business together with the design of suitable internal controls. These risks are assessed regularly and may be associated with matters such as the delivery of projects, the effective utilisation of resources and the development of the e-learning market.

All of these processes have been in place throughout the financial year.

The Board has considered the need for an internal audit function, but has decided that at this time, the size and complexity of the group do not warrant this function. This is a decision that the Board will review as the group activities develop.

Dialogue with shareholders

The group places considerable importance on communications with all shareholders. The directors make formal presentations to institutions at the time of the annual and interim results. They also make themselves available to meet with and inform potential investors of the activities of the group. There is regular dialogue with shareholders and the board welcome the opportunity to meet with private investors at the annual general meeting.

All official company announcements are available from the company website on the same day that they are released to the Stock Exchange.

Going Concern

After making enquiries, the directors have a reasonable expectation that the group and the company 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.

Report to the shareholders on directors' remuneration

Remuneration policy

The objective of the group's remuneration policy is to attract, motivate and retain high quality individuals who will contribute to the success of the group and enhance shareholder value. The Remuneration Committee decides on the remuneration of the directors, other senior staff and also the grant of share options within the group. The board as a whole decide the remuneration of the non-executives within the limits set by the Articles of Association.

The remuneration of the executive directors comprises a basic salary, provision of company car (or salary in lieu) and contribution to a personal pension plan that is based on basic salary only. They also participate in an annual bonus scheme, which is dependent upon the performance of both the company and the individual in achieving relevant and stretching targets. The group does not operate a long term incentive scheme.

Details of the remuneration of the directors are set out below:

	Salary & Fees	Benefits	Bonus	Total 2005	Total 2004	Defined contribution pension scheme	
						2005	2004
	£000	£000	£000	£000	£000	£000	£000
Executive Directors							
D M Clark	133	2	42	177	135	14	13
S J Oliver	82	1	17	100	82	7	7
S C Rayson	110	1	10	121	109	3	3
Non Executives							
JE Gordon*	19	-	-	19	-	-	-
M A Inwards*	11	-	-	11	19	-	-
I C Ritchie	8	-	-	8	8	-	-
B Stevens	8	-	-	8	8	-	-
	<u>370</u>	<u>4</u>	<u>69</u>	<u>443</u>	<u>361</u>	<u>24</u>	<u>23</u>

* JE Gordon appointed director and chairman 12 October 2004. On this date MA Inwards stepped down as Chairman and resigned from the board on 31 May 2005

During the year the directors exercised share options (2004: no option exercises) and retained the shares acquired as follows:

	Exercise price	Number of shares acquired
M A Inwards	13.5p	26,500
I C Ritchie	15.0p	150,000
D M Clark	13.5p	150,000
S C Rayson	55.0p	50,000

The interests of the directors in the share capital of the company are set out below. There were no changes between 31 May 2005 and 4 July 2005.

	At 31 May 2005	At 31 May 2004 (or appointment)
	Ordinary 1p shares	Ordinary 1p shares
JE Gordon	35,000	-
M A Inwards	371,761	345,261
I C Ritchie	180,000	30,000
B Stevens	-	-
D M Clark	2,177,381	2,027,371
S J Oliver	-	-
S C Rayson	50,000	-

Report to the shareholders on directors' remuneration *(continued)*

Share Options

The company grants share options to directors and employees under Inland Revenue approved schemes and also under an unapproved scheme. All share options are granted at the prevailing market price at the time of issue. The share options granted to the directors are as follows:

	No of options at 31 May 2004	Granted/ (exercised) during the year	No of options At 31 May 2005	Exercise price	Date of grant
M A Inwards	26,500	(26,500)	-	13.5p	7 March 1997
I C Ritchie	150,000	(150,000)	-	15p	2 November 1998
B Stevens	50,000	-	50,000	119p	3 June 2003
D M Clark	150,000	(150,000)	-	13.5p	7 March 1997
S J Oliver	50,000	-	50,000	55p	17 October 2001
	50,000	-	50,000	71p	31 May 2002
	50,000	-	50,000	89p	28 February 2003
S C Rayson	50,000	(50,000)	-	55p	17 October 2001
	50,000	-	50,000	71p	31 May 2002
	50,000	-	50,000	89p	28 February 2003

All options are exercisable between 3 and 10 years from date of grant.

