**Morse plc**

# Morse plc

**(Registered no. 3108179)**

Annual report and accounts
for the year ended 30 June 2006



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# Morse plc

## Financial Highlights

- Continuing Group revenue down 4% to £297.0 million (2005: £309.2 million)
- Operating profit [1] from continuing operations up 34% to £7.4 million (2005: £5.5 million), with operating profit from services up 14% on the prior year period
- Profit before tax [2] for continuing operations up 17% to £8.0 million (2005: £6.8 million)
- *Profit after tax of £4.2 million (2005: £1.2 million)*
- Net funds balance at 30 June 2006 of £25.7 million (2005: £36.3 million) [3]
- Adjusted basic earnings per share of 5.0p (2005: 4.2p) [4]
- Proposed final dividend of 2.7p per share (2005: 2.6p per share) resulting in a total dividend for the year up 4.0% at 3.9p per share (2005: 3.75p per share)

## Statutory

- Operating profit £12.8 million (2005: £2.2 million)
- Profit before tax £6.0 million (2005: £2.9 million)
- Basic EPS 2.6p (2005: 0.8p)

## Business Highlights

- Transformation of Group creates the opportunity for a new structure where Morse plc now oversees the operating businesses of:
  - Morse's *core operations: forming a single advisory & execution professional services firm* and targeting a doubling of percentage operating margin in the medium term
  - Monitise, Morse's secure mobile banking applications business: also to operate as stand-alone business with the potential to generate significant revenues and operating profits within the medium term

Note 1 £7.4 million continuing profit excludes all exceptional items and includes the loss of the joint ventures of £0.4 million (2005: £0.5 *million) – please refer to page 40*

Note 2 Excludes all exceptional items and includes total net financing income of £0.6 million for 2006 (2005: £1.3 million) – please refer to page 40

Note 3 Please refer to Note 33 on page 83

Note 4 Please refer to Note 4 on page 58 for adjusted basic earnings per share

# Morse plc

### About the Group

The Group comprises of Morse, an advisory & execution professional services firm, and Monitise, which provides mobile banking solutions.

The Group was established in 1983. It is headquartered in the UK and employs 1,691 people in 10 countries*.

*year ended 30 June 2006

## Morse

Morse delivers Management Consulting, Applications Consulting and Infrastructure Consulting to clients around the world that enables organisational change, improved efficiency and greater value from IT investment.

Morse's proposition is based on innovation and quality, led by the demands of clients in financial services, media & communications, commercial and other markets. Its breadth and depth of expertise in specialist business domains, key technologies and partnerships ensures a close, effective, trust-based working relationship with these clients.

The business has three streams:

### Management Consulting

*Advises on business and operational strategy, including business process re-engineering, mergers and acquisitions, and compliance.*

### Applications Consulting

*Advises on business intelligence and knowledge management, and provides data management, application support and development services.*

### Infrastructure Consulting

*Helps clients realise benefits of IT against business need, through optimising data centres, supply chain infrastructures and advising on emerging technologies.*

## Monitise

Monitise Group Limited was established by Morse to take advantage of the developing mobile banking market. Its joint ventures with LINK Group Holdings Limited – MONILINK™ and mobileATM® – are pioneering adoption of mobile banking in the UK, and there is significant overseas interest in implementing its technology, using a franchise model.

# Morse plc

## Evolution of the Group

**1983-1988 Corporate personal computing**
- Morse established to sell personal computers in London

**1989-1998 Enterprise computing**
- Key partnerships established with Sun Microsystems, HP, Oracle & IBM
- Systems and enterprise management services, software consulting
- Geographic expansion

**1999-2003 Technology integration**
- Becomes listed company
- Acquires own software development capabilities
- Acquires value-added resourcing capability

**2004-2005 Consulting, technology and support services**
- mobileATM Limited established as a joint venture between Morse and LINK Interchange Network Limited
- Acquisitions of CSTIM and Diagonal add management and business consulting
- Disposal of French reseller operation
- Monitise Limited established as the international trading company for the mobileATM® product

**2006 Specialist advisory and execution consultancy**
- Single brand engaging with clients worldwide
- Separate Monitise business, focused on mobile banking opportunities
- Disposal of German and Austrian reseller operations

# Morse plc
## Chairman's statement

This year the Group has continued to make significant progress in the transition of its core business, from its origins as an IT hardware reseller to a Group delivering consulting, technology and support. It is now in a position where these operations will become a single, unified advisory & execution professional services firm operating under a single Morse brand.

In parallel with the transition of the core business, the Group has successfully developed its secure mobile banking applications business such that it is now at a stage where it can begin to generate revenues.

The Group will now operate around these two separate businesses of Morse and Monitise.

**Results**

Group revenue from continuing operations for the year to 30 June 2006 was £297.0 million (2005: £309.2 million). Operating profit before exceptional items from continuing operations was £7.4 million (2005: £5.5 million), with operating profit from our services business increasing 14% on the prior year period. Profit before taxation and exceptional items from continuing operations was £8.0 million (2005: £6.8 million). The Group generated cash from operations of £1.8 million (2005: £1.9 million). The net funds balance at 30 June 2006 was £25.7 million (2005: £36.3 million).

The statutory profit before tax was £6.0 million after exceptional charges of £0.8 million, net interest income of £0.6 million and a loss of £1.2 million from discontinued operations.

Morse Germany was sold subsequent to the year-end and is shown in the accounts as a discontinued operation. Its assets and liabilities have been disclosed as 'held for sale'.

A final dividend of 2.7p (2005: 2.6p) will be proposed for shareholder approval at the Annual General Meeting to be convened on 9 November 2006 and, subject to shareholder approval, will be paid to shareholders on the register as at 6 October 2006. The increase in the proposed dividend is being restricted to 4% as we are aiming to resume capital growth as the primary driver of shareholder value.

**Planned changes to Group structure**

Over the last few years the Group has been transforming itself from a reseller to a consulting, technology and support company. We have undertaken this transformation in order to provide our substantial blue chip customer base with the broader offerings they now require, combining hardware, software and consultancy. We have managed this transition by a combination of organic development and acquisition. The acquisitions, together with the selective disposals we have made, have enabled us to accelerate the transformation process, and our financial controls have allowed the Group to remain consistently cash-generative, at the operating profit level.

In instances where the case for transitioning specific businesses has not been sufficiently compelling, in terms of the required resource and investment, and where their disposal could accelerate the overall development of the Group, we have disposed of those businesses. This was demonstrated in the divestment of our French and our German and Austrian reselling businesses in July 2005 and July 2006 respectively.

We now have the framework in place for the remaining significant current activities and geographies to become important components of a stand-alone advisory & execution professional services firm.

In the last three and a half years, we have also successfully exploited our in-house intellectual property capability to develop our secure mobile banking applications business, Monitise. We believe that Monitise has the potential to generate significant revenues and operating profits within the medium term.

## Morse plc

Given the significant opportunities we see for this business both in the UK and overseas, and given that it is now at a stage where it can begin to generate revenues, it will now also form a stand-alone business alongside Morse's professional services business.

These two businesses will operate as distinct entities.

**Morse**
As an advisory & execution professional services business, Morse's services are focused on three main areas: Management Consulting, Applications Consulting and Infrastructure Consulting. We will continue to manage the business broadly along these lines in the short term as we strengthen our existing sector vertical capabilities in four key markets: financial services, media & communications, commercial and public sector. Eventually we will move to a client-driven vertical model.

This business will operate under one brand, with one culture, utilising a unified client franchise and will deliver in a consistent style and develop its people with a single co-ordinated talent management process. It will be a specialist advisory & execution firm with thought leadership in its chosen sectors and emerging information technology. It will aim to deliver total solutions to its clients and to attract and retain the best talent available.

Overall, this business, in the year ended 30 June 2006, had revenue on continuing operations of £297.0 million and, excluding central costs of £4.3 million, made an operating profit on continuing operations of £14.9 million. We believe this business can, and should, move to operating margins that are consistent with other established advisory & execution firms and we therefore aim to match or exceed industry benchmarks and double the margin percentage from its current level in the medium term.

Kevin Alcock will become CEO of this business. Kevin is a founder of CSTIM, which we acquired in April 2004, and has 20 years' experience of working in leading professional services companies. He will report to Duncan McIntyre and will take day-to-day operational responsibility for this business unit.

**Monitise**
Monitise is an exciting and substantial business opportunity based around secure mobile banking applications. Alastair Lukies is the CEO and co-founder of this business. He has a proven track record of developing businesses. He will remain responsible for the day-to-day running of the business and will report to Duncan McIntyre.

**Morse plc**
With the separation of the Group's activities into two distinct operating businesses, Morse and Monitise, a holding company structure will remain in place to oversee the performance of both businesses.

We are currently reviewing the level of resource and governance cost required at the holding company level and are in the process of allocating resource, as appropriate, from the centre to each of the two operating businesses in line with their respective requirements.

Duncan McIntyre will remain CEO of this holding company as well as acting as Executive Chairman of each of the two operating businesses.

**Richard Lapthorne**
***Chairman***
**30 August 2006**

## Morse plc
### Operating review

This was an important period for the Group as we reached the culmination of the transition strategy we have been following for several years, in line with changes in IT investment and the changing needs of our clients.

**Management Consulting**
*Management Consulting comprises four businesses: CSTIM, Morse SI, SkillsHub and Morse Transaction Services.*

This was another good year for Management Consulting as we continued to grow and develop. Our revenue increased to £14.1 million (2005: £12.5 million) and operating profit was steady at £2.2 million (2005: £2.3 million).

The business recovered in the UK after a slow first quarter and overseas operations, particularly in Australia and South Africa, produced a strong performance. We are expanding operations in Continental Europe, having established a new French business to complement assignment work carried out in France, Luxembourg, Germany, The Netherlands and Switzerland. Our strategy of developing a global specialist consultancy business serving the investment industry remains a clear differentiator and extremely attractive to our clients.

**CSTIM**
*CSTIM specialises in the provision of strategy and business improvement consultancy services to the investment industry.* It delivered another strong performance, slightly exceeding expectations for the year. We began the year expecting a period of consolidation after the rapid growth of the previous two years and our move to new offices in London. With the continuing maturity of the business, we feel the foundations are now in place to push forward again. During the year, demand for outsourcing services slowed but the business showed its flexibility by winning an increased number of mandates in the areas of hedge funds, retail funds, private client business and life and pensions business.

The growth and profitability of CSTIM Australia has been most encouraging and, following that success, we are now pushing ahead with the launch of our presence in Singapore. CSTIM South Africa has had another excellent year, delivering a 100% increase in operating profit compared to 2005. The effect of this was, however, muted by adverse movements in the exchange rate.

We have also made good progress in further developing our business in Continental Europe. Over the past year, we have completed assignment work with clients in Luxembourg, France, Germany, The Netherlands and Switzerland. We recently recruited a highly skilled team in France, with professional services experience, to form CSTIM France, resulting in three new clients within the first month of trading. We believe that this strategic move will assist us to further develop our relationships with a number of French global and domestic institutions.

CSTIM's strategy of developing a global specialist consultancy business serving the investment industry remains an important differentiator and we are seeing increasing opportunities to share our skills and expertise across our various office locations.

**Morse SI**
Morse SI, our applications architecture, integration and implementation business, made good progress during the year ended 30 June 2006, delivering 11% of revenue in Management Consulting (2005: 5%).

Morse SI has built up a solid set of credentials based on the delivery of some quality work and we now have a strong team in place to drive the business forward.

