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Pace Micro Technology plc

Annual Report & Accounts :2000

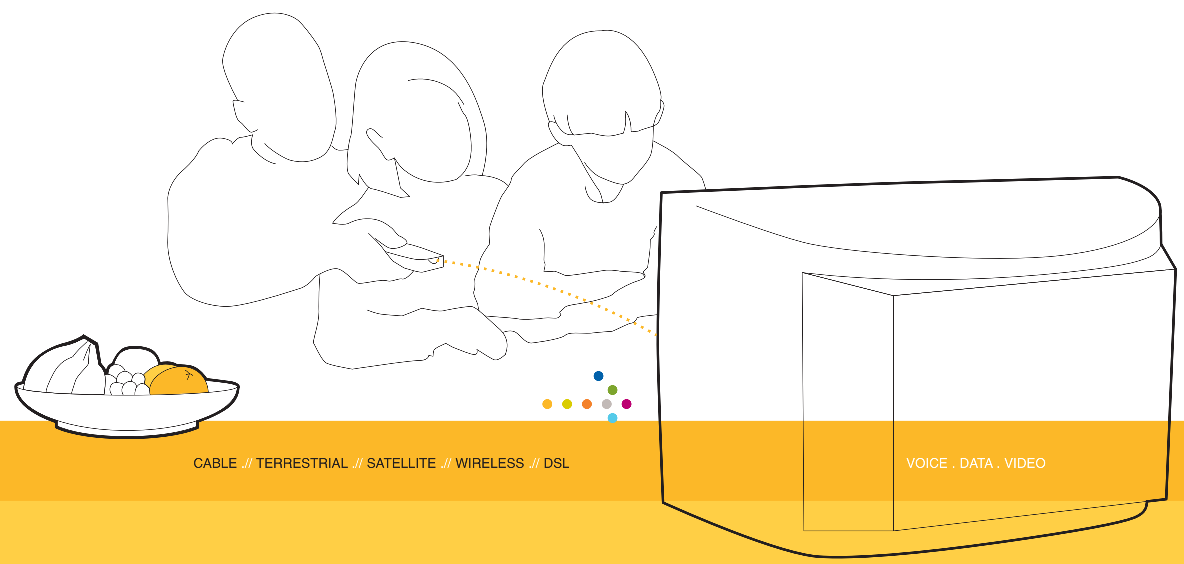
www.pace.co.uk

Enabling the digital revolution .//

The power of digital television to bring e-commerce, email and high-speed internet to the mass consumer market is transforming the way we use television and the services it enables. In this transformation, the set-top box has become the 'home gateway', the focal point for television and interactive communications within the home and with the outside world.

Pace is a leader in this revolution. The Group has been central in creating the market for digital television through its ongoing work with international broadcasters and network operators. It is now pioneering the development of even more sophisticated and powerful home gateways. These home gateways are delivering interactive services such as home shopping, home banking and the internet to new audiences, not limiting the use of online services simply to the computer literate.

The engineering expertise that has made this possible is now focusing on creating the networked home of the 21st century. The home gateway will deliver interactive services not just through the 'traditional' television screen, but will also network them to other screens or handheld devices around the home. This will make interactive two-way data, voice or television communications possible with the outside world from any point within the home.



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Directors, Secretary and Advisers .//

Directors ./
all of Victoria Road, Saltaire, Shipley, West Yorkshire BD18 3LF

Sir Michael Bett	*Non-executive Chairman*
Malcolm Myer Miller	*Chief Executive*
John Howard Dyson	*Finance Director*
Robert Arthur Fleming	*Operations Director*
David Richard Hood	*Non-executive Director*
Marvin Jones	*Non-executive Director*
Robert Ernest Lambourne	*Non-executive Director*
Kurt Peter Risdon	*Materials Director*

Company Secretary ./
Anthony John Dixon

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Highlights .//

- Turnover up 106% to £377.6m (1999: £182.8m).
- Profit before exceptional item and tax up 80% to £27.3m (1999: £15.1m).
- Diluted earnings per share before exceptional item up 88% to 9.0p (1999: 4.8p).
- Total dividend per share 0.90p (1999: 0.75p).
- Net cash £26.4m (1999: £19.8m).
- Engineering resources increase 53% to 394 employees (1999: 258), representing 52% (1999: 44%) of non-manufacturing headcount. This underlines Pace's continuing transformation into a design-led technology company.
- Exceptional growth in UK, 146% increase in sales of digital gateways.
- Two US cable wins - Time Warner and Comcast.
- Acquisition of multi-media terminals division of the Acorn Group and Vegastream Ltd to complement existing technologies.
- Outlook: Pace's strength in digital technology, together with the world-wide accelerating roll-out of gateways to meet the demand for increased digital television and interactive services, gives the Board confidence for continued growth in the coming year.

Chairman's Statement .//

I am pleased to report another successful year for Pace in which turnover, market share and profits increased. Pace was cash positive for the year. Pace demonstrated that it has world-leading development resources and integration technology to enable consumers to participate in the digital revolution through the use of their televisions.

Results and Dividend ./

Profit before tax and exceptional item was £27.3m and after exceptional item was £24.0m (1999: £15.1m before and after exceptional item) on turnover of £377.6m (1999: £182.8m). Diluted earnings per share were 9.0p before exceptional item and 7.9p after exceptional item (1999: 4.8p before and after exceptional item). The exceptional item refers to the funding of Sharesave Scheme options and is described later in my statement.

The Board proposes a final dividend of 0.60p (1999: 0.50p) making a total dividend for the year of 0.90p (1999: 0.75p).

Trading and Financial Review ./

Unit sales of over 2 million Pace digital gateways represented growth of 146% (1999: 30%) over the prior year. The UK market was the fastest growing market in the world for the platforms that are the service providers' gateway to consumers and the consumers' gateway to interactive services and the internet. The cause of the accelerated growth in the UK was the competition between satellite, terrestrial and cable broadcasters to get their gateway into the consumer's home before each other.

Gross margin for the year was 19.7% (1999: 26.5%). The decline in margin, which we signalled at the beginning of the year, was due to two major factors. First, we were determined that Pace would receive the largest share of its home market at a time of strong innovation and growth and second, the rate of decline of component prices was less than anticipated at the time we agreed terms with our customers. In the short term, we do not see that this situation will improve and we anticipate continued tightness in component supply. An important part of our continuing investment in new technology will be to reduce the cost of new and existing products, as we believe that our ability to design product to the lowest cost, faster than our competitors, is an important means of driving future growth and profitability.

The Group continued its prudent approach to providing for royalties relating to the alleged use of the intellectual property of others. During the first half of the year the major outstanding issue was settled and the excess provision was released. There are still a few unresolved matters outstanding; without any admission of liability the Board believes it has fully provided against these claims and the estimated cost of litigation. Having taken legal advice, the Board considers that there are defences available and claims against third parties that may mitigate the amounts being sought. Until further progress is made towards a resolution of the issues, it is considered appropriate to maintain the present basis of provisioning.

Overheads, net of other income, rose to £47.1m (1999: £34.3m). Expenditure on development increased to £22.3m (1999: £11.8m) or 6% of turnover (1999: 6%). Selling, general and other administrative expenses of £24.8m (1999: £22.5m) were rigorously controlled. Keeping the overall level of overheads low gives us a competitive advantage compared to others with higher operating costs. Our development and technology resource is a core competence and a significant proportion of our revenues will be invested there in order to maintain our leadership.

The Group has charged £1.9m in respect of the future cost of paying employer National Insurance Contributions on the estimated gain made by employees on unapproved options granted since April 1999. For each £1 increase in the share price, a further charge of £300,000 will be incurred on such options. With effect from the options to be granted in July 2000, it is intended, legislation permitting, that the employer National Insurance Contributions on such options will be borne by the employees.

Net assets increased to £86.6m (1999: £40.9m). Within net current assets of £56.5m (1999: £41.4m), net cash was £26.4m (1999: £19.8m). The increase in cash was achieved after funding £7.2m for buying 1,842,500 Pace shares in the Market for the Employee Benefits Trust and QUEST (see the exceptional item referred to below). Pace has £70m in existing credit lines that are sufficient for its current needs. The debt collection period improved to 7 weeks (prior year-end: 12 weeks) due to change in the customer profile. The focus on stock levels was maintained such that the stock turnover rate was 17 times at year-end (prior year-end: 14 times).

Exceptional item ./

During November 1999, the Company's QUEST (a qualifying employee share trust) purchased in the Market 1,377,500 ordinary shares of Pace for £3.9m. These shares will be held by the Trust until they are required to satisfy the exercise of options held by Pace employees in the Company's Sharesave Scheme. The difference between the exercise price of the options and the market price on the day the shares were purchased in the Market has been recorded as an exceptional item of £3.3m.

Acquisitions ./

To maintain its speed of technological advance and to satisfy its requirements for new engineers, Pace is actively seeking to acquire small to medium sized companies that demonstrate leadership in those areas that complement our forward thinking. In the last year, two such businesses were purchased; the multi-media terminals division of the Acorn Group and Vegastream Ltd. The Acorn business gave us access to ADSL technology, web browsing technology and wider skills in operating systems. Vegastream gave us access to Voice Over Internet Protocol technology as well as to the business to business telecommunications market. The purchase of Vegastream also gave rise to goodwill of £24.0m of which approximately one-fifth is contingent on the management of Vegastream meeting certain agreed profit performance targets.

Board changes ./

Peter Morgan (Non-executive Chairman) and Tim Curtis (Non-executive Director) resigned during the second half of the year after almost four years service. Our thanks are due to them for all their efforts. Three months ago I became Chairman. I am keenly anticipating the challenges and opportunities facing the Group over the next few years. Marvin Jones, who joined us in June as a Non-executive Director, sets a new dimension for Pace, as he is the first American to join our Board. This appointment says as much as any other action about the determination we have to be successful in the United States.

Outlook ./

The growth and competition within the UK digital television market has provided a significant increase in Pace's business. It has become widely recognised that the UK is ahead of the world in the rate of digital television deployment to consumer households as well as in the scale of interactive services being offered. Pace has been in the forefront of this development and is well positioned to capture increasing business world-wide as the rest of the world catches up. The orders that the Group received from Time Warner Cable and Comcast Cable Communications in the US will provide a base for future growth.

There is no doubt the rollout of the digital gateway into consumers' homes is gaining momentum. The cost of the gateway to the broadcasters and operators is falling and the functionality is increasing. Our strength in technology, together with the relationships we have with existing customers and those that we are developing with new customers, gives the Board confidence for continued growth in the forthcoming year.

Sir Michael Bett
Non-executive Chairman

10 July 2000

Chief Executive's Statement .//

Pace doubled turnover and increased fully diluted earnings per share (before exceptional item) by 88%, in a year that has been highlighted by two key factors.

Firstly, the digital television market is clearly evolving, from one which many observers expected would offer just more channels, into one in which interactive services play an integral part in television's 'digital revolution'.

Secondly, Pace is transforming itself into a technology company to fuel and serve the needs of this revolution.

As broadcasters and cable operators – collectively called network operators – roll out digital television to their subscribers, they are realising that expanding services can enhance value to the consumer and build revenues and profits for themselves. Subscribers are learning how they can alter the way they shop, access the internet and their bank, as well as watch television using sophisticated, but easy-to-use digital set-top boxes or home gateways. In an effort to encourage rapid uptake, consumers are being enticed with free gateways and low cost installation.

Across the world, the rush is on to attract digital subscribers and nowhere is this faster than in Britain, where there is competition across all four carrier platforms – satellite, cable, terrestrial and ADSL telephone lines. This is why, by the end of 2000, we are likely to see more UK homes connected to the outside world by digital television than by a personal computer. As other countries accelerate the switch to digital, they will mirror this trend. The elements that are needed for a society to receive electronic online information in their homes, without access to a PC and whilst not having to be computer literate, are beginning to take shape.

Pace has positioned itself in the digital television value chain as a supplier of interactive terminals for the home, regardless of carrier, operating system or network operator. In this way we maintain an open approach to the standards that proliferate and are in a position to build a greater variety of platforms than our competition.

As a supplier of home-interactive terminals, Pace is achieving first mover advantage in new technology solutions and can see beyond single point use. With information based around television, data and voice flowing through large and fast electronic 'pipes' into and out of the home, there will be greater competition for the main television screen. Whilst watching television, it will be distracting if other household members are sending and receiving emails at the same time. When shopping on-screen, it will be impossible to play games simultaneously. Unless there is a strict regime for using each and every service, the television will become a competitive point between various uses and family users.