As at 31 May 2005, 43 employees held options for 841,500 ordinary shares exercisable from July 1999 to October 2014 at option prices ranging from 26p to £1.19.

At 31 May 2005 the market price of Epic Group plc shares was 69.5p (2004: 95p). The price ranged from 96.5p to 69.5p during the year.

Statement of directors' responsibilities

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

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

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

Independent auditor's report to the members of Epic Group plc

We have audited the financial statements on pages 12 to 26.

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, or any other member of the Group, is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only those sections set out in the contents: Introduction, Products and services, the Chairman's Statement, the Directors' Report, Corporate Governance and Report to the shareholders on directors' remuneration. 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 opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 May 2004 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

BAKER TILLY
Registered Auditor
Chartered Accountants
Brighton

14 July 2005

Consolidated profit and loss account
for the year ended 31 May 2005

	<i>Note</i>	2005 £000	2004 £000
Turnover	2	8,104	7,296
Cost of sales		(3,810)	(3,524)
Gross profit		4,294	3,772
Administrative expenses		(2,725)	(2,887)
Operating profit on ordinary activities before interest and taxation		1,569	885
Interest receivable and similar income	6	516	479
Profit on ordinary activities before taxation	3	2,085	1,364
Tax on profit on ordinary activities	7	(550)	(330)
Profit on ordinary activities after taxation		1,535	1,034
Dividends paid and proposed	8	(1,117)	(471)
Profit retained for the financial year	15	418	563
Earnings per share	9		
Earnings per share		6.3p	4.0p
Diluted earnings per share		6.2p	3.9p

There is no material difference between historical cost profits and those shown above, therefore no separate note of historical cost profits and losses has been presented.

The Group has no recognised gains or losses during the current and previous year other than the above results.

All of the results above arose from continuing operations during the current and previous year.

Balance sheets
at 31 May 2005

	<i>Note</i>	Group		Company	
		2005	2004	2005	2004
		£000	£000	£000	£000
Fixed assets					
Tangible fixed assets	<i>10</i>	149	148	-	-
Investments	<i>11</i>	100	100	4,786	4,786
		<hr/>	<hr/>	<hr/>	<hr/>
		249	248	4,786	4,786
		<hr/>	<hr/>	<hr/>	<hr/>
Current assets					
Debtors	<i>12</i>	2,561	1,908	4,629	5,727
Cash at bank and in hand		10,281	12,470	-	-
		<hr/>	<hr/>	<hr/>	<hr/>
		12,842	14,378	4,629	5,727
		<hr/>	<hr/>	<hr/>	<hr/>
Creditors: amounts falling due within one year	<i>13</i>	(4,037)	(3,630)	(1,340)	(1,605)
		<hr/>	<hr/>	<hr/>	<hr/>
Net current assets		8,805	10,748	3,289	4,122
		<hr/>	<hr/>	<hr/>	<hr/>
Net assets		9,054	10,996	8,075	8,908
		<hr/>	<hr/>	<hr/>	<hr/>
Capital and reserves					
Called up share capital	<i>14</i>	238	262	238	262
Share premium account	<i>15</i>	26	4,114	26	4,114
Capital redemption reserve	<i>15</i>	28	-	28	-
Other capital reserve	<i>15</i>	-	1,090	-	-
Profit and loss account	<i>15</i>	8,762	5,530	7,783	4,532
		<hr/>	<hr/>	<hr/>	<hr/>
Equity shareholders' funds	<i>16</i>	9,054	10,996	8,075	8,908
		<hr/>	<hr/>	<hr/>	<hr/>

These financial statements were approved by the board of directors on 14 July 2005 and were signed on its behalf by:

Donald Clark
Director

Stephen Oliver
Director

Consolidated cash flow statement
for the year ended 31 May 2005

	<i>Note</i>	2005 £000	2004 £000
Net cash inflow from operating activities	<i>17</i>	684	818
Returns on investments and servicing of finance	<i>18</i>	525	440
Taxation		(314)	(46)
Capital expenditure	<i>18</i>	(111)	(96)
Equity dividends paid		(613)	(465)
		<hr/>	<hr/>
Cash inflow before financing		171	651
Financing	<i>18</i>	(2,360)	99
		<hr/>	<hr/>
(Decrease) / increase in cash in the year	<i>19</i>	(2,189)	750
		<hr/> <hr/>	<hr/> <hr/>

Reconciliation of net cash flow to movement in net funds
for the year ended 31 May 2005

	<i>Note</i>	2005 £000	2004 £000
(Decrease) / increase in cash in the year		(2,189)	750
		<hr/>	<hr/>
Change in net funds resulting from cash flow and movement in net funds in the year		(2,189)	750
Net funds at beginning of year		12,470	11,720
		<hr/>	<hr/>
Net funds at end of year	<i>19</i>	10,281	12,470
		<hr/> <hr/>	<hr/> <hr/>

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently throughout the accounting period in dealing with items which are considered material in relation to the group's financial statements.

Basis of preparation

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

Basis of consolidation

The group financial statements consolidate the financial statements of Epic Group plc and all its subsidiary undertakings. These financial statements are made up to 31 May 2005.

The merger accounting principles have been adopted in the consolidation of the parent company with Epic Multimedia Limited and its subsidiary companies (the 'Epic Multimedia Limited group'). The merger took place following a share for share exchange on 10 May 1996.

The acquisition method of accounting has been adopted by the Epic Multimedia Limited group. Under this method, the results of subsidiary undertakings acquired and disposed of during the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

In accordance with Section 230(4) of the Companies Act 1985, the company is exempt from the requirement to present its own profit and loss account. The amount of the profit for the financial year dealt with in the financial statements of the company is disclosed in note 15 to these financial statements.

Goodwill

Purchased goodwill (both positive and negative) arising on consolidation in respect of acquisitions before 1 June 1998, when Financial Reporting Standard 10 *Goodwill and intangible assets* was adopted, was written off to reserves in the year of acquisition. When a subsequent disposal occurs any related goodwill previously written off to reserves is written back through the profit and loss account as part of the profit or loss on disposal.

Purchased goodwill (representing the excess of the fair value of the consideration given and associated costs over the fair value of the separable net assets acquired) arising on consolidation in respect of acquisitions since 1 June 1998 is capitalised. On the subsequent disposal or termination of a business, the profit or loss on disposal or termination is calculated after charging the unamortised amount of any related goodwill. Positive goodwill is amortised to nil by equal annual instalments over its estimated useful economic life.

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers during the year and is recognised on the basis of the accounting policies on long term contracts.

Notes (continued)

1 Accounting policies (continued)

Long term contracts and work in progress

The amount of profit attributable to the stage of completion of a long term contract is recognised when the outcome of the contract can be foreseen with reasonable certainty. Turnover for such contracts is stated at cost appropriate to their stage of completion plus attributable profits, less amounts recognised in previous years. Provision is made for any losses as soon as they are foreseen.

Contract work in progress is stated at costs incurred, less those transferred to the profit and loss account, after deducting foreseeable losses and payments on account not matched with turnover.

Amounts recoverable on contracts are included in debtors and represent turnover recognised in excess of payments on account.

Other fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Leasehold improvements	-	the shorter of 10 years and the un-expired lease term
Computer equipment	-	2 to 4 years
Fixtures, fittings and equipment	-	4 years
Motor vehicles	-	4 years

Leases

Where the group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease'. Assets are capitalised and depreciated over the shorter of their estimated useful lives in accordance with the above depreciation policy and the lease term. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the interest element, which is charged to the profit and loss account, and the capital element, which reduces the outstanding obligation for future instalments.

The costs of operating leases are charged to the profit and loss account on a straight line basis over the period of the lease.

Pension benefits

The company makes payments to defined contribution arrangements for eligible staff. The annual contributions payable are charged to the profit and loss account.