This is only the second full year that Morse SI has been in operation and we are increasingly seeing the benefits that an offering that combines business and IT consultancy can deliver to our clients. Morse SI also provides a critical link to the services offered by Morse Technology & Integration around applications and infrastructure and we continue to improve our leverage of these capabilities within our blue chip client base.

**SkillsHub**

SkillsHub, our resource placement business which services the Financial Services sector, has made steady progress during 2006. It continues to provide strong support to both CSTIM and Morse SI, and contributed 14% of revenue for Management Consulting in the year ended 30 June 2006 (2005: 15%).

**Morse Transaction Services**

Morse Transaction Services, which provides consulting services to organisations undertaking merger or acquisition activities, contributed 4% of overall Management Consulting revenue in the year ended 30 June 2006 (2005: 2%).

**Business Consulting**

Business Consulting was created from the consulting business of Morse UK together with the consultancy businesses of Diagonal following its acquisition in August 2004. It has three main lines of business: Diagonal Consulting Global (covering our Oracle, SAP, enterprise service management and information management capability); Delphis (which specialises in providing resources at the infrastructure layer, mainly to the banking sector); and Marshall-Wilkins (an IT recruitment business).

In the year ended 30 June 2006 sales were £79.1 million (2005: £60.4 million) and operating profit before exceptional items was £5.8 million (2005: £5.3 million). The performance in the year ended 30 June 2006 has been distorted by the fact that Diagonal had only been owned for 10 months in the previous year. When this is taken into account, the effect is that revenue growth was approximately 19% and operating profit growth is more substantial than the 10% shown.

**Diagonal Consulting Global**

In a year of continued transformation, we integrated the Morse and Diagonal consulting businesses under a new management team, thereby transforming an SAP-dominated services business into an advisory & execution professional services firm delivering solutions across CRM, ERP, logistics, business intelligence, information management and support across a variety of technologies and to a substantial number of customers.

The business achieved an operating profit of £2.4 million on sales of £56.0 million in the year. Gross margin was 25%. Headcount at the year end was 360, 99 and 39 in the UK, Asia and USA respectively, with access to a far greater pool of associates and contractors.

We consolidated Asian operations around the Kuala Lumpur office by transferring the vast majority of resource from Singapore. This simplified the business and created a truly global support operation across each of our three main territories: UK, Asia and USA.

The new global resourcing operation has enabled us to compete on cost whilst continuing to lead on value and it has resulted in some strong new client wins. However, we are aware of the need to further rejuvenate our presence in the SAP market in order to improve market share. We did not fully capitalise on sales opportunities in this area towards the end of the year and, combined with the deferral of some client projects, this had an adverse effect on utilisation and gross margin.

We have recently established an Information Management practice. This area of the market is expanding rapidly. With our own niche Wisdom™ product, together with our alliances with leading vendors and the substantial skills and intellectual property we hold within the business, we are well positioned to grow this practice over the coming year. Wisdom™ itself continues to develop well and revenue within the Wisdom™ division was £6.3 million (2005: £4.4 million) and operating profit was £0.9 million (2005: £0.6 million).

Cross-selling between core Morse divisions is improving and we believe this will develop further over the current year supporting our transition strategy.

## Morse plc

### Delphis

Delphis completed a strong year, with an over-achievement against its operating profit target and revenue growth of 10%. It retained all of its major customers and acquired significant new clients in the banking sector. Revenue for the year ended 30 June 2006 was £19.6 million (2005: £17.8 million).

This business has been tightly managed. We initiated and completed a back office restructure to underpin scaleable and profitable growth, and reduced staff attrition rates through a package of management, communication and training initiatives. Headcount grew over the year from 284 to 340. Average fee rates have increased slightly despite rate contraction in the helpdesk and desktop engineering areas. This has been achieved by providing a broader service offering and increased value to our customers.

### Marshall-Wilkins

Marshall-Wilkins, a recruitment business that helps clients source both contract and permanent IT resource, had a disappointing year. In particular, the second half performance was poor and we have now changed the management in this business.

## UK Technology & Integration

Revenue for the year decreased by 25% to £140.7 million (2005: £188.5 million), with operating profit before exceptional items increasing to £2.6 million (2005: £1.2 million). The second half of 2006 has seen a strong recovery as the business established itself after the restructuring. In the second half, the business achieved operating profits of £2.0 million compared to £0.6 million in the first half. Headcount was 230 at 30 June 2006 (2005: 337).

In the year to 30 June 2005, we restructured our UK Technology & Integration business so that it was in a position to respond effectively to the ongoing challenges of product and price commoditisation. In the wake of this restructuring, Morse Technology & Integration ("MT&I") began the year with a plan to: focus on selected accounts and growth markets; build technology propositions to increase the services attach rate and services integrated products; implement a more efficient sales and marketing model; drive a Morse-led, vendor-supported marketing plan; and consolidate the back office for quality, productivity and agility.

Our new management team began to execute these strategies during the first quarter of the year. The sales team was restructured into client-focused teams working on selected major and growth accounts and a low-cost sales engine was created to transact lower margin business efficiently and profitably. Four MT&I technology propositions were created and taken to market: Servers, Storage, Software and Security. A number of cost efficiencies were implemented, notably the centralisation of our back office function and the integration of our customer support team with our low-cost sales engine.

In addition to several high-profile business wins, including a contract to implement Egenera Blade Frame technology worth over £4.0 million, we have increased our technology and services footprint within a number of existing customers. Importantly, we closed the year with a pipeline of 30 live opportunities in partnership with Morse Business Consulting.

The success of the restructuring and in particular the growth in services means that it is now possible to combine the services business in this unit with Delphis. This will create an extremely strong business unit.

## Europe

Continuing European revenue rose by 31% to £56.8 million (2005: £43.4 million). This unit now comprises Morse Spain and Morse Ireland after the sale of Morse France in July 2005 and Morse Germany in July 2006.

In the year ended 30 June 2006, revenue increased in Spain by 19% to £37.0 million. Since acquiring our Spanish business in 2001, this business has more than doubled its revenues and profits. It is very much client and consultancy led, as opposed to a reseller model of being product and manufacturer led. Software and services accounted for 70% of Spain's gross margin. We have invested in two new consultancy areas, Security and Service Management, and, together with our existing business, we believe these will position us well in the Spanish market. At 30 June 2006, headcount in Spain had increased to 135 (2005: 86).

The Irish business performed strongly in the year with revenues of £19.8 million. While overall headcount in Ireland remains constant, the management team has been strengthened and reorganised to meet the demands of the market. At 30 June 2006, Morse Ireland employed 37 people (2005: 37).

On 24 July 2006 we announced the sale of Morse GmbH and Morse IT Solutions Austria GmbH ("Morse Germany") to the becom Group. The consideration, net of the cash staying inside Morse Germany, is €1.0 million (£0.7 million). Most of the business in Morse Germany was based around reselling and infrastructure services and this factor, taken together with the infrastructure trading environment in Germany and the fact that the disposal of this business could accelerate the development of the Group, led us to the decision to divest of this business. Sales in Germany fell by 11% to £70.2 million and, at the year-end, staff numbers in Morse Germany had been reduced to 166 (2005: 172).

## Monitise

Monitise, the Group's secure mobile banking applications business, has made substantial progress in the year. The loss incurred in the year ended 30 June 2006 was £3.2 million (2005: 2.2 million). It has now, after three and a half years of intensive development, reached a key stage of its evolution. It represents an excellent example of our successful intellectual property development, broadening the range of services we offer and ensuring we are well placed to take advantage of the opportunities presented by the emerging mobile commerce market. The first active deployment of the Monitise mobile banking platform (branded MONILINK™) is in the UK through mobileATM Limited, Morse's 50:50 joint venture with LINK Group Holdings Limited. MONILINK™ is being integrated into the first wave of UK banks and building societies that will provide the service to their own customers under their own brands.

The LINK network could provide access to a card base of 85 million and we anticipate having 440,000 MONILINK™ customers in 2007 assuming a 2.8% service adoption, growing to over 5 million potential MONILINK™ customers in 2010 assuming an 8% take-up. Our current forecasts, in association with our partners, suggest that adoption rates for mobile phone banking services could be faster than those relating to the use of physical ATMs or internet banking.

The service is being rolled out in a phased approach, which commenced recently with a group of first direct customers in July 2006. Initial services, which are accessed securely from consumers' mobile telephones, include balance enquiries and mini-statements. The ability to perform mobile top-ups, including top-ups for family and friends, is now available to HSBC customers, bringing access to a banking card base of over 12 million. We are also at a well progressed stage in our discussions with other LINK members including Alliance & Leicester, Barclays, Lloyds TSB and Royal Bank of Scotland.

MONILINK™ has been successful in all of its supplier selections and comparisons with banks and telecoms operators. An industry user forum has been established to ensure that services made available through MONILINK™ will appeal to the broadest possible consumer base. This forum already has senior level commitment and representation from Alliance & Leicester, Barclays, Derbyshire Building Society, first direct, Lloyds TSB, HSBC and Royal Bank of Scotland.

We foresee significant opportunities overseas for this unique mobile banking platform and have established Monitise Limited to capitalise on these. Monitise owns all intellectual property and development resources and is owned 85% by Morse and 15% by LINK. We have developed a franchising model, with an upfront fee, minimum annual fees and a percentage of the revenues, for maximising international growth and are excited by the increasing pipeline of opportunities.

Currently, 12 new countries are being evaluated for suitability. We have already commenced discussions in 8 countries. Of these eight, we have engaged with key switch providers in 4 and all of these have expressed their intention to switch mobileATM® transactions in their respective territories.

Out of 14 local partners ("Local Service Providers" or "LSPs"), 8 have been identified and formally engaged in a number of territories, of which 4 have been selected and are currently engaged with us in negotiations around preferred supplier agreements. Of the 4 that have entered into discussions with us around a mobileATM® franchise, 2 are in an advanced state and 1 the UK has been formalised. Our strong existing partnerships with organisations such as BT Global Services are facilitating our planned global deployment, both in terms of credibility and execution expertise.

The market is developing rapidly and we are moving to respond appropriately. We have established a 100% owned company, Monitise Business Solutions Limited ("MBS") to further utilise our unique intellectual property. Monitise now has in excess of 40 employees driving both the UK launch and developing international opportunities. Mobile is now widely confirmed as the fifth channel for retail banking customers and we are very pleased with the robust Ecosystem model we have already established in this rapidly developing space, with substantial support from key participants.

## Processes and people

At the year-end, Group headcount stood at 1,691 (2005: 1,730). This figure has since been reduced by 166 following the disposal of Morse Germany.

As we enter this exciting new phase for Morse, we would like to thank our people once again for their expertise and professionalism. It is their skills and dedication that will help shape the future success of the Group.

## Outlook

The current financial year has started satisfactorily and, with the new focus on delivering the final pieces in establishing Morse as an advisory & execution professional services firm, together with the developments at Monitise, we are confident of good progress both in the current financial year and in the years ahead.

**Duncan McIntyre**
**Chief Executive Officer**
**30 August 2006**

# Morse plc
## Financial review

In the year to 30 June 2006, Morse has adopted IFRS in preparing its Group Accounts and as such the focus of the statements is on continuing operations. Accounting policies used in the preparation of these accounts are consistent with the policies adopted on transition to IFRS.