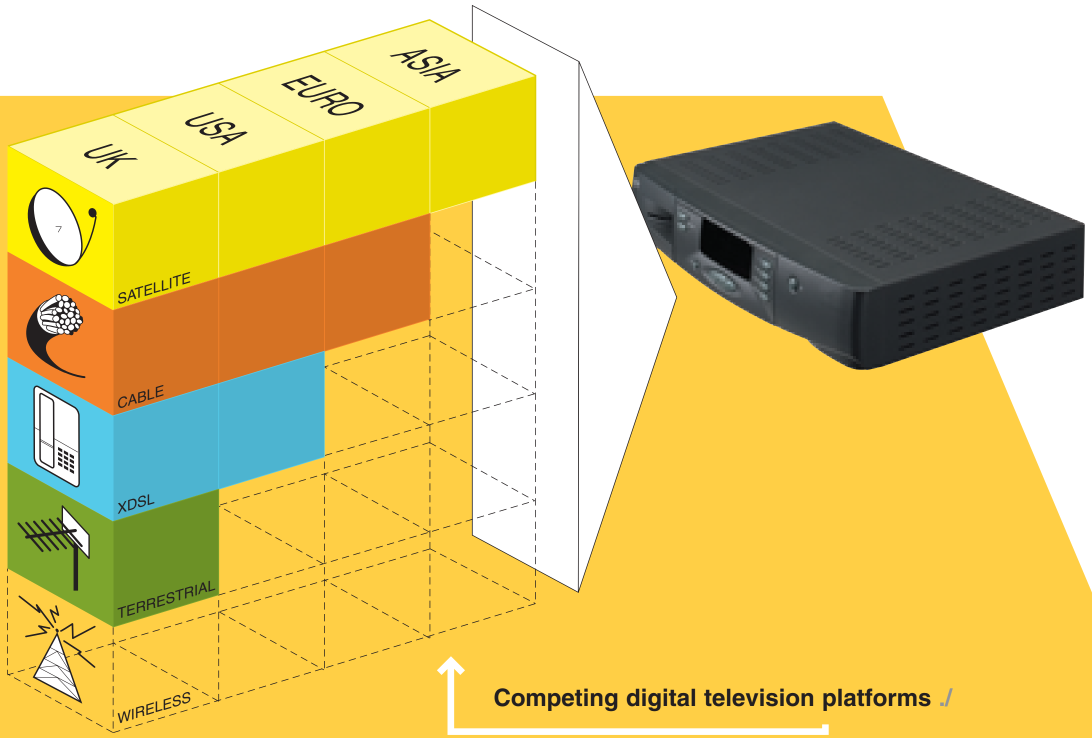
The answer lies in the networked home, where appliances connect through a home gateway. Pace is making important strides in conceiving and designing the home gateway that can connect to multiple screens and appliances around the home.

Markets ./

It is expected that a total of 20 million digital gateways will be installed around the world in 2000. By 2005 annual installations are forecast to expand to between 70 and 80 million. Whilst a few years ago the Group was shipping 75% of its products overseas, during the past year, Pace has concentrated on the fastest growing geographic market, the UK. Significant wins with all six UK operators (BSkyB, CWC, Kingston Communications, NTL, ONdigital and Telewest) have resulted in 92% (1999: 65%) of our business last year coming from within the UK.

The UK digital television industry also benefited from the Government's decision to drop the proposed additional licence fee aimed solely at digital television subscribers, in favour of a general fee increase. Pace was an active campaigner in the run up to this decision and believes it removes an important hurdle to bringing forward the date for analogue switch-off.

Elsewhere, Pace made shipments to CANAL+ in France, Poland and Italy; Sky Latin America in Brazil and Colombia; and to customers in New Zealand and Israel.



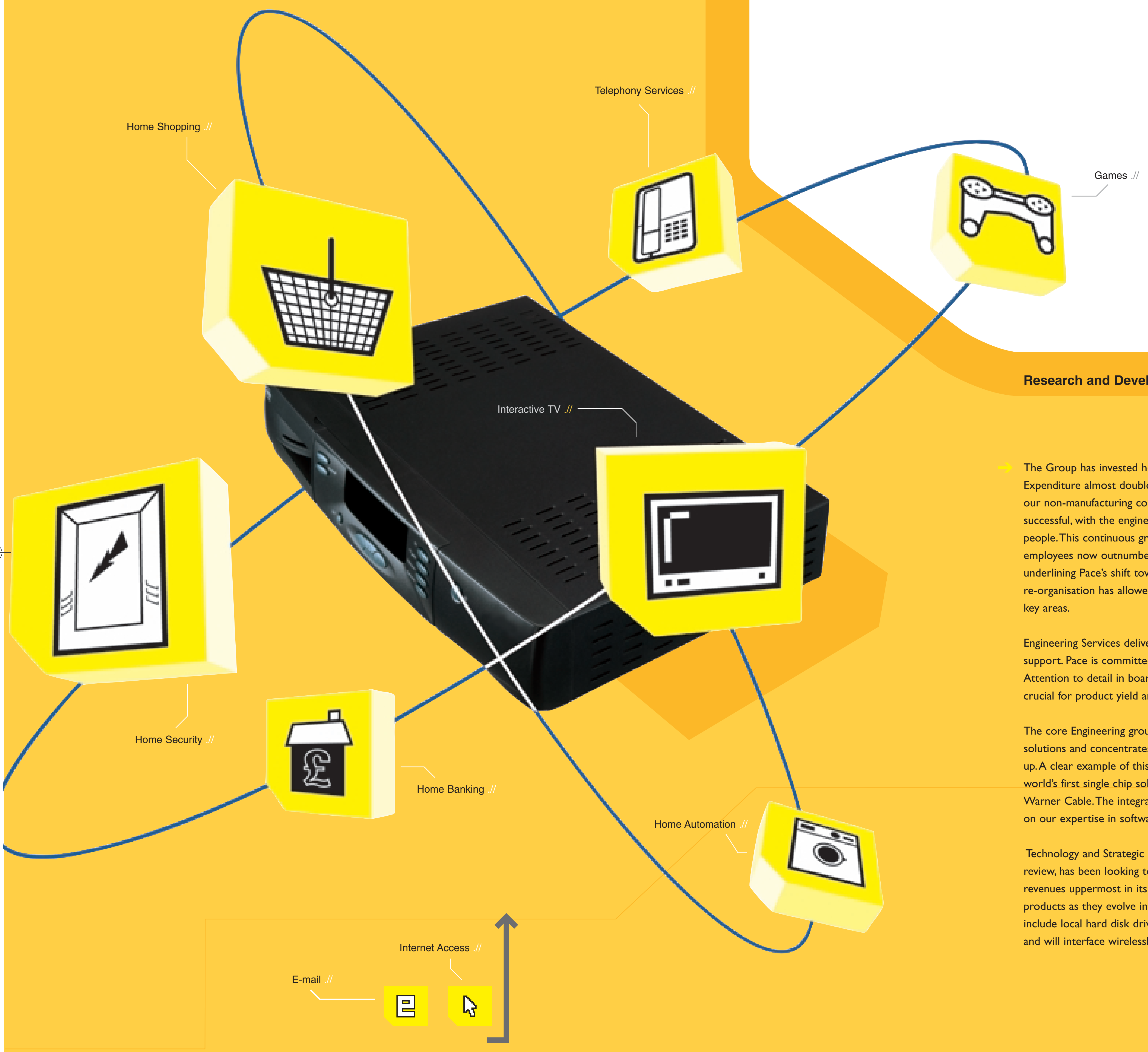
Competing digital television platforms ./

MORE PLATFORMS = MORE COMPETITION = MORE INNOVATION

Next year, the Group expects the share of overseas business to grow as shipments to the US commence and European broadcasters compete more actively. In the US, Pace has the unique position of holding licences from the two major suppliers to the market that allow it to develop digital gateways suitable for almost all of the country's digital cable networks. Time Warner Cable has awarded Pace a contract for a minimum of 750,000 gateways spread over three years. Comcast Cable Communications has awarded a contract for an initial order of 350,000 gateways.

Throughout the world there is continued interest from established and new network operators in launching digital television. Pace plays an active role in bidding for launch business and expects to make further progress throughout the coming year.

The past year also saw the launch of Pace-powered internet TV and standalone internet boxes. The Group delivered web-browsing technology to Bush Radio, a division of Alba plc, under a pan-European licensing arrangement. This contract, announced in March 2000, came out of the acquisition in June 1999 of Acorn's multi-media terminals business and was the achievement of Pace's successful integration of the 40 strong Cambridge engineering team. The team continues to provide this technology through its Information Appliance Division as well as advanced digital television technology for ADSL and cable customers.



Research and Development //

The Group has invested heavily in Research and Development. Expenditure almost doubled in the past year and represents half of our non-manufacturing costs. Recruitment campaigns have been successful, with the engineering team growing from 258 to 394 people. This continuous growth in resource means that Engineering employees now outnumber all other non-manufacturing staff, underlining Pace's shift towards a technology focus. Internal re-organisation has allowed us to create three divisions to focus on key areas.

Engineering Services deliver Computer Aided Design, test, quality and support. Pace is committed to launch on time and 'right first time'. Attention to detail in board layout, design verification and trials is crucial for product yield and reliability.

The core Engineering group designs and integrates new technology solutions and concentrates on driving costs down and functionality up. A clear example of this leadership is our integration of the world's first single chip solution in a digital cable gateway for Time Warner Cable. The integration of such complex designs relies heavily on our expertise in software authoring and development.

Technology and Strategic Development, which I mentioned in my last review, has been looking to the future, with network services and revenues uppermost in its mind. This team is defining the roadmap of products as they evolve into home gateways. These gateways will include local hard disk drive storage and games console functionality and will interface wirelessly with appliances around the home.

An important function of tomorrow's home gateways will be the ability to handle moving pictures, data and voice simultaneously over the same transmission medium. Voice will be carried over closed networks and the internet using standards and protocols that are being established today. Pace believes that this is a key technology, so we acquired during the year a specialist company, Vegastream, with skills and experience in this sector. Vegastream, based in Bracknell, Berkshire, designs gateways for offices that allow voice to be sent in packets over data networks, rather than in continuous form over dedicated circuit switched telephony networks. The technology that is employed for businesses will be adopted for use in homes and future Pace home gateways will incorporate its functionality.

Intellectual Property ./

Pace engineers have filed 105 patent applications relevant to digital television. This was a result of a successful and continuing scheme that encourages and rewards innovation. It is hoped that patents resulting from these applications will eventually become important financially, not only as a potential source of revenue, but as a defence against companies alleging the unauthorised use of their intellectual property.

Alliances and Partnerships ./

The Group works with many others who can best be described as partners. With their continued assistance, Pace aims to be the first provider to launch new solutions for network operators, offering greater functionality and enhanced value in ever increasing volumes. The Group again achieved pole position as Europe's largest manufacturer of digital set-top boxes.

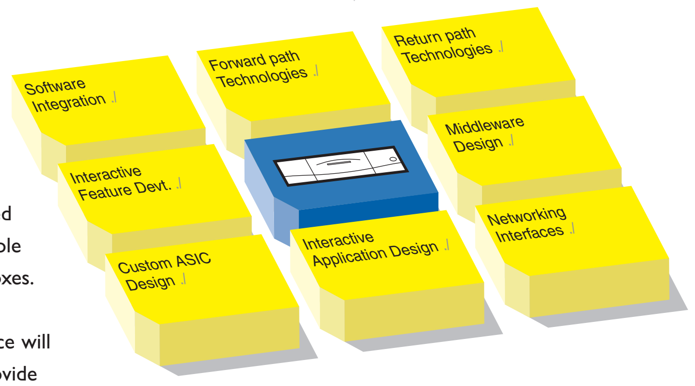
To continue the improvement in our world-wide standing, Pace will rely quite heavily on its partners, some of whom will help provide innovative software solutions whilst others will deliver leading edge components.

Earlier in the year, Pace announced its partnership with NDS to develop and promote an embedded digital hard disk drive solution for operators. This product brings personal 'video' recording through intelligent agents that record favourite programmes and enable targeted advertising. This will provide network operators with enhanced content, change the TV viewing experience for consumers and create new opportunities for advertisers.

The Group was also invited by Cisco Systems to join a consortium to develop and integrate wireless point-to-point technology for home gateways. This technology further enhances home coverage for the delivery of broadband services, ensuring their widest possible availability and is an example of the value Pace can bring to its worldwide partners. In this case, the benefit is likely to be eighteen months into the future, which is a demonstration of how far ahead one has to look in order to stay at the forefront of this industry.

Partnership is vital in continuing our open approach to technology standards and platforms. Nowhere is this more important than in the development of interactive television services. Pace has well established relationships with all the key players including CANAL+ Technologies, OpenTV and Liberate and has this year announced new relationships with Microsoft and PowerTV.

Core technical expertise ./



Like other world class companies, we are relying on resources that are in high demand and in relatively short supply. Our partners are generally constrained by time, people and capital in achieving everything that the electronics industry requires. The industry is currently enjoying a surge in demand for mobile phones, digital cameras, hard disk drives and digital gateways. This is why, throughout the past year, supplies of some components have been constrained.