Taxation

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

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Notes (continued)

2 Analysis of turnover and profit on ordinary activities before interest and taxation

The turnover and pre-tax profit are wholly attributable to the group's principal activity, the production of interactive multimedia programmes, and arise solely in the UK.

3 Profit on ordinary activities before taxation

	2005	2004
<i>Profit on ordinary activities before taxation is stated after charging</i>	£000	£000
Amounts payable to auditors:		
For audit services		
- statutory audit	13	12
For non-audit services		
- audit related regulatory reporting	4	4
- taxation services (compliance)	2	2
- further assurance services (included in exceptional item below)	-	40
-		
Depreciation and other amounts written off fixed assets:		
- owned assets	110	120
Rentals payable under operating leases:		
- hire of plant and machinery	5	5
- other operating leases	133	133
Exceptional item:		
Aborted transaction fees (including amounts in respect of group auditors)	-	115

4 Employees and directors

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

	Number of employees	
	2005	2004
Production	129	120
Administration	6	7
Sales and Marketing	19	16
	154	143
	154	143

The aggregate payroll costs of these persons were as follows:

	2005	2004
	£000	£000
Wages and salaries	4,186	4,076
Social security costs	439	432
Pension costs	54	64
	4,679	4,572
	4,679	4,572

Notes (continued)

5 Remuneration of directors

Directors' emoluments can be analysed as follows:

	2005 £000	2004 £000
Directors' emoluments:	444	361
Company contributions to money purchase pension schemes	24	23
	468	384
	468	384

A detailed analysis of the directors' remuneration including salaries, pensions, unrealised gains on share options (£221,000) and performance related bonuses is provided on pages 8 and 9.

Retirement benefits are accruing to 3 directors under money purchase pension schemes (2004: 3).

6 Interest receivable and similar income

	2005 £000	2004 £000
Interest earned on cash deposits	516	479
	516	479

7 Taxation

Analysis of charge in period

	2005 £000	2004 £000
<i>UK corporation tax</i>		
Current tax on income for the period	553	400
Adjustment in respect of prior periods	(15)	-
	538	400
<i>Deferred tax</i>		
Deferred tax (credit) in respect of prior periods	-	(78)
Deferred tax charge in respect of current period	12	8
	12	8
Total tax on profit on ordinary activities	550	330

Tax reconciliation

The differences between the corporation tax charge for the period (as shown above) and the standard rate of UK corporation tax are as follows:

Notes (continued)

7 Taxation (continued)

	2005 £000	2004 £000
<i>Current tax reconciliation</i>		
Profit on ordinary activities before tax	2,085	1,364
	<hr/>	<hr/>
Expected corporation tax at 30% (2004: 30%)	625	410
<i>Effects of:</i>		
Expenses not deductible for tax purposes	4	41
Capital allowances in excess of depreciation	(8)	(8)
Tax relief on share option exercise	(68)	-
Utilisation of tax losses	-	(43)
Adjustment in respect of prior periods	(15)	-
	<hr/>	<hr/>
Total current corporation tax charge (see above)	538	400
	<hr/> <hr/>	<hr/> <hr/>

8 Dividends

	2005 £000	2004 £000
<i>Ordinary shares:</i>		
Interim dividend 1.6p per share (2004: 0.8p)	357	209
Proposed final dividend 3.2p per share (2004: 1.0p)	760	262
	<hr/>	<hr/>
	1,117	471
	<hr/> <hr/>	<hr/> <hr/>

9 Earnings per share

The calculation of earnings per share is calculated on the profit after tax of £1,535,000 (2004: 1,034,000) divided by the weighted average number of shares in issue during the year. The weighted average number of shares in issue during the year was 24,511,055 (2004: 26,061,643). The calculation of the diluted earnings per share is calculated on 24,603,576 shares (2004: 26,650,815) being the weighted average number of shares in issue adjusted for the effects of dilutive potential shares arising from share option grants.