In the year to 30 June 2006, revenue from continuing operations decreased to £297.0 million and operating profit from continuing operations before tax, amortisation of intangible assets and exceptional items increased to £7.4 million. Net funds at 30 June 2006 were £25.7 million.

| | **2006** | | 2005 | |
|---|---|---|---|---|
| £ million | **Revenue** | **Operating profit*** | Revenue | Operating profit* |
| Management Consulting | **14.1** | **2.2** | 12.5 | 2.3 |
| Business Consulting | **79.1** | **5.8** | 60.4 | 5.3 |
| Europe (excluding Germany & France) | **56.8** | **3.4** | 43.4 | 3.3 |
| UK Technology & Integration | **140.7** | **2.6** | 188.5 | 1.2 |
| ECM (Wisdom™) | **6.3** | **0.9** | 4.4 | 0.6 |
| Group Overhead | **-** | **(4.3)** | - | (5.0) |
| Morse Core | **297.0** | **10.6** | 309.2 | 7.7 |
| Monitise | **-** | **(3.2)** | - | (2.2) |
| | **297.0** | **7.4** | 309.2 | 5.5 |

* Excluding all exceptional items.

### Exceptional items – total operations
Net exceptional costs before tax amounted to £0.8 million. This amount is analysed in more detail in Note 3 of the financial statements.

The major items included within this category are noted below.

**French disposal**
The disposal of Morse France SAS ("Morse France") gave rise to a pre-tax loss of £7.1million.

**Trading balances**
With the changing shape of our business, and, in particular, the reduced level of infrastructure business (a reduction of approximately £300 million per annum since its peak), credit balances are no longer being created at the same level as they are released. In accordance with normal accounting practices, these releases are made when confirmed with the appropriate counterparty. We announced with our interim results that an amount of £13.1 million (2005: £1.1 million) has been credited to the income statement. This has been highlighted because of the magnitude of the release in this period.

**Restructuring costs**
Restructuring costs relate primarily to property costs of £3.0 million and people costs of £1.5 million.

**Impairment of goodwill of Morse Germany**
The completion of the sale of Morse GmbH and Morse IT Solutions Austria GmbH on 21 July 2006 has indicated a need for an impairment in the carrying value of goodwill of £2.3 million and this is included in the results for the year ended 30 June 2006.

## Morse plc

### Acquisitions and disposals
There have been two major changes in the Group's operating entities compared to the prior period as set out below:

### France
On 12 July 2005, Morse sold Morse France.

### Diagonal Limited (formerly Diagonal Plc)
The year ended 30 June 2006 performance includes a full year of trading from the Diagonal Limited acquisition (completed on 27 August 2004), whilst the prior period only included 10 months of trade.

### Post Balance Sheet Event
Following the period end, on 24 July 2006, the Group announced the sale of Morse GmbH and Morse IT Solutions Austria GmbH ("Morse Germany") to the becom Group. The consideration, net of the cash staying inside Morse Germany, was €1.0 million (£0.7 million). Most of the business in Morse Germany was based around reselling and infrastructure services and, taken together with the infrastructure trading environment in Germany, the likely financial investment and management time that would have been required to transition Morse Germany and the fact that the disposal of this business could accelerate the development of the Group, led to the decision to dispose of this business. During the year, sales in Germany had fallen 11% to £70.2 million.

Morse Germany has been classified as a discontinued operation and therefore is excluded from continuing operations. As a result of this transaction, the carrying value of the goodwill in the year ended 30 June 2006 accounts has been reduced to £1.6 million.

### Taxation
The tax expense of £1.8 million represents an effective rate of 30% (2005: 59%). The underlying consolidated tax rate was 78% (2005: 86%). The high underlying tax rate was due to non-allowable costs relating to the loss on the disposal of Morse France, impairment of goodwill on the Morse German investment and intangible asset amortisation. There is a prior year tax credit of £2.9 million in relation to the German and French businesses which is no longer likely to crystallise. We believe the underlying tax rate for the Group going forward will be 30%.

### Earnings per share
Adjusted earnings per share increased by 0.8p to 5.0p (2005: 4.2p). Details can be found in Note 4 of the financial statements.

### Dividend
A final dividend of 2.7p per share (2005: 2.6p), will, subject to approval at the Annual General Meeting, be paid on 15 November 2006 to shareholders on the register as at the close of business on 6 October 2006. This gives a total dividend for the year of 3.9p, an increase of 4% on last year.

### Cashflow
Net funds at the year-end amounted to £25.7 million (2005: £36.3 million)[1]. Principal outflows during the year were dividend payments of £5.8 million and tax payments of £3.5 million.

**Eric Dodd**
*Acting Group Finance Director*
30 August 2006

Note 1 Please refer to Note 33 on page 83

## Morse plc

# Profiles: the Board

**RICHARD LAPTHORNE**
NON-EXECUTIVE CHAIRMAN
Age 63. Richard joined Morse in 1998 and was Vice Chairman of BAE until 1999. He is Chairman of Cable & Wireless and New Look.

**DUNCAN MCINTYRE**
CHIEF EXECUTIVE OFFICER
Age 47. Duncan joined Morse as Finance Director in 1994, was then appointed Commercial Director and became the Group's Chief Executive Officer in 1997. He is a qualified accountant and worked at Price Waterhouse for ten years before joining Morse. He is also a Non-Executive Director of Profero Limited.

**PHIL COLL**
EUROPEAN DIRECTOR
Age 47. Phil joined Morse in December 1995 following a 13-year career in the IT industry with CERN, IBM and Sequent. He has held several senior management positions in the Group, and was appointed to the Board in January 2002.

**DAVID BERESFORD**
MD BUSINESS CONSULTING
Age 39. David joined Morse in December 2002. Prior to joining Morse, David held senior management positions at Andersen Consulting, Diagonal Plc and Sportbusiness Group. He was appointed to the Board in August 2003.

**BILL PASSMORE**
NON-EXECUTIVE DIRECTOR
Age 65. Bill joined Morse in 1995. He is Non-Executive Chairman of Artisan Software Tools Ltd, Quester VCT5 plc, Respond Group plc and Sift Group Limited. He previously worked for DEC and Sun Microsystems where he was Vice President, Northern Europe.

**COLIN TUCKER**
NON-EXECUTIVE DIRECTOR
Age 61. Colin joined Morse in 2000. He is Deputy Chairman of Hutchison 3G and was Technical Director of Orange plc for ten years. Colin has 30 years' experience in the telecommunications and electronics industries.

**DERRICK NICHOLSON**
NON-EXECUTIVE DIRECTOR
Age 56. Derrick joined Morse in 2005. Before his appointment to the Board in December 2005, Derrick was an Executive Director and CFO of the Avecia Group. He previously worked for Astra Zeneca and ICI and held a number of senior financial positions.

**NIGEL WHITEHEAD**
NON-EXECUTIVE DIRECTOR
Age 43. Nigel Whitehead joined Morse in 2004. He is Group Managing Director of Air Systems, a division within BAE Systems, and brings with him over 20 years' management experience from varying roles within the aerospace and defence industry.

## Morse plc

**LEE CAMERON**

COMPANY SECRETARY AND GENERAL COUNSEL

Age 35. Lee joined Morse in 1998. He is responsible for legal and compliance matters across the Group and also holds the position of Legal & Commercial Director for Monitise, Morse's innovative software subsidiary specialising in the development of secure Java applications and mobile banking and payment ecosystems.

# Morse plc

**Morse plc**
Registered in England No. 3108179

**Registered office**
Profile West
950 Great West Road
Brentford
Middlesex
TW8 9EE

## Advisers

**Financial advisers and stockbrokers**
Investec Investment Banking
2 Gresham Street
London
EC2V 7QP

**Independent auditors**
KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

**Principal bankers**
Royal Bank of Scotland
PO Box 2153
1-4 Berkeley Square
London
W1A 1SN

**Registrars**
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex
BN99 6DA

**Financial calendar**

| | |
|---|---|
| Ex-dividend date | 4 October 2006 |
| Record date | 6 October 2006 |
| Annual General Meeting | 9 November 2006 |
| Dividend payment date | 15 November 2006 |

## Morse plc
### Directors' report
### for the year ended 30 June 2006

The Directors present their annual report and the audited financial statements of Morse plc and its subsidiary companies ("the Group") for the year ended 30 June 2006.

### Principal activity

The Group's principal activity during the year continued to evolve from the selling and implementing of IT solutions to that of an advisory & execution professional services company.

### Review of the business and likely future developments

A review of the business and likely future developments can be found in the Chairman's statement on pages 5 to 6, Operating review on pages 7 to 11 and Financial review on pages 12 to 13.

### Results

The results of the Group are set out on page 40.

### Dividends

The Directors propose the payment of a final dividend of 2.70p per Ordinary share (2005: 2.60p), which in addition to the interim dividend of 1.20p per Ordinary share (2005: 1.15p), amounts to a total dividend for the full year of 3.90p per Ordinary share (2005: 3.75p).

### Research and development

During the year the Group spent £1,332,000 (2005: £284,000) on research and development which was primarily attributed to its mobileATM® and Wisdom™ applications. The costs in 2005 related to Wisdom™.

### Directors and their interests

The Directors who held office during the year and to the date of this report were as follows:

| | |
|---|---|
| E Barton | (Senior Non-Executive Director - retired 1 March 2006) |
| D Beresford | (Executive Director) |
| P Coll | (Executive Director) |
| S Cruickshank | (Group Finance Director – appointed 12 July 2005 & resigned 14 June 2006) (1) |
| G James | (Group Finance Director - resigned 24 August 2005) |
| R Lapthorne | (Non-Executive Chairman) |
| D McIntyre | (Chief Executive Officer) |
| D Nicholson | (Independent Non-Executive Director - appointed 12 December 2005) |
| W Passmore | (Independent Non-Executive Director – will be retiring at the Annual General Meeting) |
| C Tucker | (Independent Non-Executive Director) |
| N Whitehead | (Independent Non-Executive Director) |

Note 1 The Board position of Group Finance Director is currently not filled following the resignation of Stuart Cruickshank on 14 June 2006, though the Company is in the process of seeking a replacement. An announcement will be made in due course. Eric Dodd is Acting Group Finance Director in the interim.

Directors' beneficial interests in the share capital (including share options) of the Company are given in the Directors' Remuneration Report on page 34. There has been no change in the Directors' interests in shares of the Company and its subsidiaries between the end of the financial year and 30 August 2006. The Register of Directors' Interests, which is open to shareholders' inspection, contains full details of Directors' shareholdings.

One third (or the nearest whole number to one third) of the Directors in office at the date of the Annual General Meeting are required to retire by rotation. Richard Lapthorne, Colin Tucker and Duncan

McIntyre, whose profiles are given on pages 14 to 15, will retire and offer themselves for re-election. Derrick Nicholson was appointed to the Board on 12 December 2005 and will retire and offer himself for election at the Annual General Meeting. Bill Passmore has announced his intention to retire at the Annual General Meeting.

**Political and charitable contributions**

During the year the Group made various charitable contributions totalling £14,588 (2005: £12,950). The Group made no political donations (2005: £nil).

**Post balance sheet event**

On 21 July 2006, Morse plc completed the disposal of its business in Germany (Morse GmbH) and Austria (Morse IT Solutions Austria GmbH) ("Morse Germany") for a maximum consideration of €9.5 million (£6.5 million), comprising an initial consideration of €7.1 million (£4.9 million) in cash and a further €2.4 million (£1.6 million) of expected deferred consideration payable in cash within 90 days of completion subject to the collection of Morse Germany's receivables, and if the business achieves certain financial targets. The sale of the business was seen as an opportunity for the Company to focus on its core business in line with its strategy.