Pace has continued to develop effective relationships with major silicon vendors. Working closely with industry leaders such as Broadcom for cable and ST Microelectronics for satellite and terrestrial products, has ensured early access to the latest technology. Whilst strong partnerships will help for the future, lead times have stretched beyond normal time frames. The Group expects that the efforts of our partners to build new plants and acquire more people will assist, but it will take most of the coming year for the situation to improve.

Financial Review ./

The past year was one of rapid turnover expansion that Pace was able to finance from internal resources.

Intangible fixed assets of £23.7m represents the goodwill incurred on the purchase of Voice Over Internet Protocol specialist, Vegastream. Of the total goodwill, £20m was incurred on completion of the purchase in March 2000; the balance will become payable if margin targets are reached. In the event of exceptional margin performance the goodwill could amount to a maximum of £40m.

Investments increased £5.1m to £11.0m, representing investments in the Company's employee share trusts, QUEST and ESOP, which have purchased a total of 9,473,866 (1999: 6,356,804) of the Company's shares. These shares will be used to satisfy the present needs of the Sharesave Scheme and to partially satisfy the needs of the discretionary share options that have been granted. The investments will be recovered as the options are exercised.

Net tangible fixed assets grew £3.4m to £13.7m. The investment in fixed assets is concentrated in providing tools to Research and Development engineers, together with maintaining up-to-date equipment in the assembly plant in Saltaire, Yorkshire. The level of investment in manufacturing is lower than might be expected, as we have not increased the capacity of own assembly, preferring to make more use of world-wide sub-contractors.

Stocks increased by £11.4m to £20.8m. In terms of stock turnover rates, this represented less than one month's cost of sales on hand at the year-end. This level of control is necessary in a fast moving environment, even though we have suffered from many 'lines-down' situations in the last year as a result of extreme tightness in the component supply chain.

Debtors rose 37% to £68.3m, less than the underlying growth in the business. This was mainly due to a change in customer mix during the year. To offset the impact on Pace that would result if one of our major customers were to fail, the Company maintains a credit insurance programme over its customer portfolio.

Cash increased £6.6m to £26.4m. This represents a significant success in the light of the doubling of turnover together with the expenditure of £7.2m in connection with the purchase in the Market of Pace shares for the Company's employee share trusts. The Company has unsecured banking facilities amounting to £20m for the next year, along with a revolving facility of £50m based on insured trade debtors.

Creditors grew less fast than revenues partly as the new regime for paying corporation taxes on account came into force during the period. The tax charge is based on a 30% rate in the UK, but is reduced to an effective rate of 27% following the funding of the QUEST.

An amount of £1.9m has been accrued for the additional cost of paying employer National Insurance Contributions on the potential gain made by holders of unapproved options granted since April 1999 (in July 1999 and January 2000). We have provided on the basis of the closing share price at the end of the financial year. Option grants that are made subsequent to June 2000 will be likely to reflect the latest drafting of the tax legislation, whereby these additional employer National Insurance Contributions will become the liability of the employees who are exercising the options.

Provisions grew by £1.8m to £18.4m as reserves for warranty and disputed royalty claims were increased in line with the growth in the business. The increase in the royalty provision was tempered by the reversal of a prior-year reserve following settlement of the largest outstanding claim during the first half of the year.

Foreign exchange issues were driven by the significant and ongoing short position in US Dollars and Euros caused by growth in UK turnover. This trend is expected to reduce over the coming two years to the point where Pace can get back to being in approximate currency balance. In the meantime, we will continue a policy of hedging a proportion of the exposure over a rolling six-month view. During the year, Sterling was strong against the US Dollar, only weakening towards the end of the financial year. Sterling weakness increases the cost of US Dollar denominated components. To the extent that Sterling continues to weaken and we are not able to pass on uncovered exposure to our customers, Pace will be under future margin pressure until we can engineer further reductions in the cost of the gateway.

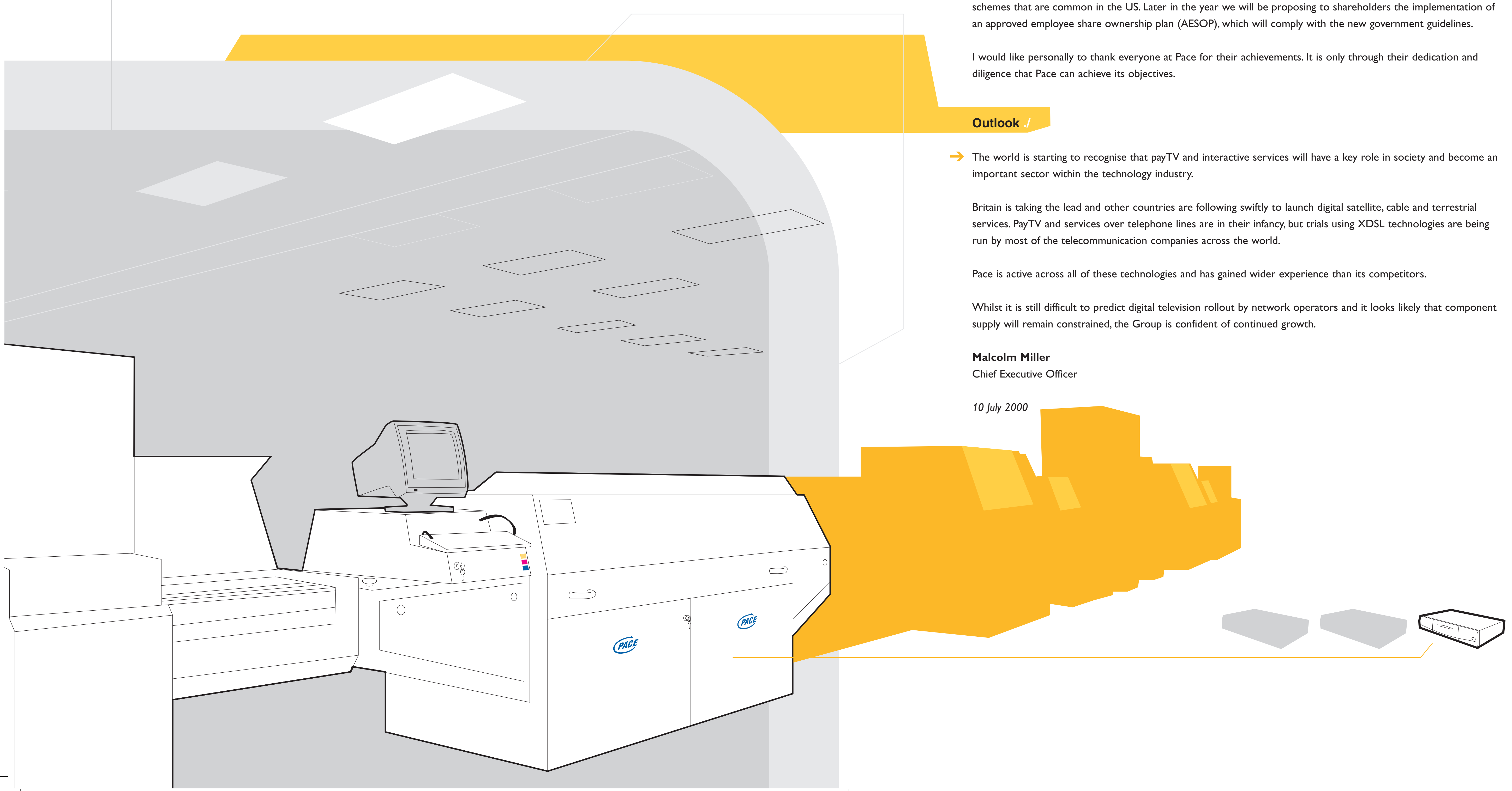
Business systems are in the process of being significantly upgraded, with a new integrated system having gone live in June 2000. This will enable us in the future to manage our worldwide business without the need to greatly increase administrative staff. In addition, we have invested heavily in IT systems to improve the productivity of engineers and their interfaces with the manufacturing and testing processes.

Manufacturing ./

The Group successfully doubled production volumes over the past year using its Yorkshire-based manufacturing facility and subcontractors located throughout the world. The task was managed by a cross-functional team, which ensured we were able to bring together components, facilities and test equipment at the right time and place, despite a very difficult procurement environment.

Whilst the plant at Saltaire can produce up to one million boxes a year, representing approximately half last year's volume, it is expected that future increases in capacity will come from external sources.

In common with the rest of the electronics industry, we are continually working to improve the quality of our products. We set goals for each product and ensure that the field failures are analysed to eliminate their root causes.



People ./

The Group ended the year with just over 1,200 people. This represents an increase of approximately 150 people, most of whom are based in Research and Development in Saltaire, Cambridge, our new offices in Bracknell and Boca Raton, Florida. During the coming year, we are aiming to recruit at least 200 engineers, based in these locations.

To achieve its mission to be the world's leading company in digital platforms for networks that carry data, voice and video, the Group must enhance the skills of its employees and continue to recruit. Pace has a committed strategy for the people it employs which covers training, improving communication, and matching rewards to performance and recruitment. Already, 650 employees are members of the Company Sharesave Scheme and over 400 employees have discretionary share options. To make sure that we can continue to attract and retain the engineers who design our products, we will hold an Extraordinary General Meeting to approve a share option scheme that is more like schemes that are common in the US. Later in the year we will be proposing to shareholders the implementation of an approved employee share ownership plan (AESOP), which will comply with the new government guidelines.

I would like personally to thank everyone at Pace for their achievements. It is only through their dedication and diligence that Pace can achieve its objectives.

Outlook ./

The world is starting to recognise that payTV and interactive services will have a key role in society and become an important sector within the technology industry.

Britain is taking the lead and other countries are following swiftly to launch digital satellite, cable and terrestrial services. PayTV and services over telephone lines are in their infancy, but trials using XDSL technologies are being run by most of the telecommunication companies across the world.

Pace is active across all of these technologies and has gained wider experience than its competitors.

Whilst it is still difficult to predict digital television rollout by network operators and it looks likely that component supply will remain constrained, the Group is confident of continued growth.

Malcolm Miller
Chief Executive Officer

10 July 2000

Product Review .//

Pace Micro Technology is the world's largest dedicated developer of digital set-top box or 'home gateway' technology. The Company is actively involved in all digital platforms – satellite, terrestrial, cable, wireless and DSL – through alliances with broadcasters, network operators and technology partners throughout the world. The main elements of Pace's current product range are described below.

Satellite Home Gateways ./

Pace's digital roots are in satellite set-top boxes which, like all Pace products, are evolving into home gateways and this year included:

BSkyB 'Digibox' for SkyDigital: This is the highest specification home gateway Pace has delivered to a News Corporation operator. It currently uses a 35Mips (millions of instructions per second) processor, with a 256 colour on-screen display, seven-day electronic programme guide, teletext, bank card reader, and 12Mbytes of memory. This home gateway runs NDS conditional access and supports email and numerous other interactive applications including games, home shopping and banking services.

CANAL+ 'Black Box': This cost-effective home gateway is built for European broadcaster CANAL+ and its subsidiaries in France, Italy and Poland. It packs digital television into a home gateway with a processor running at 30Mips and includes a bank card reader, a telephone modem for interactive services and some games capability. The gateway operates using the CANAL+ Technologies conditional access and interactive systems.

News Corporation 'World Box': This platform is used by News Corporation affiliates worldwide and has been delivered this year to Sky New Zealand and across Latin America. It has a 30Mips processor and typically carries a total of 6Mbytes of memory for applications. The user interface is capable of 16 colours and the gateway has several interfaces for connecting to telephones, computers and other devices. The gateway's conditional access and programming environment are both provided by NDS.

Digital Terrestrial Home Gateways

Pace was one of the first to launch digital terrestrial home gateways. This product is supplied to ONdigital and has a 256 colour on-screen display, single card reader and supports teletext, email and other interactive services. It uses a 30Mips processor, has 14Mbytes of memory, and runs the CANAL+ conditional access and programming environment.

Cable Home Gateways ./

Pace delivered cable home gateways to Cable & Wireless Communications, NTL and Telewest during the year. Powerful devices with 80Mips processors, 24Mbytes of memory and a high-speed cable modem, they enable data downloads from the network to the home gateway at speeds of up to 38Mbytes per second. This data can be used for web-surfing and a variety of interactive applications. The product uses NagraVision conditional access and Liberate or PowerTV programming environments. Cable home gateways also have the option of an ethernet port, enabling connection to computers and other peripherals.

BskyB Digibox .//

DSL4000 Interactive Digital Receiver .//

Telewest .//

Shopping Mate .//

Asynchronous Digital Subscriber Line (ADSL) Home Gateways

Pace has shipped ADSL home gateways to numerous customers including Kingston Communications in the UK. This home gateway provides digital television, interactive services and web-surfing over standard copper telephone lines.