Notes (continued)

10 Tangible fixed assets

<i>Group</i>	Leasehold Improvements £000	Fixtures & Fittings £000	Computer Equipment £000	Total £000
<i>Cost</i>				
At beginning of year	83	283	3,188	3,554
Additions	5	2	104	111
	-----	-----	-----	-----
At end of year	88	285	3,292	3,665
	-----	-----	-----	-----
<i>Depreciation</i>				
At beginning of year	80	270	3,056	3,406
Charge for year	3	14	93	110
	-----	-----	-----	-----
At end of year	83	284	3,149	3,516
	-----	-----	-----	-----
<i>Net book value</i>				
At 31 May 2005	5	1	143	149
	=====	=====	=====	=====
At 31 May 2004	3	13	132	148
	=====	=====	=====	=====

Notes (continued)

11 Fixed asset investments

Group	Investments
	£000
<i>Cost</i>	
At beginning and end of year	245
	<hr/>
<i>Provisions</i>	
At beginning and end of year	145
	<hr/>
<i>Net book value</i>	
At 31 May 2005	100
	<hr/> <hr/>
At 31 May 2004	100
	<hr/> <hr/>

Company	Shares in group undertakings £000	Loans to group undertakings £000	Total £000
<i>Cost</i>			
At beginning and end of year	1,220	3,566	4,786
	<hr/>	<hr/>	<hr/>
<i>Provisions</i>			
At beginning and end of year	-	-	-
	<hr/>	<hr/>	<hr/>
<i>Net Book Value</i>			
At 31 May 2005	1,220	3,566	4,786
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 31 May 2004	1,220	3,566	4,786
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

The subsidiary undertakings, Epic Multimedia Limited and Enlighten UK Limited, are wholly owned. The subsidiaries are involved in multimedia production and publishing and are registered in England and Wales.

Notes (continued)

12 Debtors

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Amounts falling due within one year:				
Trade debtors	1,361	1,017	-	-
Amounts recoverable on contracts	1,052	703	-	-
Amounts owed by subsidiary undertakings	-	-	4,629	5,727
Other debtors	9	9	-	-
Prepayments and accrued income	81	109	-	-
Deferred tax (recoverable in more than 1 year)	58	70	-	-
	<u>2,561</u>	<u>1,908</u>	<u>4,629</u>	<u>5,727</u>

The deferred tax balance represents the tax effect of depreciation in excess of capital allowances.

13 Creditors: amounts falling due within one year

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Payments received on account	1,446	1,792	-	-
Trade creditors	177	212	-	-
Amounts owed to group undertakings	-	-	569	1,259
Corporation tax	633	409	-	-
Other taxes and social security	532	361	-	-
Dividends payable	771	267	771	267
Accruals and deferred income	478	589	-	79
	<u>4,037</u>	<u>3,630</u>	<u>1,340</u>	<u>1,605</u>

14 Called up share capital

	2005		2004	
	Authorised £000	Issued and fully paid £000	Authorised £000	Issued and fully paid £000
Ordinary shares of 1p each	2,500	238	2,500	262

The issued share capital of the company is 23,743,103 (2004: 26,175,076) ordinary shares of 1p each.

During the year the company repurchased 2,828,473 ordinary shares of 1p each at a cost of £2,444,000. It also issued 396,500 ordinary shares of 1p each as a result of exercises under share option agreements, the proceeds to the company were £84,000.

The company has granted share options over 841,500 (2004: 1,326,000) ordinary shares to 43 employees (2004: 55). The options have been granted between 2 July 1996 and 6 October 2004 and are exercisable between 3 and 10 years from the date of grant, the exercise prices being between £0.26 and £1.19.

Notes (continued)

15 Reserves

Group	Share premium account £000	Capital redemption reserve £000	Other capital reserve £000	Profit and loss account £000	Total £000
At beginning of year	4,114	-	1,090	5,530	10,734
Transfer	-	-	(1,090)	1,090	-
Share capital subscribed	80	-	-	-	80
Capital reconstruction	(4,168)	-	-	4,168	-
Share capital repurchased	-	28	-	(2,444)	(2,416)
Retained profit for the year	-	-	-	418	418
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
At end of year	26	28	-	8,762	8,816
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Following a review of the group structure, the directors decided that various dormant subsidiaries were no longer required and have commenced the process to get these dissolved. As a result of this review it was identified that the other capital reserves of £1,090,000 could be treated as distributable reserves and a transfer has been made above to reflect this.