The sale of the business resulted in a non-cash exceptional charge of £2.3 million in the period to 30 June 2006 on the impairment of the goodwill balance.

**Disabled employees**

The Group recognises the importance of non-discriminatory employment practice and has an equal opportunities policy that includes the employment of people with disabilities. The Group gives full consideration to applications for employment from disabled persons where the requirements of the job can be fulfilled.

Where existing employees become disabled, it is the Group's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide training, career development and promotion wherever appropriate.

**Employee involvement**

During the year, the policy of providing employees with information about the Group has been continued through its internal newsletter. Regular meetings are held between management and employees to allow a free flow of information and ideas. Employees are encouraged to participate directly in the success of the business through the Group's share option schemes and have been encouraged to reinvest in the Group through participation in a Save As You Earn Scheme.

**Environment**

Due to the nature of the Company's business, the Directors believe it has a relatively minor impact on the environment. Nevertheless, the Company endeavours through its Environmental Policy to reduce this impact as far as possible. The Environmental Policy is regularly reviewed and, where necessary, revised to keep it in line with the Company's business requirements. The Company meets FTSE's corporate responsibility criteria and is a constituent company on the FTSE4Good Index Series.

Following an independent external audit (not undertaken by the Group's auditors), the Company has chosen not to set environmental Key Performance Indicators ("KPIs") due to its relative size and the limited impact which it has on the environment. The Company believes that its current Environmental Policy ensures that it is responsible and pro-active in limiting its environmental impact.

The Company ensures that all of its internal infrastructure is purchased in compliance with the RoHS Directive (the restriction of the use of certain hazardous substances in electrical and electronic equipment).

## Morse plc

**Risk**
Senior management are aware of their responsibility for managing risk within their Strategic Business Units ("SBU"). Each SBU head reports to the Board on the status of these risks through management reports.

Group risk is regularly reviewed at Board level to ensure that risk management is being implemented and monitored effectively.

The Board's policy is to ensure the SBUs are empowered to run their businesses effectively and appropriately, bearing in mind the requirements for timely decision making and commercial reality.

The Company regularly reviews its commercial insurance programme and maintains an appropriate and adequate portfolio of insurance policies in line with the nature, size and complexity of the business.

Operationally, an approvals matrix has been established to ensure that risk is approved at the relevant managerial level. Standard form contracts are provided for commercial use and to assist the commercial function to negotiate within an appropriate and approved safety zone.

Through management reports, risks are highlighted and monitored to identify potential business risk areas and, wherever possible, to quantify and address the risk with a contingency/mitigation plan.

**Business review**
The Directors have provided the following business review in accordance with the Companies Act. Accordingly, the Company is disclosing the main trends and factors likely to affect the future development, performance and position of the Company's business.

KPIs, whilst set at Group level, have been devised to allow the Board and shareholders to monitor the Group as a whole, as well as operating businesses within the Group.

The Company has financial KPIs which it monitors on a regular basis at Board level and, where relevant, at SBU operational executive management meetings as follows:

| | 30 June 2006 | 30 June 2005 |
|---|---|---|
| 1. Continuing Group revenue[(1)] | £297.0 million | £309.2 million |
| 2. Operating profit[(2)] from continuing operations | £7.4 million | £5.5 million |
| 3. Profit before tax for continuing operations [(3)] | £8.0 million | £6.8 million |
| 4. Net funds balance [(1)] | £25.7 million | £36.3 million |

Note 1 – *for the discussion of these financial KPIs please refer to the Chairman's statement at pages 5 to 6, the Operating review at pages 7 to 11* and the Financial review at pages 12 to 13
Note 2 – £7.4 million continuing profit excludes all exceptional items and includes the loss of the joint ventures of £0.4 million (2005: £0.5 million) – please refer to page 40
Note 3 – excludes all exceptional items and includes total net financing income of £0.6 million for 2006 (2005: £1.3 million) – please refer to page 40

The Company has provided in the Chairman's statement and Operating review details of various risks it faces, which include:

- the maintenance of a healthy net funds balance (see page 5 – Chairman's statement) for the Group to be able to invest for its future development;
- non-profitable and low margin business entities especially in the reselling base, where the transition to an advisory & execution business has not been sufficiently quick, detracting from corporate objectives and effort (see page 5 – Chairman's statement);
- seasonal fluctuations in demand, especially in our consultancy-based businesses, coupled with a maturing market which can result in non-recoverable consultancy costs (see page 8 – Operating review);

- phasing issues with major new clients in the confirmation of contracts prior to work commencing resulting in under utilised resources (see page 8 – Operating review);
- not rationalising cost bases effectively to eradicate duplication of effort (see page 8 – Operating review); and
- the need to continually rejuvenate our presence with key third party suppliers to ensure that we are not potentially losing existing and potential revenue streams (see page 8 – Operating review).

The Company has announced that it will be transforming the core Morse business to a 'one company' organisation and therefore monitors its KPIs at a Group level. The 'one company' framework will highlight common themes throughout the Company promoting one brand and one culture.

The Company perceives and closely monitors the following major trends, opportunities and risks for the year ending 30 June 2007 and beyond:

- ensuring that the Group's objectives of growing revenue and profit in line with market expectations are met, given the strategy of transforming the business into two distinct areas - core Morse and Monitise - and ensuring that this transformation is effectively and successfully implemented;
- ensuring the transformation of the Company strategy from a reseller to a single advisory & execution professional services business;
- focusing client attention on the strong Morse brand;
- improving margins so that they are consistent with other advisory & execution firms;
- ensuring that we represent and maintain a global image to our clients in an ever competitive market;
- revenue maintenance is a risk to the business. However, ensuring that this is bolstered by increased revenue quality and margin growth is seen as key to ensure that the more important KPI of profit underpins the top-line numbers;
- in our consultancy-based businesses, seasonal fluctuations especially in the summer months presents a risk. However, ensuring that the pipeline of work is effectively managed and maintained and grown in key accounts has and will continue to ensure that the businesses maintain healthy cash flow;
- fee rates continue to face downwards pressure. However the focus from the Group on a 'one company' approach and leveraging off other business units should help to provide a more tailored niche offering to avoid further deterioration; and
- with the Monitise business, building upon the successes achieved in creating a stand-alone business entity, and maintaining, growing upon and capitalising on the impressive intellectual property portfolio already built around the brand, ensuring that the challenges of high capital outlay are balanced with the need to carefully match future expenditure and revenue.

***Corporate and social responsibility policy***

The Company embraces corporate social responsibility and encourages all of its subsidiaries to become involved in local projects and initiatives on an ad-hoc level dependent on employee interest and participation.

**Supplier payment policy and practice**

The Group supports the Better Payment Practice Code (previously the CBI's Prompt Payers Code), to which it subscribes, when dealing with all of its suppliers. A copy of the code can be obtained from the Department of Trade and Industry, DTI Publications, Orderline, Admail 528, London SW1W 8YT.

It is the Group's policy that payments to suppliers are made in accordance with agreed terms and conditions on an individual basis provided all trading terms and conditions have been complied with.

The average number of creditor days for the Group for the year was 44 (2005: 33) - the Company does not have any trade creditors.

## Morse plc

### Substantial shareholdings

The Company has been notified pursuant to Sections 198-208 of the Companies Act 1985 that the following shareholders held 3% or more of the Company's Ordinary shares as at 30 August 2006:

| Shareholder | Number of shares held | % of the issued share capital |
|---|---|---|
| 3i Group Asset Management | 24,767,399 | 16.15 |
| Harris Associates | 21,704,900 | 14.15 |
| UBS Global Asset Management (UK) | 18,286,286 | 11.92 |
| Liontrust Asset Management | 9,342,520 | 6.09 |
| GAM | 6,965,000 | 4.54 |
| Capital International | 5,939,900 | 3.87 |
| Morley Fund Management | 5,349,655 | 3.49 |
| Legal & General Investment Management | 5,269,622 | 3.44 |

See Directors' Remuneration Report for the table of Directors' Shareholdings on page 34.

### Interests in own shares

The Company did not make any acquisitions of its own shares during the year. The Company held a balance of 1,132,345 shares in respect of shares held in its EBTs (2005: 1,242,730 shares)

### Annual General Meeting

The Annual General Meeting of the Company will be held on 9 November 2006.

### Going concern

The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future. For this reason, they continue to adopt the 'going concern' basis for preparing the accounts.

### Auditors

A resolution to re-appoint KPMG Audit Plc will be proposed at the Annual General Meeting.

### Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditors are unaware. Each Director has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

Approved by the Board of Directors on 30 August 2006 and signed on its behalf.

**Lee Cameron**
Company Secretary

## Morse plc

### Statement of Directors' responsibilities in respect of the Directors' report and the financial statements

The Directors are responsible for preparing the Directors' report and the Group and parent company financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law the Directors have elected to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

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

The directors are responsible for the maintenance and integrity of the corporate and financial information included in the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from the legislation in other jurisdictions.

# Morse plc
## Corporate Governance Statement

### Combined Code on Corporate Governance Compliance Statement
The Board is committed to the main provisions of the July 2003 Combined Code on Corporate Governance (the "Code") and endeavours to comply with the Code in all respects. This report highlights the way in which the Board believes it has been compliant with the provisions of the Code during the year.

The Company was compliant with the Code as set out below other than where illustrated within this report.

### The Board of Directors
The Board collectively embraces its responsibilities and accountability in reserving certain matters for its review and approval, including an effective overall strategy, prudent financial strategy and planning, strategic aims, human resources to ensure the Company can meet its objectives, material acquisitions and disposals, investments and capital projects.

The Board believes it makes its decisions in the best interests of the Company ensuring that its obligations to shareholders and others are effectively met.

The Board currently consists of three Executive Directors and four Non-Executive Directors (excluding the Chairman). For the period between Stuart Cruickshank joining the Board on 12 July 2005 and Gavin James resigning from the Board on 24 August 2005, the Company was not compliant with Code Provision A.3.2 (which requires at least half the Board, with the exclusion of the Chairman, to be Independent Non-Executive Directors). As reported in the Report and Accounts 2005, the Board views this non-compliance as a timing issue. It is the Company's policy to always have at least half the Board comprised of Independent Non-Executive Directors.

The Board ensures that there is an Independent Director appointed as the Senior Non-Executive Director. This position was held by Eric Barton and, following his retirement from the Board on 1 March 2006, this position has been assumed by Derrick Nicholson who joined the Board on 12 December 2005.

All Non-Executive Directors excluding the Chairman are considered by the Board to be independent for the purposes of the Code even though they are permitted to hold other directorships with other companies. The Chairman is also considered by the Board to be independent. Bill Passmore was appointed as a Non-Executive Director of the Company on 29 September 1995. Whilst he has been a Non-Executive Director of the Company for more than nine years, he is still considered by the Board to be independent for the purposes of the Code and his range of other current directorships and wide previous experience has allowed him to bring distinct and challenging views to Board discussions. Following the retirement of Eric Barton on 1 March 2006, which had been anticipated, the Board felt that it was important to continue to retain Bill Passmore's on-going commitment during the continuing transition period of the Company, though he has announced that he will be retiring from the Board at the Annual General Meeting.

The balance between Executive and Non-Executive Directors has been reviewed by the Nominations Committee and the Board, and there is a formal process for the appointment of new Directors to ensure that suitable candidates are identified.