Integrated Digital Television

As a result of Pace's digital television integration programme in 1998 and 1999, it developed modules for integrated satellite and terrestrial digital television. LG Electronics of Korea purchased this technology to create the world's first SkyDigital integrated digital television.

Internet on Television

Pace has developed web-browsing technology for television that can be built as a set-top box or integrated into a television. This technology allows the user to transfer between television and the internet at the press of a button. Pace has licensed this technology to Alba plc.

Voice over Internet Protocol

Pace's new Vegastream subsidiary specialises in Voice Over Internet Protocol (VoIP) telephony. Vegastream use their VoIP technology to create gateways that link traditional circuit switched telephony networks and new VoIP networks. IP is a communication standard by which any combination of voice, data and video can be integrated into a single data stream and delivered over data networks.

Future Products

Pace is pioneering digital technology for the home and is now evolving its home gateways into higher powered terminals that will enable networked homes. In these homes, the set-top box is the home gateway for interactive communication, enabling consumer devices and services to interact with each other and the outside world. These home gateways involve higher speed processors, better value, better graphics, and innovations such as integrated hard disk drives.

A set of products has now been defined to establish the networked home. We expect to demonstrate in the next year:

Home Gateway with Integrated Hard Disk Drive

Pace engineers have integrated hard disk or mass storage technology into the home gateway, enabling viewers to pause and record live programmes. The programming is stored in a digital format on the hard disk drive, which ensures that replayed programming is of the same broadcast quality as the original, not usually experienced on traditional video recorders.

Shopping Mate

This concept is a handheld home shopping device, linked wirelessly to the home gateway. It enables consumers to connect with retailers and order goods, using the home gateway, without interrupting 'main screen' television viewing.

PC Connect and TV Connect

These devices provide wireless links to the home gateway for the PC and television. This link then enables high-speed access to broadband communications networks that deliver high-speed internet and data services to both terminals.

Glossary of terms ./

Conditional access: *An encryption/decryption process, which controls access to the broadcaster's services and ensures secure purchase transactions for interactive services. Access is usually enabled by a 'Smart Card', activated by the broadcaster once a subscription is paid.*

Programming environment: *Often known as the API (Application Programme Interface), this is the software that enables the broadcaster to create their own unique service. For example, it allows software developers to write interactive television software that can be used in the home gateway.*

Report of the Directors .//

The directors present their report to shareholders together with the audited financial statements for the year ended 3 June 2000.

Principal activities

The Group's principal activities are the development, manufacture and distribution of digital receivers and receiver decoders which provide a gateway for the reception of digital television and the reception/transmission of interactive services, Voice Over Internet Protocol and high speed data. Each of these services may be delivered over satellite, cable, terrestrial and DSL transmission systems.

Business review and financial results

A review of the Group's activities, developments and the financial results for the year are presented in the Chairman's Statement and Chief Executive's Statement on pages 4 to 15. The consolidated profit and loss account for the year ended 3 June 2000 is set out on page 30. Profit before tax and exceptional item was £27.3 million and after exceptional item was £24.0 million (1999 before and after exceptional item: £15.1 million).

The directors recommend the payment of a final dividend of 0.60p per share (1999: 0.50p) to be paid on 23 October 2000 to shareholders on the register at the close of business on 15 September 2000. An interim dividend of 0.30p per share (1999: 0.25p) was paid on 7 April 2000. The total dividend for the year will amount to 0.90p per share (1999: 0.75p).

Share capital

Changes in the Company's share capital during the year ended 3 June 2000 are set out in note 22 to the financial statements.

Significant shareholdings

The Company has been notified of the following significant shareholdings as at 10 July 2000:

	Number of shares	% of issued share capital
David Hood and related family trusts	55,457,769	25.2
Robert Fleming and related family trusts	11,027,776	5.0
Pace Micro Technology Employee Benefits Trust	6,821,804	3.1

Report of the Directors .// continued

Directors

The names of the current directors of the Company are shown below. Other than as described, all those listed held office throughout the year.

Sir Michael Bett, CBE
Sir Michael, aged 65, joined the Board in February 2000 and was appointed Chairman on 31 March 2000. He is also Chairman of Just2clicks.com plc, acting Chairman of Compel Group plc, and Non-executive Director of Eyretel plc. He was previously Deputy Chairman of British Telecommunications plc and Chairman of Cellnet Group Ltd. He has held a number of offices in addition to his community and industry experience, and is currently Pro-Chancellor of Aston University. From 1995 to 2000 he was First Commissioner for the Civil Service.

Malcolm Miller
Malcolm, aged 44, was appointed as Chief Executive in November 1997. Previously, he was European Chief Executive Officer of Sega Europe Ltd and prior to that Marketing Director and then Managing Director of Amstrad plc.

John Dyson
John, aged 52, was appointed Finance Director in November 1997. He is also a Non-executive Director of IFX Power plc. Prior to his employment at the Company he was Vice President of Finance, Europe for LSI Logic Corporation. Other previous appointments included positions as Finance Director of CASE Group Plc and Norbain Plc.

Robert Fleming
Robert, aged 43, joined the Company in 1982 and became Operations Director in 1984, with responsibility for production and distribution. With effect from February 1999 he assumed responsibility for the Engineering function within the Group.

David Hood, OBE
David, aged 52, founded Pace in 1982. He was Joint Chief Executive until November 1997 when he became Advanced Technology Director. In September 1998 David became a Non-executive Director.

Marvin Jones
Marvin, aged 62, is a US citizen and was appointed a Non-executive Director on 5 June 2000. He is Chief Executive Officer of The National Cable Television Center and Museum, Denver, USA. Previously, he was an Executive Vice President of AT&T Broadband and Internet Services and President and Chief Executive Officer of TCI Communications, Inc.

Robert Lambourne
Bob, aged 48, was appointed as a Non-executive Director in June 1996 and in February 2000 was appointed Senior Independent Director. He is also Finance Director of RMC Group plc and a director of Huttig Building Products, Inc. Previously, he was an executive director of Hepworth PLC and prior to that he was Finance Director of Foseco plc.

Kurt Risdon
Kurt, aged 54, joined Pace in 1991 as Materials and Purchasing Manager and was appointed as Materials Director in March 1996. In October 1999 Kurt assumed overall responsibility for Purchasing, Materials, Manufacturing and Distribution.

During the year the following persons also held office as directors:
Timothy Curtis resigned 11 February 2000 **Peter Morgan** resigned 31 March 2000

Malcolm Miller and John Dyson will retire by rotation at the Annual General Meeting, and each being eligible, will offer themselves for re-election. Sir Michael Bett and Marvin Jones, having been appointed by the Board subsequent to the date of the last AGM, will hold office until the forthcoming Annual General Meeting and will then offer themselves for election by that meeting.

Details of the executive directors' service contracts including those of Malcolm Miller and John Dyson are disclosed on page 24 of this Report. Sir Michael Bett and Marvin Jones, being Non-executive Directors, do not have service contracts.

Directors' interests in contracts

There were no significant contracts during or at the end of the year with any member of the Group in which any director is or was materially interested other than service contracts and the items referred to in note 34 to the financial statements.

Report of the Directors .// continued

Employment policies
The directors recognise the importance of the Group's employees to its success and future development and are committed to providing an environment that will attract, motivate and reward high quality employees. The Group continues to invest in training and development and has strong links with local colleges for courses leading to NVQ, BTEC and City & Guilds qualifications, as well as undertaking development in-house.

Employees are kept informed of matters affecting them as employees and the factors affecting the performance of the Group through employee meetings/briefings and a Company newsletter, "Pacesetter". Meetings of the Employee Consultation Work Group, an elected forum for the discussion of work related issues, are held with members of the Executive Team at least six times per year.

The Group welcomes applications for employment from all sectors of the community and is striving to promote equality of opportunity in employment regardless of sex, disability or ethnic origin. It is the Group's policy that training, career development and promotion opportunities should be available to all employees.

Payment to suppliers
It is the policy of the Group to agree terms and conditions for its business transactions with suppliers. Payment is made in accordance with those terms, subject to the other terms and conditions being met by the supplier. The Group does not follow any code or standard on payment practice. Creditor days at the end of the year for the Group and Company were 40 days (1999: 39 days).

Year 2000
The Group evaluated most of its products and computer-based systems and facilities (and those of critical suppliers and other third parties with whom the Group conducts business) to determine whether they were Year 2000 compliant. No significant issues were noted. The costs incurred were not material to the financial results of the Group.

Research and development
The directors regard it as fundamental to the future success of the Group to engage in a substantial ongoing programme of research and development of new products spending £22.3 million (1999: £11.8 million) during the year.

Donations
The Group has established a Charitable Donations Committee comprised of 7 employees under the chairmanship of Rob Fleming. This Committee considers all requests for charitable assistance within a financial budget and criteria approved by the Board annually. Further details of the charitable donations made and criteria for award adopted by the Charitable Donations Committee can be obtained from the Company Secretary.

During the year the Group donated £27,233 (1999: £16,561) to charitable causes. No political donations were made.

Single European Currency
The Group has significant activities in Europe and predominantly transacts in the customer's local currency. The Group's systems have been adapted to meet the demands of trading with entities based in countries adopting a single European currency. The costs incurred were not material to the financial results of the Group. All related costs have been expensed as incurred in accordance with generally accepted accounting practice.

Environmental Policy
The Board has adopted an Environmental Policy Statement regarding the activities and working environment of the Group. A copy of the Environmental Policy Statement can be obtained from the Company Secretary.

Auditors
KPMG Audit Plc held office as auditors during the year. A resolution for the re-appointment of KPMG Audit Plc will be proposed at the forthcoming Annual General Meeting.

Annual General Meeting
The Annual General Meeting of the Company will be held on 6 September 2000 at The Marriott Hotel, 4 Trevelyan Square, Boar Lane, Leeds LS1 6ET. Full details of the business to be transacted at the meeting will be set out in the Notice of Annual General Meeting.

Corporate Governance .//

The Combined Code establishes fourteen Principles of Good Governance, which are split into four areas described below: Directors; Directors' Remuneration; Accountability and Audit; and Relations with Shareholders. This statement comprises a narrative on how the Company has applied the Principles.

The Company has adopted the transitional approach for the Combined Code set out in the letter from the UK Listing Authority to listed companies at the end of September 1999.

The directors believe that the Company has complied throughout the year with Section 1 of the Combined Code. The Board confirms that it has established the procedures necessary to implement the guidance "Internal Control: Guidance for Directors on the Combined Code".

Directors
The Group is controlled through the Board of Directors which comprises four executive and four independent non-executive directors who bring a wide range of skills and experience to the Board. Biographical details of all directors are to be found on page 19. The Chairman, Sir Michael Bett, is mainly responsible for the running of the Board and ensuring that directors receive sufficient relevant information on financial, business and corporate issues prior to meetings. The responsibilities of the Chief Executive, Malcolm Miller, focus on running the Group's business and implementing Group strategy. The Chief Executive is assisted in managing the business on a day-to-day basis by the Executive Team as further described below. All the non-executive directors are independent of management and make a significant contribution to the functioning of the Board, thereby helping to ensure that no one individual or group dominates the Board's decision making process. In addition, the Board has appointed Bob Lambourne as the Senior Independent Director. All directors are able to take independent professional advice at the Company's expense in the furtherance of their duties, if necessary.

The Board has a formal schedule of matters specifically reserved to it and normally meets monthly. It is responsible for overall Group strategy, acquisition and divestment policy, approval of major capital expenditure projects and consideration of significant financing matters. It reviews the strategic direction of the Group and conducts formal strategy reviews together with other senior executives within the Group twice a year.

All directors, in accordance with the Combined Code, will submit themselves for re-election at least once every three years.

The Board has established the following committees, each of which has written terms of reference, which specify its authority and duties:

- The Audit Committee is comprised of three non-executive directors, Sir Michael Bett, David Hood and Bob Lambourne (Chairman). The Committee receives and reviews reports from management and from the auditors relating to the interim and annual accounts and the control systems in use throughout the Group. The Committee met four times during the year. Meetings are held by the Committee with the auditors without executive management being present at least once a year.

- The Executive Committee is chaired by Malcolm Miller as Chief Executive. The Committee meets monthly and ensures that the strategy, plans and policies previously agreed by the Board are implemented. The Committee comprises all of the executive directors and is attended on a regular basis by the following senior executives who, together with the executive directors, comprise the Executive Team:

Paul Ashmore	Director of Sales
Anthony Dixon	Director of Legal Services
Timothy Fern	Director of Engineering
Maggie Pedder	Director of Personnel
Andrew Trott	Director of Technology and Strategic Development
Andrew Wallace	Director of Marketing

- The Remuneration Committee is comprised of non-executive directors David Hood, Marvin Jones and Bob Lambourne and is chaired by Sir Michael Bett. The Committee is responsible for setting the remuneration of the executive directors and other members of the Executive Team, including making recommendations regarding the grant of share options. The members of the Committee have no personal interest, other than as shareholders, in the matters to be decided, no potential conflicts of interest arising from cross-directorships and no day-to-day involvement in the running of the business. The Committee met four times during the year.