Under a court approved capital reconstruction in May 2005 the balance then outstanding on the share premium account was transferred to the profit and loss account of the company. This is reflected in the accounts of both the group and the company.

Company	Share premium account £000	Capital redemption reserve £000	Profit and loss account £000	Total £000
At beginning of year	4,114	-	4,532	8,646
Share capital repurchased	-	28	(2,444)	(2,416)
Share capital subscribed	80	-	-	80
Capital reconstruction	(4,168)	-	4,168	-
Retained profit for the year	-	-	1,527	1,527
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
At end of year	26	28	7,783	7,837
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Notes *(continued)*

16 Reconciliations of movements in shareholders' funds

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Profit/(loss) for the financial year	1,535	1,034	2,644	(293)
Dividends	(1,117)	(471)	(1,117)	(471)
Share capital subscribed net of issue costs	84	99	84	99
Share capital repurchased	(2,444)	-	(2,444)	-
	<hr/>	<hr/>	<hr/>	<hr/>
Net movements to shareholders' funds	(1,942)	662	(833)	(665)
Opening shareholders' funds	10,996	10,334	8,908	9,573
	<hr/>	<hr/>	<hr/>	<hr/>
Closing shareholders' funds	9,054	10,996	8,075	8,908
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

17 Reconciliation of operating profit to net cash inflow from operating activities

	2005 £000	2004 £000
Operating profit	1,569	885
Depreciation	110	120
Profit on the disposal of fixed assets	-	(9)
Increase in debtors	(674)	(64)
Decrease in creditors	(321)	(114)
	<hr/>	<hr/>
Net cash inflow from operating activities	684	818
	<hr/> <hr/>	<hr/> <hr/>

Notes (continued)

18 Analysis of cash flows for headings netted in the cash flow statement

	2005 £000	2004 £000
Returns on investments and servicing of finance		
Interest received	525	440
	<u>525</u>	<u>440</u>
Net cash inflow from returns on investment and servicing of finance	525	440
	<u><u>525</u></u>	<u><u>440</u></u>
Capital expenditure		
Purchase of tangible fixed assets	(111)	(105)
Receipts from the disposal of fixed assets	-	9
	<u>(111)</u>	<u>(96)</u>
Net cash outflow from capital expenditure	(111)	(96)
	<u><u>(111)</u></u>	<u><u>(96)</u></u>
Financing		
Issue of ordinary share capital	84	99
Share capital repurchased	(2,444)	-
	<u>(2,360)</u>	<u>99</u>
Net cash (outflow) / inflow from financing	(2,360)	99
	<u><u>(2,360)</u></u>	<u><u>99</u></u>

19 Analysis of net funds

	At beginning of year £000	Cash flow £000	At end of year £000
Cash at bank and in hand	12,470	(2,189)	10,281
	<u>12,470</u>	<u>(2,189)</u>	<u>10,281</u>
Total	12,470	(2,189)	10,281
	<u><u>12,470</u></u>	<u><u>(2,189)</u></u>	<u><u>10,281</u></u>

20 Commitments

The group had annual commitments under non-cancellable operating leases as follows:

	2005		2004	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
Company and group				
Operating leases which expire:				
In two to five years inclusive	-	5	-	5
Over five years	133	-	133	-
	<u>133</u>	<u>5</u>	<u>133</u>	<u>5</u>
	<u><u>133</u></u>	<u><u>5</u></u>	<u><u>133</u></u>	<u><u>5</u></u>

Notes *(continued)*

21 Financial Instruments

The Group's financial instruments comprise cash and various items (such as trade debtors and trade creditors) that arise directly from its operations. The main purpose of these financial instruments is to finance the Group's operations. The disclosures in this note exclude short term debtors and creditors.

It is, and has been throughout the period 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 interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks. The Group finances its operations through retained profits and cash balances. The policy throughout the period has been that surplus cash balances are placed on short term deposits with major European banks at variable interest rates.