The posts of Chairman and Chief Executive Officer are held by different Directors and their differing responsibilities defined. The Chairman leads the Board in determining strategy, achievement of objectives and organising the business of the Board, but has no involvement in the day-to-day business of the Group. The Chief Executive Officer is responsible for formulating the Group's strategy and for the Group's day-to-day business and is accountable to the Board for the financial and operational performance of the Group.

## Morse plc

The Board believes its style of involvement with the senior executives through the Chief Executive Officer and the Executive Directors is the most effective way to provide confidence in the control environment of the Company. Through openness and discussion, the Board endeavours to understand and provide leadership as to the willingness of the Company to take appropriate risks in the interests of the shareholders. The Board focuses almost exclusively on operational and strategic matters and thereby lays the foundation for an understanding of the business which facilitates effective governance.

The Board meets at least six times during the year and holds other meetings as necessary. All Directors have access to the Company Secretary, who, under the direction of the Chairman, is responsible for ensuring Board procedures are followed. The Chairman is responsible for ensuring all Directors receive accurate and appropriate information in a timely manner in advance of Board meetings. The Board is provided with comprehensive information to enable it to discharge its duties.

The Company Secretary, under the direction of the Chairman, is also responsible for ensuring that there is good information flow to and within the Board and its Committees. The role also involves ensuring that the flow of information between the Board and the senior executives within the business is maintained and that the Board is duly updated and made aware of any governance matters. The Company Secretary is responsible for ensuring that Board procedures are followed and complied with. The appointment and removal of the Company Secretary is the responsibility of the entire Board.

The Chairman ensures the effective contribution of the Non-Executive Directors and ensures the maintenance of good and constructive relations by them with the Executive Directors.

The Company has Directors' and Officers' Liability Insurance cover in place covering all directors and officers.

A procedure exists for all Directors to be entitled to take independent professional advice, if necessary, at the Company's expense where they need to ensure they are discharging their responsibilities as Directors.

One third of Directors in office at the date of the Annual General Meeting are required to retire by rotation. Directors are required to retire at least every three years. Directors appointed to the Board during and after the period are required to seek election at the first Annual General Meeting following their appointment. Any re-election of a Non-Executive Director, which would take them over a six-year appointment, is subject to rigorous review taking into account the need for progression of the Board.

The performance of the Executive Directors (excluding the Chief Executive Officer) is evaluated by the Chairman in consultation with the other Non-Executive Directors and the Chief Executive Officer. The Non-Executive Directors, led by the Senior Independent Director, are responsible for the performance evaluation of the Chairman and the Chief Executive Officer, after having sought the input of all other Directors. The results of these evaluations are used when considering the re-election of Board members. The results will also be used by the Chairman and Senior Independent Director to ensure the strengths and weaknesses of the Board are recognised and that there is planned and progressive refreshing of the Board.

Going forward and in compliance with Code provision A.6, the Company will continue to review and consider whether appropriate methods and processes for establishing a more formal annual evaluation of all Directors is required. The Company is therefore not currently compliant with Code provision A.6.1 in that the performance evaluation methods are not formalised. The current informal evaluation covers individual contribution and commitment.

The Chairman and the Board believe that the Board and each Committee of the Board are operating appropriately and effectively. They focus on operational issues and are carried out in an atmosphere of openness. Papers are usually produced in advance to support agenda items. The Executive Directors, as managers, always seek to provide appropriate answers to all questions asked by the Non-Executive Directors.

## Morse plc

*The Directors' details, along with their membership of each Board Committee and attendance record, is set out in the table below (other members may attend at the invitation of the Committee):*

**Board Structure and Attendance between 1 July 2005 and 30 June 2006**

| | Status | Audit Committee Member | Nominations Committee Member | Remuneration Committee Member | Board Meetings Attended | Audit Committee Attended | Nominations Committee Attended | Remuneration Committee Attended |
|---|---|---|---|---|---|---|---|---|
| **No. of Meetings held** | | | | | 10 | 2 | 2 | 6 |
| Richard Lapthorne | Non-Executive | No | Yes[6] | No | 10 | - | 2 | - |
| Duncan McIntyre | Executive | No | No | No | 10 | - | - | - |
| Gavin James[1] | Executive | No | No | No | 1 | - | - | - |
| Stuart Cruickshank[2] | Executive | No | No | No | 8 | - | - | - |
| Phil Coll | Executive | No | No | No | 9 | - | - | - |
| David Beresford | Executive | No | No | No | 9 | - | - | - |
| Colin Tucker | Non-Executive | Yes | Yes | Yes | 7 | 1 | 1 | 4 |
| Bill Passmore | Non-Executive | Yes | Yes | Yes | 10 | 2 | 1 | 5[9] |
| Eric Barton[3] | Non-Executive | Yes | Yes | Yes | 7 | 2 | 1 | 4 |
| Nigel Whitehead | Non-Executive | Yes | Yes | Yes[7] | 9 | 2 | 2 | 4 |
| Derrick Nicholson[4,8] | Non-Executive | Yes[5] | Yes | Yes | 6 | 1 | 2 | 4 |
| Lee Cameron | Company Secretary | No | No | No | 10 | - | - | - |

| | |
|---|---|
| Note 1 | *Gavin James served on the Board until 24 August 2005* |
| Note 2 | Stuart Cruickshank was appointed to the Board on 12 July 2005 and resigned on 14 June 2006 |
| Note 3 | Eric Barton was the Senior Independent Director until he retired from the Board on 1 March 2006 |
| Note 4 | Derrick Nicholson was appointed to the Board on 12 December 2005 |
| Note 5 | *Derrick Nicholson became Chairman of the Audit Committee from 1 March 2006* |
| Note 6 | Richard Lapthorne is Chairman of the Nominations Committee |
| Note 7 | Nigel Whitehead is Chairman of the Remuneration Committee |
| Note 8 | Derrick Nicholson has assumed the role of Senior Independent Director following Eric Barton's retirement from the Board on 1 March 2006 |
| Note 9 | Bill Passmore announced his resignation from the Remuneration Committee during the fifth meeting |

*During the year, there are occasions when Directors are unable to attend Board and Committee* meetings. In those circumstances, the absent Director is provided with a copy of the Board papers and the resultant minutes and has the opportunity to raise questions at a subsequent meeting.

All new Non-Executive Directors are to be appointed for specified terms.

Notice periods for all Directors are set at one year or less.

### The Committees of the Board

The following Committees have been established to assist the Board in fulfilling its responsibilities.

#### *Audit Committee*

During the year the Committee meets at least twice and on other occasions as and when necessary to fulfil its duties. A record of individual attendance is listed in the table above. The Chairman, Chief Executive Officer, Group Finance Director and external auditors are invited to attend all meetings.

This Committee is responsible for overseeing the involvement of the Group's auditors in the planning and review of the Group's financial statements and any other formal announcements relating to the Group's financial performance, for recommending the appointment and fees of its auditors, and for discussing with the auditors the findings of the audit and issues arising from the audit. The Committee considers the independence and objectivity of the auditors with regard to the way in which it conducts its audit duties. It reviews the Group's compliance with accounting, legal and listing requirements. It is also responsible, along with the Board, for reviewing the effectiveness of the systems of internal control.

The Committee's terms of reference are available for public inspection at the Company's registered office.

In the normal course, the Company will expect its auditors to provide audit and tax services, subject to auditor objectivity, independence regarding audit duties, review and re-tendering every four years. The Audit Committee has discretion to vary this review period depending on satisfaction with the audit process. A review was conducted this year and the Audit Committee's recommendation is that KPMG Audit Plc be re-appointed as the Company's auditors. An appropriate resolution will be put before the shareholders at this year's Annual General Meeting.

All other non-audit/tax advisory (e.g. due diligence) services will always be benchmarked by management to ensure value for money, auditor objectivity and independence of advice. Management may exercise its discretion to retain the auditors for such services subject to a de minimis of £50,000 per individual transaction or, for a series of smaller transactions, fees aggregating 50% of the annual combined audit and tax fee as projected in each year's initial auditors' review. Transactions involving higher fees, or where the independence of the auditors may be called into question, may be agreed by the Audit Committee Chairman who will, at his discretion, refer the matter for approval by the full Audit Committee in material cases. The auditors will not receive management consultancy work.

The members of the Audit Committee are the four Non-Executive Directors: Nigel Whitehead, Bill Passmore, Colin Tucker and Derrick Nicholson, who chairs the Committee. Eric Barton chaired the Audit Committee until his retirement from the Board on 1 March 2006.

The Board is satisfied that at least one member of the Audit Committee has recent and relevant financial experience.

The role of the Audit Committee is to monitor all financial statements of the Company, review internal financial controls, consider the need for an internal audit function and report to the Board on its findings if it considers action or improvement is required.

The Board reviews the Company's requirement for an internal audit function on an annual basis. It has determined that the Group is not sufficiently complex in overall size or structure to warrant a dedicated internal audit function. The Audit Committee considers they have adequate structures in place to monitor financial statements and review financial controls without the requirement for a permanent internal audit function. This position will be kept under annual review and, should an internal audit function become necessary or desirable in the future, measures will be taken to ensure the Company establishes an internal audit function without delay.

The Company has a formal 'whistle-blowing' policy made available to all employees of the Company and all subsidiary companies in compliance with Code Provision C.3.4.

**Remuneration Committee**
The Committee considers and approves specific remuneration packages for each Executive Director following consultation with the Chairman. In accordance with guidelines set by the Board, it determines the Group's policy on remuneration of senior executives and controls the operation of share option schemes and the grant of options.

Remuneration of Non-Executive Directors is set by a Committee of the Board consisting of at least two Executive Directors.

The Committee's terms of reference are available for public inspection at the Company's registered office.

The members of the Remuneration Committee are Derrick Nicholson, Colin Tucker and Nigel Whitehead, who chairs the Committee. Bill Passmore was a member and Chairman of the Remuneration Committee until his resignation from the Committee on 28 April 2006. The Remuneration report appears on pages 30 to 37.

**Nominations Committee**

The Committee meets as required to initiate the selection process of, and make recommendations to, the Board with regard to the appointment of new Directors.

The Board has established a procedure of formal appointment of new Board Directors based upon merit and objective criteria, ensuring the appointee has sufficient time to devote to the role. The Board is satisfied with the plans for assessment of Directors, updating of skills and knowledge regarding the Company to fulfil their functions, and orderly succession, ensuring that an appropriate core level of skill and experience is maintained within the Company and on the Board. Any significant commitments which might conflict with the effectiveness of new appointees is disclosed to the Board before appointment. Major shareholders are given the opportunity to meet new Non-Executive Directors at the Annual General Meeting.

The Board requires its members to make it aware of any changes in commitments which might give concern regarding the effectiveness of that member.

The Board does not allow any Executive Directors to take on more than one Non-Executive Directorship in a FTSE 100 company or the Chairmanship of such company.

The members of the Nominations Committee are the Chairman and the four Non-Executive Directors. The Committee is chaired by Richard Lapthorne.

The employment contracts for the Non-Executive Directors are made available for public inspection at the Company's registered office.

The Committee's terms of reference are also available for public inspection at the Company's registered office.

Stuart Cruickshank and Derrick Nicholson were appointed to the Board on 12 July 2005 and 12 December 2005 respectively. They were selected with the assistance of external search consultants. In compliance with Code Provision A.5.1, they were given a full, formal and tailored induction on joining the Board. Shareholders have the opportunity to meet with all the Directors at the Annual General Meeting.