- The Nominations Committee is comprised of David Hood, Marvin Jones and Bob Lambourne, together with Malcolm Miller and is chaired by Sir Michael Bett. Its purpose is to consider and make recommendations to the Board regarding the appointment of new directors.

Corporate Governance .// continued

Directors' remuneration

The Remuneration Committee reviews the performance of the executive directors and other members of the Executive Team as a prelude to recommending their annual remuneration, bonus awards and award of share options to the Board for final determination. The final determinations are made by the Board as a whole but no director plays a part in any discussions concerning his own remuneration.

The Remuneration Report of the Board to Shareholders is set out on pages 24 to 27 and includes the remuneration policy of the Group and details of directors' incentive payments and the related performance criteria.

Accountability and audit

Operational and financial reporting

A detailed review of the performance of the Group's business is contained in the Chief Executive's Statement. This statement, together with the Chairman's Statement and the Report of Directors, is intended to present a balanced assessment of the Group's position and prospects. The directors' responsibility for the financial statements is described on page 28.

Internal financial controls

Overall responsibility for the Group's system of internal financial control rests with the Board of Directors. The Board has delegated certain of its powers to the Audit Committee to review the effectiveness of the systems of control and to receive reports from auditors and management as appropriate.

During the year and up to the date of this report, the Board carried out a review of the effectiveness of the Group's internal financial controls. The reviews were undertaken in accordance with the Joint Working Group's guidance under the following five headings and were aimed at clearly identifying the systems already in place and the action plans necessary to improve areas of control weakness.

- **The control environment**
  Subject to those powers and limits of authority reserved by the Board, and to the Group policies and guidelines they have established, the conduct of the business of the Group is delegated within a clearly defined organisational structure and approved level of authority. The Board has also adopted a code of ethics, which has been incorporated in the Employee Handbook issued to all members of staff to emphasise the directors' commitment to upholding the highest standards of integrity and personal conduct in all matters concerning the Group.

- **Risk assessment**
  The directors and senior managers are responsible for identifying and monitoring sources of potential business risk and financial risk and for taking such preventative and protective actions, as they consider necessary to manage effectively such risks. During the year the internal audit function of the Group has conducted a risk assessment review of the Group's business in conjunction with the Executive Team. The Board has received and considered this review as part of an annual risk and control assessment.

- **Financial control and information systems**
  The Group's strategic direction is reviewed regularly by the Board and plans, budgets and performance targets are reviewed and approved at least annually. Directors receive monthly summaries of financial results which compare actual performance with targets, together with detailed management reports which identify the reasons for variances and the progress achieved. Forecasts are revised on a regular basis in line with actual and expected performance.

- **Control procedures**
  Financial control procedures have been developed for all of the main business functions and have been documented in a procedures manual. Authorisation limits for purchases and capital expenditure are clearly specified and procedures are in place for minimising exposure to weaknesses in the receipt, handling and despatch of goods.

Corporate Governance .// continued

- **Monitoring systems**
  Monitoring of the internal control systems is carried out by internal audit staff on a continual basis.

  Although no system of internal financial control can provide absolute assurance against material misstatement or loss, the Group's systems are designed to provide the directors with reasonable assurance that transactions are authorised and completely and accurately recorded, that assets are safeguarded and that material errors, irregularities and actions contrary to Group policies and directions are either prevented or promptly discovered.

- **Going concern**
  The directors, having taken account of the Group's net cash resources and bank facilities and having reviewed the Group's budget and forecasts for the year to 2 June 2001, consider that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Relations with shareholders

The Board has made considerable efforts to establish relationships with institutional shareholders through presentations being made at least twice a year in order to communicate the Group's objectives. The Board is also keen to communicate with private investors both in correspondence with the Company Secretary and through the Group's web site (www.pace.co.uk). Shareholders are encouraged to participate at the Annual General Meeting on 6 September 2000 at which the Board will be introduced and will be available for questions.

Remuneration Report .//

Remuneration of executive directors

The policy of the Group is to ensure that remuneration packages are competitive and designed to attract, retain and motivate executive directors and senior executives of a high calibre and to reward them for performance. The policy seeks to provide rewards and incentives that reflect corporate and individual performance which align with the objectives of the Group.

The main components of the remuneration packages derived from the above policy are set out below:

Salary

Basic salary for each executive director is determined by the Remuneration Committee, taking into account the performance of the individual and information from independent sources on the rates of salary for comparable jobs. In setting salaries, the Committee also takes into account pay and employment conditions in the Group as a whole.

Performance bonus

The Company established a performance related bonus scheme for the executive directors and other key members of management for the year ended 3 June 2000 which was based on successful achievement of corporate and individual objectives. The corporate objectives were linked to the interests of shareholders and the key measure therefore was the profitability of the Group for the full financial year. Achievement of bonus was dependent on the Group's pre-tax profits (before exceptional item) exceeding £18 million with the capacity to earn additional bonus increments upon achievement of higher profit targets up to a ceiling of £25 million. In addition, a number of individual personal objectives were set for each director which aligned with the objectives of the Group for the year. The bonuses awarded by the Committee in respect of the year ended 3 June 2000, having regard to achievement of corporate and personal objectives, are shown in the table on page 26 and are not pensionable.

Benefits in kind

Each director is entitled to benefits such as the provision of a fully expensed company car plus fuel (or cash alternative), private medical insurance, permanent health insurance and life insurance, in line with market practice. The Company provides a serviced flat adjacent to its Saltaire premises for the use of Malcolm Miller.

Pension contributions

In the year under review, contributions were paid into the executive directors' pension schemes at rates determined by the Board. Contributions have continued to be paid at the rate of 15% of each director's basic salary subject to Inland Revenue limits. The Group does not operate any defined benefit schemes.

Service contracts

Each of the executive directors has a service contract with the Company. Each of these agreements is terminable by the Company on twelve months' prior written notice or by the relevant director on not less than six months' prior written notice.

Share option schemes

The Committee believes that share ownership encourages employees to contribute further towards improvements in the Group's performance. To this end, three share option schemes have previously been established under which employees may obtain ordinary shares:

- A regular savings scheme (the "Sharesave Scheme"), which is open to directors and employees of the Group and under which options, granted at an initial discount of 20% against the quoted market price, are normally exercisable on completion of a three-year SAYE contract.

- An Inland Revenue Approved Scheme (the "Approved Scheme") under which all employees and full-time directors of the Company or any subsidiary, who do not have and have not had within the previous twelve months a material interest in the Company and are not within twelve months of retirement, are eligible to participate. Participation is at the discretion of the Board, acting in accordance with the recommendations of the Remuneration Committee. Under the Approved Scheme, options may be granted at the prevailing quoted market price and may usually be exercised between three and ten years from the date of the grant. The aggregate exercise price payable for the shares over which outstanding options may be held by any option holder is restricted to the appropriate legislative limit, which is currently £30,000.

- An Unapproved Scheme, which is similar to the Approved Scheme, although certain rules of the Approved Scheme are not included e.g. the limit of £30,000 mentioned above and the exclusion of employees who have a material interest in the Company.

Remuneration Report .// continued

In granting options under the Approved Scheme and the Unapproved Scheme, the Board may include objective performance targets or other conditions as it thinks fit and has included such performance conditions based on growth in earnings per share of 15% plus inflation over a three year period in all grants since the listing of the Company.

On 29 June 2000 a circular was sent to shareholders setting out details of a proposed new scheme, The Pace 2000 Unapproved Share Option Scheme, which is proposed to replace the above Unapproved Scheme.

Prior to admission of the ordinary shares to listing, individual option agreements (the "Super Options") were established for certain of the executive directors at flotation, including Kurt Risdon. The Super Options became exercisable in full, in June 2000, after the fourth anniversary of listing. Any Super Options not exercised by the seventh anniversary of the date of the option agreements will lapse. The Super Options have an exercise price of 172p per share. Exercise of the Super Options is not subject to any other conditions.

Remuneration of Non-executive Directors

The Non-executive Directors do not have service contracts and do not participate in any incentive plans. Their fees, which are determined by the Board as a whole, are non-pensionable and within the limits set out in the Articles of Association.

Remuneration Report .// continued

Directors' remuneration

Total directors' remuneration for the year ended 3 June 2000 was as follows:

	2000 £000	1999 £000
Fees	132	116
Salaries and benefits in kind	741	700
Performance-related bonuses	675	428
Pension contributions	102	98

The remuneration of individual directors for the year to 3 June 2000 is set out in the table below:

	Salaries /fees	Performance bonus	Benefits in kind	Total remuneration		Pension contributions	
				2000	1999	2000	1999
Executive Directors	£000	£000	£000	£000	£000	£000	£000
Malcolm Miller	250	250	22	522	440	38	38
John Dyson	168	150	1	319	271	22	23
Robert Fleming	168	150	1	319	237	22	19
Kurt Risdon	115	125	15	255	180	17	15
	701	675	39	1,415	1,128	99	95
Non-executive Directors							
Sir Michael Bett	25	-	-	25	-	-	-
David Hood	21	-	1	22	20	3	3
Bob Lambourne	21	-	-	21	18	-	-
Tim Curtis	15	-	-	15	18	-	-
Peter Morgan	50	-	-	50	60	-	-
	833	675	40	1,548	1.244	102	98

Directors' interests in shares and share options

The interests of directors holding office at the year-end and those of their immediate families in the ordinary share capital of the Company at 3 June 2000 and at the beginning of the year are set out below:

	3 June 2000 Shares		Under option	30 May 1999 Shares		Under option
	Beneficial	Non-Beneficial	Beneficial	Beneficial	Non-Beneficial	Beneficial
Sir Michael Bett	3,750	-	-	-	-	-
Malcolm Miller	10,000	-	2,226,792	10,000	-	1,886,792
John Dyson	19,000	-	732,020	20,000	-	582,020
Robert Fleming	11,027,776	978,573	23,214	11,027,776	1,878,573	23,214
David Hood	55,457,769	183,154	-	55,457,769	318,154	-
Bob Lambourne	14,500	-	-	14,500	-	-
Kurt Risdon	2,940	-	350,620	2,940	-	375,620

There were no changes in the directors' interests in the ordinary share capital of the Company between 3 June 2000 and 10 July 2000.

Remuneration Report .// continued

Share options

The directors' interests in options over the ordinary shares of the Company were as follows:

	At 30 May 1999	Number of options Granted	Exercised	At 3 June 2000	Option Price	Exercise Period From	To
Malcolm Miller							
Approved Scheme	56,603	-	-	56,603	53.0p	17.11.00	16.11.07
Unapproved Scheme	1,830,189	-	-	1,830,189	53.0p	17.11.00	16.11.04
Unapproved Scheme	-	340,000	-	340,000	200.0p	07.07.02	06.07.09
John Dyson							
Approved Scheme	56,603	-	-	56,603	53.0p	17.11.00	16.11.07
Unapproved Scheme	509,434	-	-	509,434	53.0p	17.11.00	16.11.04
Unapproved Scheme	-	150,000	-	150,000	200.0p	07.07.02	06.07.09
Sharesave Scheme	15,983	-	-	15,983	61.0p	01.10.01	31.03.02
Kurt Risdon							
Approved Scheme	70,588	-	-	70,588	42.5p	19.08.00	18.08.07
Unapproved Scheme	136,470	-	-	136,470	42.5p	19.08.00	18.08.04
Unapproved Scheme	-	75,000	-	75,000	200.0p	07.07.02	06.07.09
Sharesave Scheme	23,214	-	-	23,214	42.0p	01.10.00	31.03.01
Super Options	145,348	-	100,000	45,348	172.0p	26.06.97	27.06.03
Robert Fleming							
Sharesave Scheme	23,214	-	-	23,214	42.0p	01.10.00	31.03.01

On 22 November 1999 Kurt Risdon exercised 100,000 Super Options and sold 100,000 shares arising at a price of £4.69 per share creating a gain of £297,000. No options were lapsed and, save as aforesaid, no share options were exercised by the directors during the year. The mid-market share price on 2 June 2000 (the last dealing day before the year-end) was 943p. The lowest and highest prices during the year were 1245.5p and 184.5p respectively.

Employee Trusts

The Company has established the Pace Micro Technology Employee Benefits Trust which is capable of acquiring shares in the Company in the Market and using them for the purposes of satisfying new share options granted under the Company's Share Option Schemes. During the year the Trust acquired a total of 465,000 shares in the Company at a cost of £3,365,000.