**Relations with shareholders**

The Company and Board recognise the importance of developing and maintaining good relationships with its shareholders. There are regular dialogues with shareholders to ensure that issues and concerns are raised, including presentations following the Company's interim and preliminary announcements. The Company also uses the Annual General Meeting as an opportunity to communicate with its shareholders. All Directors are required to attend the Annual General Meeting and the Chairmen of the Audit, Remuneration and Nominations Committees are also available to answer shareholders' questions.

Notice of the 2006 Annual General Meeting will be despatched to shareholders not less than 20 business days before the meeting. At the Annual General Meeting, details of all proxy votes will be made available in accordance with the provisions of the Code. Separate resolutions on each substantially separate issue, in particular any proposal relating to the Annual Report and Accounts, will be made at the Annual General Meeting.

## Morse plc

Eric Barton was Senior Independent Non-Executive Director until his retirement from the Board on 1 March 2006, and Derrick Nicholson has assumed responsibility for this role. The role includes being available to shareholders if they have concerns which have not been resolved following contact through normal channels – being the Chairman, the Chief Executive Officer or Group Finance Director. The Company is in the process of appointing a new Group Finance Director following the resignation of Stuart Cruickshank on 14 June 2006 and, in the interim, this position is held by Eric Dodd in an acting capacity.

Information is made available to shareholders on the Group's website, which can be found at morse.com.

### Management structure

The Executive Directors meet regularly as part of the Executive Committee, which comprises both the Executive Directors and Strategic Business Unit Heads, to discuss strategic and operational matters. Executive Directors also attend Subsidiary Board meetings where necessary and appropriate.

### Health and safety

The Company recognises the importance of this and understands the high standards required to ensure the health, safety and welfare of its employees at work, its customers and the general public. The Company has an exemplary health and safety record.

### Internal control systems

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness on an annual basis. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

Elements of the system of material controls (which includes financial, operational and compliance controls) are:

- an annual budget is prepared to facilitate the monitoring of the Group's business and financial activities and is formally adopted by the Board;
- Board meetings are held on a regular basis to consider performance against budget, the management accounts and the forecast for the coming months;
- within each Strategic Business Unit, the relevant Strategic Business Unit Head meets with senior managers of companies within that Strategic Business Unit to discuss issues particular to that company;
- the Audit Committee meets at least twice a year to consider the plans and the results of the audit performed by the external auditors. The external auditors have direct access to the Audit Committee and vice versa; and
- business processes and internal control procedures are maintained through the BSI Certified BS EN ISO 9001: 2000 Business Process documentation.

### Risk management

During the year there were processes to ensure that business risk is considered, assessed and monitored as an integral part of the business. The Directors are of the view that from 1 July 2005 and up to the date of approval of the Annual Report and Accounts, there is an ongoing process for identifying, evaluating and managing the Group's significant risks that is regularly reviewed by the Board.

### Statement from Independent Directors

The Non-Executive Directors have been asked to provide their views on the effectiveness of the corporate governance processes within Morse to ensure compliance with the Code. These views have been determined by the Non-Executive Directors and shared with the full Board in open session.

"We have addressed the quality of the relationship between the Chairman and Chief Executive Officer, the openness of the Chief Executive Officer with the Board, the visibility of checks and balances between the Executive Directors and whether all questions asked by the Non-Executive Directors in Board and Committee meetings have been appropriately addressed. The Non-Executive Directors have concluded that issues are fully debated at Board and Committee meetings and subjected to rigorous scrutiny without detracting from any openness in Board relationships at all levels - particularly as between the Chief Executive Officer and the Chairman and between the Executive and Non-Executive Directors."

# Morse plc
## Directors' Remuneration Report

### Introduction
The Board presents its report on remuneration, which sets out the policy and disclosures in relation to Directors' remuneration. This report will be submitted to shareholders for their approval at the Annual General Meeting of the Company to be held on 9 November 2006 and has been produced in accordance with the Directors' Remuneration Report Regulations 2002.

### Remuneration Committee
The Remuneration Committee reviews and determines on behalf of the Board the overall remuneration package of the Executive Directors. The Chief Executive Officer recommends and monitors the remuneration of all senior executives. Its terms of reference are available for public inspection.

Its members, all Independent Non-Executive Directors, are Nigel Whitehead (Chairman), Derrick Nicholson and Colin Tucker. Bill Passmore was a member and Chairman of the Remuneration Committee until his resignation on 28 April 2006. The Chairman and Chief Executive Officer may, upon the Committee's invitation, also attend the meetings of the Committee. The Chief Executive Officer does not attend where his own remuneration is being considered.

During the year, advice has been sought from New Bridge Street Consultants LLP in relation to current market trends and best practice with regard to Directors' remuneration. The Committee has also used New Bridge Street Consultants LLP to act as independent consultants during the year ended 30 June 2006 and plans to continue to use them to act as independent consultants in the year ending 30 June 2007. No other services are offered by New Bridge Street Consultants LLP to the Company save for technical advice relating to the operation of the Company's share incentive arrangements.

### Remuneration Policy for Executive Directors
The Company's remuneration policy is designed to ensure that Executive Directors' rewards are competitive when compared to similar companies, to recognise the plans for the Group and align the interests of Directors and shareholders. The remuneration packages comprise base salary, benefits, performance-related bonuses, defined contribution pensions and long-term incentive rewards. Base salaries are set to ensure the Company can recruit and retain the most capable talent, which we believe is vital for driving shareholder value. Strong emphasis is then placed on the variable performance-related aspects of the overall package to ensure performance during a fiscal year can be correctly rewarded. Base salaries are normally set at median market level with variable incentives (bonus and share option arrangements) offering upper quartile earnings for upper quartile performance in a normal market environment.

There were no contracts of significance subsisting during or at the end of the year in which a Director of the Company is or was materially interested.

The current elements of the remuneration packages can be summarised as follows:

### Base Salary
Salaries are normally reviewed annually in December by the Remuneration Committee in accordance with the terms above. The Group results for the previous trading year, individual performance and market rates are considered. The Executive Directors' salaries were increased by an average of 4.29% in January 2006 (March 2005: 3.50%).

The Executive Directors' base salaries as at 30 June 2006 were:

| | |
|---|---|
| Duncan McIntyre | £320,000 |
| Philip Coll | £185,000 |
| David Beresford | £185,000 |

# Morse plc

### Benefits
Benefits include the provision of a company car or allowance, private medical insurance, life insurance and permanent health insurance.

### Annual Performance-Related Bonus
The annual bonus plan has a maximum threshold of 100% of base salary. In 2006, target bonuses for individual Directors were set in a range of 35% to 55% of base salaries. These bonuses are triggered by achieving the agreed performance objectives of the Group. Bonus payments are non-pensionable and are payable after the Group's statutory accounts have been audited. In respect of the year ended 30 June 2006, £148,334 of bonuses were awarded to the Executive Directors of the Company (2005: £280,000). This represents 16.67% of the possible maximum bonuses available to Executive Directors. For the year ending 30 June 2007, any bonus payable will be based solely on achieving agreed financial targets.

### Pensions
The Company operates a defined contribution scheme (money purchase) which is operated for Executive Directors and employees. The Company contribution rate is set at a fixed amount for each of the Executive Directors: Duncan McIntyre's rate is set at £35,000, and Messrs Coll's and Beresford's rates are both set at £25,000, making an average contribution of 12.32%. This is below the recommendation of 14% from the Remuneration Committee, which was made in July 2003 following a thorough review of market practice.

### *Share Incentive Schemes*
Executive share incentives are considered to be a key part of management retention and motivation. The policy of the Company is to incentivise Directors and other executives to perform at high levels and to align their interests with those of shareholders.

The Company operates an options-based long-term incentive policy. Under the Unapproved and Approved versions of the Executive Share Option Schemes 2000, all option grants were subject to a performance condition that "there be an average annual increase in adjusted earnings per share of at least 5% more than the average annual percentage increase in the Retail Price Index in the three-year performance period." Options granted under the Morse Unapproved Executive Share Option Scheme preceding the 2000 Scheme contained the same 5% provision, but in addition allowed re-testing in a fourth consecutive financial year.

The adjusted basic earnings per share (EPS) after goodwill amortisation and exceptional items was the chosen performance measure as it was a commonly used measure of the Company's financial performance.

Further details of the Executive Share Option Schemes and the Directors' interests are given below.

At the Company's Annual General Meeting held on 1 November 2004, the Long-Term Incentive Plan ("Plan") was adopted. Save for exceptional circumstances, no individual may receive awards under the Plan in any financial year over shares having a market value on grant in excess of 150% of his or her annual rate of base salary. Prior to the Committee making an award under the Plan, it may require a prospective participant to buy and retain Ordinary shares in the Company worth up to one-third of the value of the shares over which the proposed award would be made.

Awards will normally vest following the third anniversary of grant once the Committee has determined the extent to which the applicable performance conditions have been satisfied and provided the participant is still employed in the Group.

## Morse plc

The performance condition attached to awards granted under the Plan relates to the Company's relative total shareholder return ("TSR") performance against the FTSE All-Share Software and Computer Services Sector.

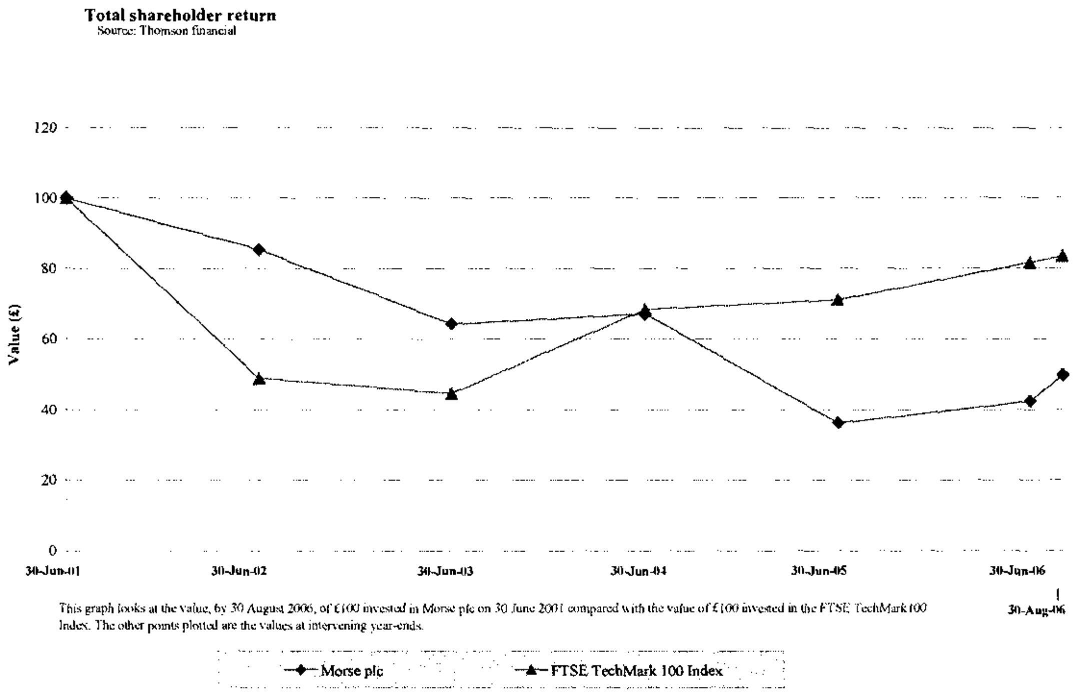
The percentage of Shares subject to an award that may vest is as follows:

| Rank of the Company's TSR against FTSE All-Share Software & Computer Services Sector | Percentage of award that vests |
|---|---|
| Below median | 0% |
| Median | 25% |
| Upper quartile | 100% |
| Between median and upper quartile | 25% - 100% on a straight-line basis |

The performance period will be a single three-year period, which will begin on the date on which an award is granted and end three years later. There is no provision for re-testing. In addition, irrespective of the Company's TSR performance, no awards will vest unless the Committee is satisfied that the Company's earnings per share grows in real terms over the three-year performance period (unless the Committee believes that it would be inappropriate to apply this underpin).