The Company has established the Pace QUEST (Qualifying Employee Share Trust) which is capable of acquiring shares in the Company either through purchase in the Market or allotment and using any such shares for the purposes of satisfying options under the Company's Sharesave Scheme. During the year the QUEST acquired a total of 2,777,500 shares, of which 1,377,500 were acquired in the Market at an average price of £2.81 and 1,400,000 were acquired by way of allotment at a price of £7.10 per share.

On 1 June 2000, 125,438 options under the Company's Sharesave Scheme were exercised and were satisfied by shares held by the QUEST.

By Order of the Board
Anthony J Dixon
Company Secretary

10 July 2000

Statement of Directors' Responsibilities .//

Statement of Directors' Responsibilities

The following statement, which should be read in conjunction with the Auditors' Report set out on page 29, is made for the purpose of clarifying the respective responsibilities of the directors and auditors.

The directors are required by company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss 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 which are disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is not appropriate to presume that the Group will continue in business.

The directors are responsible for ensuring that proper accounting records are maintained which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. The directors 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.

Auditors' Report to the Members of Pace Micro Technology plc ./

We have audited the financial statements on pages 30 to 49.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for preparing the Annual Report. As described on page 28, this includes responsibility for preparing the financial statements in accordance with applicable United Kindom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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. We also report to you if, in our opinion, the Report of the Directors is not consistent with the financial statements, if the Group 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 or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on page 22 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risks and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

BASIS OF AUDIT 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 Group'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 as at 3 June 2000 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds
10 July 2000

Consolidated Profit and Loss Account ./

For the year ended 3 June 2000

	Note	2000 £000	1999 £000
Turnover	2	**377,621**	182,836
Cost of sales		**(303,385)**	(134,431)
Gross profit		**74,236**	48,405
Other operating income and charges			
Before exceptional item	4	**(47,106)**	(34,251)
Exceptional item	5	**(3,300)**	–
	4	**(50,406)**	(34,251)
Operating profit		**23,830**	14,154
Net interest receivable	6	**142**	942
Profit on ordinary activities before taxation		**23,972**	15,096
Tax on profit on ordinary activities	9	**(6,589)**	(4,869)
Profit on ordinary activities after taxation		**17,383**	10,227
Dividends paid and payable	10	**(1,908)**	(1,556)
Retained profit for the financial year	24	**15,475**	8,671
Earnings per ordinary share	11	**8.3p**	4.8p
Diluted earnings per ordinary share	11	**7.9p**	4.8p
Dividends per ordinary share	10	**0.90p**	0.75p

RESULTS BEFORE EXCEPTIONAL ITEM

	Note	£000	£000
Operating profit		**27,130**	14,154
Profit on ordinary activities before taxation		**27,272**	15,096
Earnings per ordinary share	11	**9.5p**	4.8p
Diluted earnings per ordinary share	11	**9.0p**	4.8p

The accompanying accounting policies and notes form an integral part of these financial statements.

Acquisitions are dealt with in note 14.

Consolidated Balance Sheet ./

As at 3 June 2000

	Note	2000 £000	2000 £000	1999 £000	1999 £000
Fixed assets					
Intangible	12		**23,676**		–
Tangible	12		**13,730**		10,299
Investments	13		**11,020**		5,919
			48,426		16,218
Current assets					
Stocks	15	**20,781**		9,415	
Debtors	16	**68,256**		49,963	
Cash at bank and in hand	28	**26,395**		19,762	
		115,432		79,140	
Creditors: amounts falling due within one year	17	**(58,892)**		(37,748)	
Net current assets			**56,540**		41,392
Total assets less current liabilities			**104,966**		57,610
Creditors: amounts falling due after more than one year	18		**(2)**		(93)
Provisions for liabilities and charges	21		**(18,407)**		(16,570)
Net assets			**86,557**		40,947
Capital and reserves					
Called up equity share capital	22		**11,007**		10,723
Share premium account	23		**52,986**		19,171
Shares to be issued	14		**4,593**		–
Profit and loss account	24		**17,971**		11,053
Total equity shareholders' funds			**86,557**		40,947

These financial statements were approved by the Board of Directors on 10 July 2000 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman

John Dyson - Finance Director

Company Balance Sheet ./

As at 3 June 2000

	Note	2000 £000	2000 £000	1999 £000	1999 £000
Fixed assets					
Tangible	12		**13,464**		10,265
Investments	13		**35,641**		6,096
			49,105		16,361
Current assets					
Stocks	15	**20,632**		9,415	
Debtors	16	**68,048**		52,634	
Cash at bank and in hand		**26,553**		19,212	
		115,233		81,261	
Creditors: amounts falling due within one year	17	**(60,094)**		(40,864)	
Net current assets			**55,139**		40,397
Total assets less current liabilities			**104,244**		56,758
Creditors: amounts falling due after more than one year	18		**(2)**		(93)
Provisions for liabilities and charges	21		**(18,407)**		(16,570)
Net assets			**85,835**		40,095
Capital and reserves					
Called up equity share capital	22		**11,007**		10,723
Share premium account	23		**52,986**		19,171
Shares to be issued	14		**4,593**		
Profit and loss account	24		**17,249**		10,201
Total equity shareholders' funds			**85,835**		40,095

These financial statements were approved by the Board of Directors on 10 July 2000 and were signed on its behalf by:

Sir Michael Bett - Non-executive Chairman

John Dyson - Finance Director

Consolidated Cash Flow Statement

For the year ended 3 June 2000

	Note	2000 £000	1999 £000
Net cash inflow from operating activities	26	**29,559**	16,206
Returns on investments and servicing of finance	27	**109**	927
Taxation		**(8,306)**	(968)
Capital expenditure and financial investments	27	**(17,059)**	(12,708)
Equity dividends paid		**(1,684)**	(945)
Cash flow before financing		**2,619**	2,512
Financing	27	**4,014**	(1,163)
Increase in cash in the year		**6,633**	1,349

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS

	Note	2000 £000	1999 £000
Increase in cash in the year		**6,633**	1,349
Cash flow from decrease in debt		**442**	1,335
New finance leases		**–**	(163)
Movement in net funds in the year		**7,075**	2,521
Net funds at start of year		**19,234**	16,713
Net funds at end of year	28	**26,309**	19,234

Consolidated Statement of Total Recognised Gains and Losses and Reconciliation of Movements in Shareholders' Funds ./

For the year ended 3 June 2000

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2000 £000	1999 £000
Profit for the year	**17,383**	10,227
Currency translation differences on foreign currency net investments	**132**	115
Total recognised gains and losses for the year	**17,515**	10,342

MOVEMENTS IN SHAREHOLDERS' FUNDS

	2000 £000	1999 £000
Profit for the year	**17,383**	10,227
Dividends paid and payable	**(1,908)**	(1,556)
Retained profit for the year	**15,475**	8,671
Other recognised gains and losses relating to the year	**132**	115
Issue of ordinary share capital	**34,099**	9
Shares to be issued	**4,593**	–
Write off arising on issue of shares to the QUEST	**(8,689)**	–
Net addition to equity shareholders' funds	**45,610**	8,795
Equity shareholders' funds at 29 May 1999	**40,947**	32,152
Equity shareholders' funds at 3 June 2000	**86,557**	40,947

Notes ./

1 ACCOUNTING POLICIES

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

Basis of preparation

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

Basis of consolidation

The Group financial statements consolidate those of the Company and of its subsidiary undertakings (see note 13) drawn up to 3 June 2000. Unless otherwise stated, the acquisition method of accounting has been adopted. Profits or losses on intra-group transactions are eliminated in full.

Financial year end

The annual financial statements are drawn up to the Saturday nearest to 31 May. The current year's financial statements are for the 53 weeks ended 3 June 2000 and the previous year's financial statements are for the 52 weeks ended 29 May 1999.

Depreciation

Depreciation is calculated to write down the cost less estimated residual value of all tangible fixed assets by equal annual instalments over their expected useful lives. The periods generally applicable are:

Long leasehold properties	Period of lease
Short leasehold properties	Period of lease
Plant and machinery	2 - 10 years
Motor vehicles	4 years

Research and development

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

Government grants

Government grants in respect of capital expenditure are credited to a deferred income account and are released to the profit and loss account by equal annual instalments over the expected useful lives of the relevant assets.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Deferred taxation

Deferred taxation is provided for under the liability method using the tax rates estimated to arise when the timing differences reverse and is accounted for to the extent that it is probable that a liability or asset will crystallise. Unrecognised deferred tax is disclosed as a contingent asset or liability.

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses represents the excess of consideration over the fair value of the underlying net assets. Goodwill is shown as an asset in the balance sheet and amortised on a straight line basis over its economic useful life, to a maximum of 20 years.

Goodwill previously eliminated against reserves has not been re-instated in accordance with the transitional arrangements contained in FRS10 'Goodwill and Intangible Assets'. However, the reported profit or loss on any future sale of a previously acquired business will include any goodwill previously written off.

Notes ./ continued

1 ACCOUNTING POLICIES (continued)

Foreign currencies

Transactions in foreign currencies are translated at the exchange rate ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at the balance sheet date.

Exchange differences of a trading nature are dealt with in the profit and loss account. Exchange differences on the restatement of the net investment in overseas subsidiaries and the difference between the profit and loss account translated at the average rate and the closing rate are recorded as movements on reserves.

Financial instruments are used to reduce certain exposures to fluctuations in foreign exchange rates. If the instrument is used to hedge a trading exposure then any gain or loss is dealt with in the profit and loss account. Any gain or loss on an instrument used to hedge an exposure on the net investment in overseas subsidiaries is recorded as a movement on reserves.

Contributions to pension fund

The pension costs charged to the profit and loss account represent the amount of the contributions payable to the scheme during the year.

Leased assets

Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet and depreciated over their expected useful lives. The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to the profit and loss account over the period of the lease.

All other leases are regarded as operating leases and the payments made under them are charged to the profit and loss account on a straight line basis over the lease term.

2 TURNOVER

Turnover represents the invoiced value of goods sold and services provided in the year, stated exclusive of value added tax.

The geographical analysis of turnover which arises from principal activities is as follows:

Turnover by destination	**2000**	1999
	£000	£000
United Kingdom	**345,673**	119,169
Europe	**22,524**	25,927
Far East (including Australasia)	**7,168**	14,759
Rest of the world	**2,256**	22,981
	377,621	182,836

By origin	Turnover		Profit/(loss) before taxation		Net assets/(liabilities)	
	2000	1999	**2000**	1999	**2000**	1999
	£000	£000	**£000**	£000	**£000**	£000
United Kingdom	**377,614**	182,822	**23,930**	14,635	**85,275**	40,009
Europe	**–**	–	**(30)**	102	**230**	(1,640)
Far East (including Australasia)	**7**	13	**(35)**	355	**923**	2,407
Rest of the world	**–**	1	**107**	4	**129**	171
	377,621	182,836	**23,972**	15,096	**86,557**	40,947

The Group's principal activities are the development, manufacture and distribution of digital receivers and receiver decoders which provide a gateway for the reception of digital television and the reception/transmission of interactive services, Voice Over Internet Protocol and high speed data. Each of these services may be delivered over satellite, cable, terrestrial and DSL transmission systems.

Notes ./ continued

3 PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION IS STATED AFTER CHARGING/(CREDITING)

	2000	1999
	£000	£000
Group auditors' and their associates' remuneration		
- audit services	**110**	143
- non audit services	**75**	82
Company auditors' and their associates' remuneration		
- audit services	**101**	121
- non audit services	**42**	63
Depreciation of tangible fixed assets		
- owned	**6,369**	5,369
- held under finance leases and hire purchase contracts	**667**	1,550
Other operating lease rentals		
- land and buildings	**1,057**	944
- plant and machinery	**300**	–
- motor vehicles	**183**	18
Government grants	**–**	(45)
(Profit)/loss on disposal of tangible fixed assets	**(37)**	33

4 OTHER OPERATING INCOME AND CHARGES

	2000	1999
	£000	£000
Distribution costs	**886**	644
Administrative expenses	**8,955**	6,976
Development expenditure	**22,320**	11,803
Other charges	**15,748**	18,109
Other operating income	**(803)**	(3,281)
	47,106	34,251
Exceptional item (see note 5)	**3,300**	–
	50,406	34,251

5 EXCEPTIONAL ITEM

The Company has established a QUEST (qualifying employee share ownership trust) for the purpose of buying and distributing ordinary shares in the Company on the exercise of options under the Sharesave Scheme. During the year the QUEST purchased 1,377,500 ordinary shares in the Market at an average price of £2.81. The Company provided the funds for this purchase and has written off the excess, being £3,300,000, of the purchase price over the exercise price of the options. This amount is allowable for UK corporation tax.

6 NET INTEREST RECEIVABLE

	2000	1999
	£000	£000
Finance charges in respect of finance leases and similar hire purchase contracts	**(15)**	(122)
Other interest payable	**(2)**	(38)
Interest payable and other similar charges	**(17)**	(160)
Interest receivable	**159**	1,102
	142	942

7 REMUNERATION OF THE DIRECTORS

The remuneration and share options of the directors are disclosed in the Report of the Directors on pages 24 to 27.

Notes ./ continued

8 STAFF NUMBERS AND COSTS

The average number of employees were:	**2000**	1999
Manufacturing	**497**	495
Sales and marketing	**65**	67
Research and development	**344**	192
Administration	**200**	165
	1,106	919

Staff costs:	**£000**	£000
Wages and salaries	**28,793**	20,943
Social security costs	**2,676**	2,019
Other pension costs	**652**	483
Redundancy	**160**	221
	32,281	23,666

9 TAX ON PROFIT ON ORDINARY ACTIVITIES

The tax charge is based on the profit for the year and represents:	**2000**	1999
	£000	£000
United Kingdom corporation tax at 30% (1999: 30.8%)	**5,631**	7,798
Overseas taxation	**13**	145
Deferred tax (note 21)	**945**	(3,074)
	6,589	4,869

The tax charge benefited from tax relief on the contribution to the QUEST of £8,689,000, relating to the issue of 1,400,000 ordinary shares. The contribution is reported as a movement on reserves.

10 DIVIDENDS PAID AND PAYABLE

	2000	1999
	£000	£000
Interim dividend of 0.30p per ordinary share paid 7 April 2000 (1999 : 0.25p)	**660**	536
Proposed final dividend of 0.60p per ordinary share payable 23 October 2000 (1999 : 0.50p)	**1,321**	1,072
Dividends waived by Pace Micro Technology Employee Benefits Trust and QUEST	**(73)**	(52)
	1,908	1,556

The proposed final dividend will be paid to shareholders on the register at the close of business on 15 September 2000.

11 EARNINGS PER ORDINARY SHARE

Earnings per ordinary share have been calculated by reference to the profit for the year before and after the exceptional item, and after taxation, on the average number of ordinary shares of 5p in issue during the year. The earnings before exceptional item were £19,776,000 and after exceptional item were £17,383,000 (1999: before and after exceptional item £10,227,000). The average number of qualifying ordinary shares in issue during the year was 209,169,000 (1999: 211,206,000). The ordinary shares held by the Pace Micro Technology Employee Benefits Trust and the QUEST are excluded from this calculation as the right to receive a full dividend has been waived.

Diluted earnings per ordinary share vary from basic earnings per ordinary share due to the effect of the notional exercise of outstanding share options. The diluted earnings before exceptional item were £19,776,000 and after exceptional item were £17,383,000 (1999: before and after exceptional item £10,227,000). The diluted number of qualifying ordinary shares was 219,050,000 (1999: 214,459,000).

Notes ./ continued

12 FIXED ASSETS

Group	**Intangible goodwill £000**	**Long leasehold buildings £000**	**Short leasehold land and buildings £000**	**Plant and machinery £000**	**Motor vehicles £000**	**Tangible Fixed Assets Total £000**
Cost						
At 29 May 1999	–	65	3,830	27,488	772	32,155
Additions	23,976	–	797	9,253	11	10,061
Acquisitions	–	–	–	529	–	529
Disposals	–	–	(82)	(87)	(276)	(445)
Exchange adjustments	–	–	–	8	(1)	7
At 3 June 2000	23,976	65	4,545	37,191	506	42,307
Amortisation/depreciation						
At 29 May 1999	–	–	2,240	19,161	455	21,856
Provided in the year	300	–	583	6,314	139	7,036
Disposals	–	–	(25)	(71)	(216)	(312)
Exchange adjustments	–	–	–	(2)	(1)	(3)
At 3 June 2000	300	–	2,798	25,402	377	28,577
Net book amount at 3 June 2000	**23,676**	**65**	**1,747**	**11,789**	**129**	**13,730**
Net book amount at 29 May 1999	–	65	1,590	8,327	317	10,299
Company						
Cost						
At 29 May 1999		65	3,830	27,400	742	32,037
Additions		–	797	8,962	–	9,759
Acquisitions		–	–	529	–	529
Disposals		–	(82)	(63)	(246)	(391)
At 3 June 2000		65	4,545	36,828	496	41,934
Depreciation						
At 29 May 1999		–	2,240	19,089	443	21,772
Provided in the year		–	583	6,261	134	6,978
Disposals		–	(25)	(54)	(201)	(280)
At 3 June 2000		–	2,798	25,296	376	28,470
Net book amount at 3 June 2000		**65**	**1,747**	**11,532**	**120**	**13,464**
Net book amount at 29 May 1999		65	1,590	8,311	299	10,265

Further details of the goodwill are given in note 14.

The figures stated above include assets held under finance leases and similar hire purchase contracts as follows:

	Group and Company	
	Plant and machinery £000	**Motor vehicles £000**
Net book amount at 3 June 2000	**145**	**118**
Net book amount at 29 May 1999	679	299
Depreciation provided during the year	534	133

Notes ./ continued

13 FIXED ASSET INVESTMENTS

Group	Own shares £000	Investments other than loans £000	Total £000
Cost at 29 May 1999	5,919	45	5,964
Additions	5,101	–	5,101
Cost at 3 June 2000	11,020	45	11,065
Provision at 29 May 1999 and 3 June 2000	–	45	45
Net book value at 3 June 2000	**11,020**	**–**	**11,020**
Net book value at 29 May 1999	5,919	–	5,919

Company	Own shares £000	Shares in group undertakings £000	Investments other than loans £000	Total £000
Cost at 29 May 1999	5,919	177	45	6,141
Additions	5,101	24,444	–	29,545
Cost at 3 June 2000	11,020	24,621	45	35,686
Provision at 29 May 1999 and 3 June 2000	–	–	45	45
Net book value at 3 June 2000	**11,020**	**24,621**	**–**	**35,641**
Net book value at 29 May 1999	5,919	177	–	6,096

Investments comprise £11,020,000 (1999: £5,919,000) in respect of 9,473,866 (1999: 6,356,804) of the Company's own shares held by the Pace Micro Technology Employee Benefits Trust and the QUEST. The amounts will be recovered from employees on the exercise of options.

The Pace Micro Technology Employee Benefits Trust has granted options to employees over these ordinary shares of 5p each as follows:

Number of ordinary shares subject to option	Exercise period	Price per share pence
3,180,000	24 September 2001 to 23 September 2008	64.0
1,630,000	26 January 2002 to 25 January 2009	84.5
1,272,500	7 July 2002 to 6 July 2009	200.0
40,000	20 March 2003 to 19 March 2010	945.0
6,122,500		

The QUEST has acquired shares in the Company either through purchase in the Market or by allotment for the purpose of satisfying the following Sharesave Schemes:-

Number of ordinary shares subject to option	Exercise period	Price per share pence
18,214	1 June 2000 to 30 November 2000	76.0
1,365,308	1 October 2000 to 31 March 2001	42.0
372,761	1 October 2001 to 31 March 2002	61.0
575,396	1 April 2002 to 30 September 2002	84.0
276,347	1 October 2002 to 31 March 2003	178.0
159,702	1 April 2003 to 30 September 2003	664.0
2,767,728		

Notes ./ continued

13 FIXED ASSET INVESTMENTS (continued)

At 3 June 2000 the Company had a beneficial interest in the equity of the following principal undertakings:

	Percentage holding	Country of incorporation	Country of operation	Class of share capital held
Pace Distribution GmbH in liquidation	100%	Germany	Germany	Ordinary
Pace Scandinavia A/S in liquidation	100%	Denmark	Denmark	Ordinary
Pace Micro Technology A/S in liquidation	100%	Norway	Norway	Ordinary
Pace Digital Italia srl in liquidation	100%	Italy	Italy	Ordinary
Pace Micro Technology (HK) Limited	100%	Hong Kong	Hong Kong	Ordinary
Pace Micro Technology (Asia) Limited*	100%	Hong Kong	Hong Kong	Ordinary
Pace Micro Technology (Thailand) Limited**	100%	Thailand	Thailand	Ordinary
Pace Micro Technology (Australia) Pty Ltd.	100%	Australia	Australia	Ordinary
Pace Micro Technology (SA) (PTY) Ltd. in liquidation	100%	South Africa	South Africa	Ordinary
Pace Micro Technology (Support Services) Limited	100%	UK	USA	Ordinary
Pace Micro Technology France SARL	100%	France	France	Ordinary
Pace Micro Technology (Asia Pacific) Limited**	100%	Hong Kong	Hong Kong	Ordinary
Vegastream Limited	100%	UK	UK	Ordinary

* Denotes company owned by Pace Scandinavia A/S.

** Denotes company owned by Pace Micro Technology (HK) Limited.

Each of the subsidiary undertakings listed above has been consolidated in the Group's financial statements.

Certain of the above subsidiaries have been placed voluntarily into liquidation as part of the Group's restructuring exercise.

14 ACQUISITIONS

On 3rd June 1999, the assets and liabilities of the multi media terminals division of Acorn Group PLC were acquired for £209,000. No goodwill arose on the purchase.

On 7 March 2000, the whole of the issued share capital of Vegastream Limited was acquired. The initial consideration totalled £19,847,000 and deferred consideration has been estimated at £4,593,000. Total consideration is capped at £40,000,000. Goodwill of £23,976,000 is estimated to have arisen on the acquisition, of which £300,000 has been amortised in the current year. The goodwill is being amortised over a period of 20 years, being the estimated economic useful life. The Group results include a post-acquisition loss of £151,000.

The following table explains the adjustments made to the book value of the assets and liabilities acquired to arrive at fair values included in the consolidated financial statements at the date of acquisition. The cash flow effects of the acquisition are stated in note 27.

	Book Amount £000	Revaluation £000	Alignment of Accounting Policies £000	Fair Value to the Group £000
Intangible fixed assets	133	–	(133)	0
Tangible fixed assets	529	–	–	529
Current assets	1,985	(66)	–	1,919
Creditors and provisions	(1,760)	(14)	–	(1,774)
	887	(80)	(133)	674
Goodwill				23,976
				24,650
Satisfied by:				
Cash				352
Issue of ordinary share capital				19,705
Deferred contingent issue of ordinary share capital				4,593
				24,650

It has been necessary to revalue certain of the assets and liabilities acquired to recognise a potential shortfall in their realisable value. Furthermore it is the accounting policy of the Group to expense the cost of licences as incurred, not to capitalise as an intangible fixed asset.

Notes ./ continued

15 STOCKS

	Group		Company	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Raw materials and consumable stores	**17,467**	4,942	**17,318**	4,942
Work in progress	**1,367**	1,435	**1,367**	1,435
Finished goods	**1,947**	3,038	**1,947**	3,038
	20,781	9,415	**20,632**	9,415

16 DEBTORS

	Group		Company	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Amounts falling due within one year:				
Trade debtors	**63,913**	45,165	**63,818**	45,155
Amounts owed by subsidiary undertakings	**–**	–	**299**	2,904
Other debtors	**637**	1,015	**293**	948
Prepayments and accrued income	**1,577**	709	**1,509**	553
	66,127	46,889	**65,919**	49,560
Amounts falling due after more than one year:				
Deferred tax (See note 21)	**2,129**	3,074	**2,129**	3,074
	68,256	49,963	**68,048**	52,634

17 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Trade creditors	**38,853**	17,945	**38,754**	17,887
Amounts owed to subsidiary undertakings	**–**	–	**1,611**	3,507
Corporation tax	**4,403**	7,941	**4,251**	7,694
Social security and other taxes	**728**	531	**721**	531
Other creditors	**3,295**	4,196	**3,276**	4,181
Accruals	**9,765**	5,657	**9,633**	5,586
Deferred income	**501**	–	**501**	–
Amounts due under finance leases and similar hire purchase contracts (see note 19)	**84**	435	**84**	435
Proposed dividend	**1,263**	1,043	**1,263**	1,043
	58,892	37,748	**60,094**	40,864

18 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		Company	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Amounts due under finance leases and similar hire purchase contracts (see note 19)	**2**	93	**2**	93
	2	93	**2**	93

Notes ./ continued

19 BORROWINGS

Borrowings consist solely of finance leases and similar hire purchase contracts and are repayable as follows:

	Group		Company	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Within one year	**84**	435	**84**	435
After one and within two years	**2**	86	**2**	86
After two and within five years	**–**	7	**–**	7
	86	528	**86**	528

The overdraft facility of £20 million is unsecured and is available until July 2002.

A revolving facility to a maximum of £50 million, on the sale of insured trade debtors, is available until May 2001.