The Committee has chosen this performance condition as it believes it appropriate for executives to be encouraged to generate returns to shareholders greater than the Company's sector peers. The extent to which the performance conditions are satisfied will be determined by the Committee.

The following graph shows the value of £100 invested in Morse plc on 30 June 2001 compared with the value of £100 invested in the TechMark 100 Index. Morse has been a constituent of this Index for all of this period and it is therefore deemed to be the most appropriate comparator.



## Morse plc

### Employee Share Schemes

The Company operates a number of employee share schemes in which the Executive Directors are also entitled to participate. Details of the awards, granted and outstanding, under each of the schemes are given in Note 5 to the financial statements.

The Company announced on 30 August 2006 that the transition of the Group, from being a technology reseller to an advisory & execution professional services company, was nearing completion and that as part of this transition the Company would be structured around two separate and distinct businesses; Morse and Monitise. Each of these businesses will operate with their own boards and management structures. Appropriate incentives will be used to ensure that the executives and management within these businesses perform at high levels and align their interests with those of the shareholders. The incentive plans will utilise the Company's existing framework of option schemes and long-term incentives.

### Morse Group Company Share Option Plan

A number of employees and senior managers were granted options in 1998 based on the terms of the Morse Group Company Share Option Plan which was established by the Company on 3 December 1996. All of these options have been exercised or are currently exercisable.

### Employee Share Option Scheme

Shortly prior to listing, all employees of Morse (apart from Directors) who had commenced employment with the Group prior to 17 February 1999 were granted options under this Scheme. The value of most of the options granted was based on both basic salary and length of service. No further options have been granted under this Scheme since listing.

### Unapproved Executive Share Option Scheme

A number of Directors and members of senior management have been granted options under this Scheme with the intention of motivating and retaining such key personnel. No options have been granted under this Scheme since April 2000 and it has since been replaced by the Unapproved Executive Share Option Scheme 2000.

### *Unapproved Executive Share Option Scheme 2000 and Approved Executive Share Option Scheme 2000*

These Schemes were designed to provide the flexibility required in a competitive market, and were adopted by the Company at the Annual General Meeting in November 2000. Details of the options granted under these Schemes are given in Note 5 to the financial statements.

### Sharesave Share Option Schemes

The Company has established an Inland Revenue-approved Sharesave Scheme and an international Save As You Earn Scheme. Sharesave options will be exercisable on completion of an associated savings contract. The Sharesave options may be granted at a discount of up to 20% to the market price of the Company's shares on the day prior to the day of invitation, as permitted by the rules of the Scheme.

### Diagonal Option Schemes

At the time of the acquisition of Diagonal Plc, Diagonal employees who held options over Diagonal shares under the Diagonal Plc Discretionary Award of Share Options Scheme, the Diagonal Plc Long-Term Incentive Plan, the Diagonal Plc 1997 Savings-Related Share Option Scheme and the Claritas Share Option Scheme exchanged their options for equivalent options over Morse shares. There are options over Morse shares which remain outstanding under these schemes but no further options will be granted under these schemes.

## Morse plc

### Monitise Share Option Schemes

Ten per cent of Monitise Group Limited's authorised share capital has been allocated to be issued as share options for management and staff. Share options have been, and will be, granted over shares in Monitise Group Limited pursuant to the rules of the Monitise Group Limited Share Option Scheme.

### Service Contracts

Executive Directors are employed on a rolling contract and have a 12-month notice period both to and from the Company. They contain no provisions for termination payments other than those that may arise under notice provisions, which the Company believes reflects market and best practice. Non-Executive Director appointments contain a one-month notice provision and are for a 12-month duration. There are no compensation provisions for early termination of Non-Executive Director appointments.

### Directors as at 30 June 2006:

| Director | Employing Company | Date of Contract |
|---|---|---|
| D Beresford | Morse plc | Jul 2004 |
| P Coll | Morse plc | Jul 2004 |
| R Lapthorne | Morse plc | Jan 1999 |
| D McIntyre | Morse plc | Jul 2004 |
| D Nicholson | Morse plc | Dec 2005 |
| W Passmore | Morse plc | Feb 1999 |
| C Tucker | Morse plc | Mar 2000 |
| N Whitehead | Morse plc | Dec 2004 |

### Directors' Shareholdings

The Directors' and their families' beneficial interests in the share capital of the Company at 30 June 2006 are shown below:

| | **30 June 2006** Beneficial Ord shares of 10p | **30 June 2006** Share options Ord shares of 10p | 30 June 2005 Beneficial Ord shares of 10p | 30 June 2005 Share options Ord shares of 10p |
|---|---|---|---|---|
| R Lapthorne | **300,000** | - | 300,000 | - |
| D McIntyre[1,2] | **6,060,087** | **805,252** | 5,929,587 | 638,500 |
| W Passmore | **45,000** | - | 45,000 | - |
| C Tucker | - | - | - | - |
| P Coll | **106,271** | **589,577** | 25,521 | 630,269 |
| D Beresford[3] | **43,181** | **270,000** | 15,831 | 393,000 |
| D Nicholson | **1,926** | - | 1,926 | - |
| N Whitehead | - | - | - | - |

Note 1 Included in D McIntyre's beneficial shares are 704,468 (2005: 704,468) Ordinary shares held in trust for his minor children
Note 2 D McIntyre's shareholding represents 3.95% (2005: 3.93%) of the total issued share capital as at 30 August 2006
Note 3 Included in D Beresford's beneficial shares are 27,350 Ordinary shares held in the name of Joanna Beresford

From 30 June 2006 to 30 August 2006 there have been no changes in the Directors' interests.

### Non-Executive Directors' Fees

The Non-Executive Directors are not involved in decisions determining their own remuneration, with their fees being set by the Executive Directors.

## Morse plc

The Company's policy on Non-Executive Directors' remuneration is to ensure that Non-Executive Director fees are competitive when compared to similar companies (as measured by the appropriate market measures), are aligned with the interests of shareholders, and reflect the time, commitment and responsibilities of the role. Fees for Non-Executive Directors will be reviewed against appropriate comparator positions every year by a committee of at least two Executive Directors. Total fees paid will reflect the position in the market for companies of similar market capitalisation in the IT and IT services field and reflect the total number of days' service required.

There is no policy of paying Non-Executive Directors' remuneration in shares, and share options will not be granted to them. Non-Executive Directors do not receive any bonuses or pension contributions.

**The following sections of the Directors' Remuneration Report have been subject to audit.**

Directors' emoluments comprised:

| | | | | | 2006 | | 2005 |
|---|---|---|---|---|---|---|---|
| **Summary** | **Base salary/ fees** | **Annual bonus** | **Benefits and allowances** | **Total exc pensions** | **Pension cont** | Total exc pensions | Pension cont |
| | £ | £ | £ | £ | £ | £ | £ |
| R Lapthorne | 100,000 | - | - | 100,000 | - | 90,000 | - |
| D McIntyre | 315,250 | 60,000 | 14,864 | 390,114 | 19,845 | 368,290 | 12,000 |
| G James[1] | 16,388 | - | 960 | 17,348 | 810 | 235,544 | 9,720 |
| P Coll | 183,063 | 30,000 | 10,664 | 223,727 | 12,799 | 240,765 | 7,500 |
| D Beresford | 177,500 | 30,000 | 9,114 | 216,614 | 13,062 | 227,790 | 7,000 |
| S Cruickshank[2,5] | 419,327 | 28,334 | 10,536 | 458,197 | 7,150 | - | - |
| E Barton[3] | 20,000 | - | - | 20,000 | - | 27,000 | - |
| W Passmore | 30,000 | - | - | 30,000 | - | 27,000 | - |
| C Tucker | 30,000 | - | - | 30,000 | - | 27,000 | - |
| N Whitehead | 30,000 | - | - | 30,000 | - | 14,625 | - |
| D Nicholson[4] | 16,731 | - | - | 16,731 | - | - | - |
| **Total** | **1,338,259** | **148,334** | **46,138** | **1,532,731** | **53,666** | 1,258,014 | 36,220 |

Note 1 Gavin James resigned from the Board on 24 August 2005
Note 2 Stuart Cruickshank resigned from the Board on 14 June 2006
Note 3 Eric Barton retired from the Board on 1 March 2006
Note 4 Derrick Nicholson joined the Board on 12 December 2005. His fees are set at the same level as for other Non-Executive Directors
Note 5 Stuart Cruickshank's base salary includes a payment in lieu of notice totalling £224,455 which was paid after the year-end

# Morse plc

*Interest in Share Options*

| Name | Options Held At 1 July 2005 | Options Granted During The Year | Options Exercised During The Year | Options Cancelled During The Year[8] | Options Held At 30 June 2006 | Earliest Date Of Exercise | Expiry Date |
|---|---|---|---|---|---|---|---|
| **Duncan McIntyre** | | | | | | | |
| Unapproved Executive Share Option Scheme | 98,000[1] | - | - | - | 98,000 | Mar 2005 | Mar 2009 |
| Approved & Unapproved Executive Share Option 2000 | 280,000[3] | - | - | (280,000) | - | Jul 2006 | Jul 2013 |
| Sharesave Option Scheme 4 | 10,500[4] | - | (10,500) | - | - | Nov 2005 | Apr 2006 |
| Morse plc Long Term Incentive Plan | 250,000[6] | - | - | - | 250,000 | Dec 2007 | Dec 2008 |
| Sharesave Option Scheme 7 | - | 12,808[7] | - | - | 12,808 | Feb 2009 | Aug 2009 |
| Morse plc Long Term Incentive Plan | - | 444,444[6] | - | - | 444,444 | Mar 2009 | Mar 2010 |
| **Phil Coll** | | | | | | | |
| Unapproved Executive Share Option Scheme | 56,000[1] | - | - | - | 56,000 | Mar 2002 | Mar 2009 |
| Unapproved Executive Share Option Scheme | 30,769[2] | - | - | - | 30,769 | Sep 2005 | Sep 2009 |
| Sharesave Option Scheme 4 | 10,500[4] | - | (10,500) | - | - | Nov 2005 | Apr 2006 |
| Approved & Unapproved Executive Share Option 2000 | 163,000[3] | - | - | (163,000) | - | Jul 2006 | Jul 2013 |
| Approved & Unapproved Executive Share Option 2000 | 120,000[5] | - | - | - | 120,000 | Jul 2007 | Apr 2014 |
| Morse plc Long Term Incentive Plan | 250,000[6] | - | - | - | 250,000 | Dec 2007 | Dec 2008 |
| Morse plc Long Term Incentive Plan | - | 120,000[6] | - | - | 120,000 | Sep 2008 | Sep 2009 |