The finance leases are repayable by equal quarterly and monthly instalments with interest at rates of between 0.95% and 1.1% over the finance house base rate.

20 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Short term debtors and creditors that meet the definition of a financial asset or liability respectively have been excluded from all FRS 13 analysis as permitted by the Standard.

(a) Interest rate risk profile of financial assets.

	Floating rate	Interest free	Total
Currency	**£000**	**£000**	**£000**
At 3 June 2000:			
Sterling	32,658	13	**32,671**
At 29 May 1999:			
Sterling	20,381	9	20,390
US Dollar	129	20	149
Euro	411	–	411
Other	394	–	21,311
	21,315	29	21,344

The Sterling floating rate financial assets represent deposits placed on the overnight money market at LIBOR.

Notes ./ continued

20 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS continued

(b) Interest rate risk profile of financial liabilities.

Currency	Floating rate £000	Interest free £000	Total £000
At 3 June 2000:			
Sterling	86	–	**86**
US Dollar	4,464	–	**4,464**
Euro	1,587	–	**1,587**
Other	225	–	**225**
	6,362	–	**6,362**
At 29 May 1999:			
Sterling	528	–	528
Euro	1,582	–	1,582
	2,110	–	2,110

The Sterling floating rate financial liabilities represent finance leases and similar hire purchase contracts disclosed in note 19. The interest rate on US Dollar, Euro and other floating rate financial liabilities is linked to bank base rate.

(c) Currency exposures.
The table below shows the Group's currency exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group which are not denominated in the operating or functional currency of the operating unit involved.

	Net foreign currency monetary assets/(liabilities)			
Functional currency of group operation	**US Dollar £000**	**Euro £000**	**Other £000**	**Total £000**
At 3 June 2000:				
Sterling	(22,833)	(7,937)	(1,396)	**(32,166)**
Other	(100)	(332)	1,147	**715**
Total	(22,933)	(8,269)	(249)	**(31,451)**
At 29 May 1999:				
Sterling	(2,411)	(2,424)	(818)	(5,653)
Other	18	(340)	–	961
Total	(2,393)	(2,764)	465	(4,692)

(d) Gains and losses on hedges.
During the year, the Group experienced a US Dollar and Euro shortage as a consequence of its purchases not being offset by sales in the respective currencies. The Group enters into forward foreign currency contracts to eliminate certain currency exposures that arise on sales and purchase contracts denominated in foreign currencies.

	Sell Currency	Buy Currency	Value	Average Rate	Maturity
At 3 June 2000:					
	Sterling	US Dollar	$90m	1.5901	June 2000 to October 2000
	Sterling	Euro	€6m	1.6408	June 2000 to November 2000
At 29 May 1999:					
	Sterling	US Dollar	$10m	1.6237	June 1999

The unrealised gains on the above contracts amount to £3,531,000, of which £2,095,000 has been matched against monetary assets and liabilities denominated in the respective currencies and recognised in the profit and loss account.

Notes ./ continued

20 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS continued

e) Fair value.
Set out below is a comparison by category of book values and fair values of the financial assets and liabilities. The fair values are estimated by discounting the future cash flows to net present values using the prevailing market rates.

	2000 Book value £000	**2000 Fair value £000**	1999 Book value £000	1999 Fair value £000
Primary financial instruments held or issued to finance the Group's operations:				
Finance lease and similar hire purchase contracts	**(86)**	**(86)**	(528)	(528)
Cash and other liquid funds	**26,395**	**26,395**	19,762	19,762
Derivative financial instruments held to hedge the currency exposure:				
Forward foreign exchange contracts	**2,095**	**2,095**	91	91

21 PROVISIONS FOR LIABILITIES AND CHARGES

	Royalties under negotiation (see note 31) £000	Onerous contracts £000	Warranties £000	Total £000
Group and Company				
At 29 May 1999	13,938	1,443	1,189	16,570
Charge/(credit) for the year	6,269	(1,139)	4,077	9,207
Utilised	(5,372)	(235)	(1,763)	(7,370)
At 3 June 2000	**14,835**	**69**	**3,503**	**18,407**

The directors consider that to disclose the detailed amounts unused on the settlement of claims during the year would be seriously prejudicial to other royalty claims currently undergoing negotiation or in dispute. Accordingly the directors have aggregated amounts released unused with additional provisions made in order to arrive at the charge for the year shown above.

Deferred taxation recognised and unrecognised in the financial statements is set out below. The amounts unrecognised represent a contingent asset at the balance sheet date and are calculated using a tax rate of 30% (1999: 30%).

	Recognised asset		Unrecognised asset	
	2000 £000	**1999 £000**	**2000 £000**	**1999 £000**
Group and Company				
Accelerated capital allowances	–	–	1,504	1,075
Other timing differences	2,129	3,074	3,431	1,790
	2,129	**3,074**	**4,935**	**2,865**

Notes ./ continued

22 SHARE CAPITAL

	2000 Number	2000 £000	1999 Number	1999 £000
Authorised				
Ordinary shares of 5p each	**300,000,000**	**15,000**	300,000,000	15,000
Allotted, called up and fully paid				
Ordinary shares of 5p each	**220,133,839**	**11,007**	214,459,328	10,723

During the year, the Company allotted Ordinary shares as follows:

	Number	Option price per share (p)	Nominal value £'000	Consideration £'000
Employee share option schemes				
	1,306,641	172	66	2,248
	1,084,453	190	54	2,060
	12,500	200	1	25
Employee sharesave schemes				
	68,969	152	4	105
	28,820	42	1	12
	693	61	–	–
	5,277	84	–	4
Issued to the QUEST	1,400,000	–	70	9,940
Acquisition of Vegastream Limited	1,767,158	–	88	19,705
	5,674,511		**284**	**34,099**

The Company has granted options which are subsisting (including directors' options and options granted prior to listing of the Company) in respect of the following presently unissued ordinary shares of 5p each.

Number of ordinary shares subject to option	Exercise period	Price per share pence
236,090	27 June 1997 to 26 June 2003	172.0
147,615	25 June 1999 to 24 June 2006	190.0
59,012	25 June 1999 to 24 June 2003	172.0
270,588	19 August 2000 to 18 August 2007	42.5
526,470	19 August 2000 to 18 August 2004	42.5
113,206	17 November 2000 to 16 November 2007	53.0
2,339,623	17 November 2000 to 16 November 2004	53.0
42,857	28 April 2001 to 27 April 2008	70.0
507,143	28 April 2001 to 27 April 2005	70.0
36,585	26 May 2001 to 25 May 2008	82.0
213,415	26 May 2001 to 25 May 2005	82.0
1,320,000	7 July 2002 to 6 July 2009	200.0
1,620,500	11 January 2003 to 10.January 2010	599.5
44,036	1 April 2003 to 30 September 2003	664.0
7,477,140		

The Pace Micro Technology Employee Benefits Trust has granted additional options over existing shares and the QUEST has acquired shares to satisfy certan sharesave option schemes. Details of these additional options are shown in note 13.

Notes ./ continued

23 SHARE PREMIUM ACCOUNT

	£000
Group and Company	
At 29 May 1999	19,171
Premium on allotment of shares to the QUEST	9,870
Premium on other allotments	23,945
At 3 June 2000	**52,986**

The shares allotted during the year are listed in note 22.

24 PROFIT AND LOSS ACCOUNT

	£000
Group	
At 29 May 1999	11,053
Retained profit for the year	15,475
Exchange differences	132
Write off arising on the issue of shares to the QUEST	(8,689)
At 3 June 2000	**17,971**

	£000
Company	
At 29 May 1999	10,201
Retained profit for the year	15,737
Write off arising on the issue of shares to the QUEST	(8,689)
At 3 June 2000	**17,249**

The cumulative amount of purchased goodwill charged to reserves at 3 June 2000 was £360,000 (1999: £360,000).

25 PROFIT FOR THE YEAR

The parent company has taken advantage of Section 230 of the Companies Act 1985 and has not included its own profit and loss account in these financial statements. The Group profit includes a parent company profit before dividends of £17,645,000 (1999: £10,818,000).

26 RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2000 £000	1999 £000
Operating profit	**23,830**	14,154
Exceptional item	**3,300**	–
Operating profit before exceptional item	**27,130**	14,154
Exchange differences	**121**	124
Goodwill amortisation	**300**	–
Depreciation	**7,036**	6,919
Deferred income	**–**	(45)
(Profit)/loss on disposal of tangible fixed assets	**(37)**	33
(Increase)/decrease in stocks	**(10,814)**	4,282
(Increase) in debtors	**(17,537)**	(17,489)
Increase in creditors	**21,523**	2,828
Increase in provisions for liabilities and charges	**1,837**	5,400
Net cash inflow from operating activities	**29,559**	16,206

Notes ./ continued

27 ANALYSIS OF CASH FLOWS FOR HEADINGS NETTED IN THE CASH FLOW STATEMENT

	2000	1999
	£000	£000
Returns on investments and servicing of finance		
Interest received	**147**	1,234
Interest paid	**(23)**	(185)
Finance lease and asset loan interest paid	**(15)**	(122)
Net cash inflow for returns on investments and servicing of finance	**109**	927
Capital expenditure and financial investments		
Purchase of tangible fixed assets	**(10,061)**	(7,106)
Acquisition of own shares for Pace Micro Technology Employee Benefits Trust and QUEST	**(7,149)**	(5,919)
Net cash outflow from acquisitions	**(18)**	–
Sale of tangible fixed assets	**169**	317
Net cash outflow for capital expenditure and financial investments	**(17,059)**	(12,708)
Financing		
Issue of ordinary share capital	**4,456**	9
Capital element of finance lease rental payments	**(442)**	(1,157)
Repayment of asset loans	**–**	(15)
Net cash flow from financing	**4,014**	(1,163)

28 ANALYSIS OF CHANGE IN NET FUNDS

	At 29 May 1999 £000	Cash flow £000	Other non cash changes £000	**At 3 June 2000 £000**
Cash in hand	19,762	6,633	–	**26,395**
Finance leases	(528)	442	–	**(86)**
	19,234	7,075	–	**26,309**

29 MAJOR NON-CASH TRANSACTIONS

During the year the Group and Company entered into finance lease arrangements in respect of assets with a total capital value at inception of the leases of £Nil (1999: £163,000).

30 CAPITAL COMMITMENTS

	Group and Company	
	2000	1999
	£000	£000
Contracted but not provided for	**4,876**	2,463

Notes ./ continued

31 CONTINGENT LIABILITY

The owners of patents covering technology allegedly used by the Group have indicated claims for royalties relating to the Group's use (including past usage) of that technology. Whilst negotiations over these liabilities continue, they are not concluded. The directors have made provision for the potential royalties payable based on the latest information available. Having taken legal advice, the Board considers that there are defences available that may mitigate the amounts being sought. The Group will vigorously negotiate all claims but, in the absence of agreement, the amounts provided may prove to be different from the amounts at which the potential liabilities are finally settled.

32 PENSIONS

The Company contributes to several defined contribution pension schemes for the benefit of the directors and certain employees. The assets of the schemes are administered by trustees in funds independent from those of the Company.

At 3 June 2000, contributions of £Nil (1999 : £Nil) were outstanding and payable to the schemes.

33 LEASING COMMITMENTS

The following annual lease commitments are due within one year:

	Group		**Company**	
	2000	1999	**2000**	1999
	£000	£000	**£000**	£000
Land and buildings				
Within one year	**52**	30	**–**	–
Between one and five years	**324**	31	**324**	31
In five years or more	**1,353**	1,017	**973**	1,017
	1,729	1,078	**1,297**	1,048
Plant and machinery				
Between one and five years	**354**	–	**354**	–
	2,083	1,078	**1,651**	1,048

34 RELATED PARTY TRANSACTIONS

The Company purchases travel services at commercial rates, on an ad hoc basis from Multiflight Limited. The amount purchased during the year ended 3 June 2000 was £22,447 (1999: £4,495) of which £3,259 (1999: £Nil) was outstanding at the year end. Multiflight Limited is a company which is controlled by David Hood, a Non-executive Director of Pace Micro Technology plc.

Five Year Record ./

	2000	**1999**	**1998**	**1997**	**1996**
	£000	£000	£000	£000	£000
Turnover	**377,621**	182,836	184,034	219,625	195,584
Profit/(loss) before tax	**23,972**	15,096	(12,120)	18,406	18,221
Profit/(loss) before exceptional item and tax	**27,272**	15,096	(12,120)	18,406	18,221
Profit/(loss) after tax	**17,383**	10,227	(12,992)	12,244	12,208
Diluted EPS	**7.9p**	4.8p	(6.0p)	5.7p	6.1p
Diluted EPS before exceptional item	**9.0p**	4.8p	(6.0p)	5.7p	6.1p
Net assets excluding goodwill	**62,881**	40,947	32,152	47,295	21,220