# Morse plc

**Phil Coll (continued)**

| Name | Options Held At 1 July 2005 | Options Granted During The Year | Options Exercised During The Year | Options Cancelled During The Year[8] | Options Held At 30 June 2006 | Earliest Date Of Exercise | Expiry Date |
|---|---|---|---|---|---|---|---|
| Sharesave Option Scheme 7 | - | 12,808[7] | - | - | 12,808 | Feb 2009 | Aug 2009 |
| **David Beresford** | | | | | | | |
| Approved & Unapproved Executive Share Option 2000 | 243,000[3] | - | - | (243,000) | - | Jul 2006 | Jul 2013 |
| Morse plc Long Term Incentive Plan | 150,000[6] | - | - | - | 150,000 | Dec 2007 | Dec 2008 |
| Morse plc Long Term Incentive Plan | - | 120,000[6] | - | - | 120,000 | Sep 2008 | Sep 2009 |

**Summary of Executive Directors' Options**

| | Options Held At 1 July 2005 | Options Granted During The Year | Options Exercised During The Year | Options Cancelled During The Year[8] | Options Held At 30 June 2006 |
|---|---|---|---|---|---|
| **Duncan McIntyre** | 638,500 | 457,252 | (10,500) | (280,000) | 805,252 |
| **Phil Coll** | 630,269 | 132,808 | (10,500) | (163,000) | 589,577 |
| **David Beresford** | 393,000 | 120,000 | - | (243,000) | 270,000 |
| **Total** | **1,661,769** | **710,060** | **(21,000)** | **(686,000)** | **1,664,829** |

| | | | | | |
|---|---|---|---|---|---|
| Note 1 | Exercise Price of | £2.500 | Note 5 | Exercise Price of | £1.375 |
| Note 2 | Exercise Price of | £2.275 | Note 6 | Exercise Price of | £nil |
| Note 3 | Exercise Price of | £1.040 | Note 7 | Exercise Price of | £0.730 |
| Note 4 | Exercise Price of | £0.900 | Note 8 | Options cancelled in June 2006 for failure to achieve performance conditions | |

The market price of the Company's shares at the end of the year was £0.785 (2005: £0.70).

During the year the market price ranged between £0.665 and £1.277.

No other Directors have been granted share options in the shares of the Company or other Group entities.

Signed on behalf of the Board

**Nigel Whitehead**
Chairman of the Remuneration Committee
30 August 2006

# Morse plc

## Report of the independent auditors to the members of Morse plc

We have audited the group and parent company financial statements (the "financial statements") of Morse plc for the year ended 30 June 2006 which comprise the group income statement, the group and parent company balance sheets, the group cash flow statement, the group statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Directors' Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent company financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 22.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the group financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

### Basis of audit opinion

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

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

## Morse plc

### Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 30 June 2006 and of its profit for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 30 June 2006; and
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

**KPMG Audit Plc**
Chartered Accountants
Registered Auditor

8 Salisbury Square
London
EC4Y 8BB

30 August 2006

# Morse plc
## Consolidated income statement
## for the year ended 30 June 2006

| | Note | Continuing £'000 | Discontinued £'000 | 2006 Total £'000 | *2005 Total £'000 |
|---|---|---|---|---|---|
| Group revenue | 2 | **296,956** | **70,164** | **367,120** | 429,531 |
| *Cost of sales* | | **(232,339)** | **(58,572)** | **(290,911)** | (341,606) |
| Exceptional trading balance release | 3 | **8,831** | **-** | **8,831** | - |
| Total cost of sales | | **(223,508)** | **(58,572)** | **(282,080)** | (341,606) |
| Gross profit | | **73,448** | **11,592** | **85,040** | 87,925 |
| Distribution expenses | | **(27,867)** | **(10,634)** | **(38,501)** | (51,853) |
| Administrative expenses before exceptional restructuring costs, exceptional trading balance release and impairment | | **(28,976)** | **(2,205)** | **(31,181)** | (27,809) |
| Exceptional trading balance release | 3 | **4,300** | **-** | **4,300** | - |
| Exceptional restructuring costs and impairment | 3 | **(3,936)** | **(2,885)** | **(6,821)** | (6,072) |
| Administrative expenses | | **(28,612)** | **(5,090)** | **(33,702)** | (33,881) |
| Operating profit/(loss) before exceptional restructuring costs, exceptional trading balance releases and impairment | | **7,774** | **(1,247)** | **6,527** | 8,263 |
| Exceptional trading balance releases | 3 | **13,131** | **-** | **13,131** | - |
| Exceptional restructuring costs and impairment | 3 | **(3,936)** | **(2,885)** | **(6,821)** | (6,072) |
| *Operating profit/(loss)* | 2,6 | **16,969** | **(4,132)** | **12,837** | 2,191 |
| Financial income | 7 | **697** | **274** | **971** | 1,954 |
| Financial expenses | 7 | **(300)** | **(53)** | **(353)** | (685) |
| Net financing income | | **397** | **221** | **618** | 1,269 |
| Share of loss of jointly controlled entities and associates which are accounted for under the equity method | | **(401)** | **-** | **(401)** | (551) |
| Exceptional loss on sale of discontinued operations | 3 | **-** | **(7,058)** | **(7,058)** | - |
| Profit/(loss) before taxation | | **16,965** | **(10,969)** | **5,996** | 2,909 |
| UK taxation | | **(974)** | **-** | **(974)** | (848) |
| Overseas taxation | | **(1,022)** | **171** | **(851)** | (852) |
| Taxation | 8 | **(1,996)** | **171** | **(1,825)** | (1,700) |
| Profit/(loss) for the year | 2 | **14,969** | **(10,798)** | **4,171** | 1,209 |
| Attributable to: | | | | | |
| Equity holders of the parent | | **14,780** | **(10,798)** | **3,982** | 1,105 |
| Minority interests | | **189** | **-** | **189** | 104 |
| Profit/(loss) for the year | 2 | **14,969** | **(10,798)** | **4,171** | 1,209 |
| Dividends | 9 | | | **5,754** | 5,176 |
| Basic earnings per share | 4 | **9.7p** | **(7.1p)** | **2.6p** | 0.8p |
| Diluted earnings per share | 4 | **9.5p** | **(6.9p)** | **2.6p** | 0.8p |

*Refer to page 41 for the 2005 prior year analysis of continuing and discontinued activities.

# Morse plc
## Consolidated income statement
## for the year ended 30 June 2005

| | Note | Total continuing £'000 | Total discontinued £'000 | 2005 Total £'000 |
|---|---|---|---|---|
| Group revenue | 2 | 309,228 | 120,303 | 429,531 |
| Cost of sales | | (241,469) | (100,137) | (341,606) |
| Exceptional trading balance release | 3 | - | - | - |
| Total cost of sales | | (241,469) | (100,137) | (341,606) |
| *Gross profit* | | *67,759* | *20,166* | *87,925* |
| Distribution costs | | (37,591) | (14,262) | (51,853) |
| Administrative expenses before exceptional restructuring costs and exceptional trading balance release | | (24,088) | (3,721) | (27,809) |
| Exceptional trading balance release | 3 | - | - | - |
| Exceptional restructuring costs | 3 | (5,256) | (816) | (6,072) |
| Administrative expenses | | (29,344) | (4,537) | (33,881) |
| Operating profit before exceptional restructuring costs and exceptional trading balance releases | | 6,080 | 2,183 | 8,263 |
| Exceptional trading balance releases | 3 | - | - | - |
| Exceptional restructuring costs | 3 | (5,256) | (816) | (6,072) |
| Operating profit | 2,6 | 824 | 1,367 | 2,191 |
| Financial income | 7 | 1,588 | 366 | 1,954 |
| Financial expenses | 7 | (559) | (126) | (685) |
| *Net financing income* | | 1,029 | 240 | 1,269 |
| Share of loss of jointly controlled entities and associates which are accounted for under the equity method | | (551) | - | (551) |
| Profit before taxation | | 1,302 | 1,607 | 2,909 |
| UK taxation | | (848) | - | (848) |
| Overseas taxation | | (740) | (112) | (852) |
| Taxation | 8 | (1,588) | (112) | (1,700) |
| Profit/(loss) for the year | 2 | (286) | 1,495 | 1,209 |
| *Attributable to:* | | | | |
| Equity holders of the parent | | (390) | 1,495 | 1,105 |
| Minority interests | | 104 | - | 104 |
| Profit/(loss) for the year | 2 | (286) | 1,495 | 1,209 |
| Dividends | 9 | | | 5,176 |
| Basic earnings per share | 4 | (0.2p) | 1.0p | 0.8p |
| Diluted earnings per share | 4 | (0.2p) | 1.0p | 0.8p |

# Morse plc
## Consolidated statement of recognised income and expense for the year ended 30 June 2006

| | Note | Year ended 30 June 2006 £'000 | Year ended 30 June 2005 £'000 |
|---|---|---|---|
| *Foreign exchange translation differences* | *22* | **267** | (85) |
| Net income and expense recognised directly in equity | *22* | **267** | (85) |
| Profit for the year | | **4,171** | 1,209 |
| Total recognised income and expense | | **4,438** | 1,124 |

*Total recognised income and expense for the period is* attributable to:

| | | | |
|---|---|---|---|
| Equity holders of the parent | | **4,249** | 1,020 |
| Minority interest | | **189** | 104 |
| Total recognised income and expense | | **4,438** | 1,124 |

# Morse plc
## Consolidated balance sheet
## as at 30 June 2006

| | Note | 30 June 2006 £'000 | 30 June 2005 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 11 | **3,615** | 4,391 |
| Goodwill | 10 | **51,168** | 55,018 |
| Other intangibles | 10 | **6,484** | 7,044 |
| Investments | 12 | **255** | 514 |
| Other financial assets | 13 | **119** | - |
| Deferred tax assets | 14 | **50** | 30 |
| **Total non-current assets** | | **61,691** | 66,997 |
| **Current assets** | | | |
| Inventories | 15 | **7,123** | 8,296 |
| Assets classified as held for sale | 25 | **34,400** | 19,329 |
| Trade and other receivables | 16 | **83,584** | 103,321 |
| Cash and cash equivalents | 17 | **17,800** | 40,015 |
| **Total current assets** | | **142,907** | 170,961 |
| **Total assets** | | **204,598** | 237,958 |
| ***Liabilities*** | | | |
| **Current liabilities** | | | |
| Interest bearing loans and borrowings | 20 | **(350)** | (329) |
| Trade and other payables | 18 | **(98,621)** | (142,533) |
| Tax payable | | **(7,832)** | (9,502) |
| Financial liabilities | 20 | **(206)** | - |
| Liabilities classified as held for sale | 25 | **(28,176)** | (15,950) |
| Provisions | 19 | **(1,621)** | (2,669) |
| **Total current liabilities** | | **(136,806)** | (170,983) |
| **Non-current liabilities** | | | |
| Interest bearing loans and borrowings | 20 | **(625)** | (584) |
| Deferred tax liability | 14 | **(57)** | (158) |
| Provisions | 19 | **(2,652)** | (1,758) |
| **Total non-current liabilities** | | **(3,334)** | (2,500) |
| **Net assets** | | **64,458** | 64,475 |
| **Capital and reserves** | | | |
| Called up share capital | 21,22 | **15,338** | 15,106 |
| Share capital to be issued | 22 | **3,803** | 6,229 |
| Share premium account | 22 | **70,385** | 69,786 |
| Other reserves | 22 | **27,563** | 25,088 |
| Retained earnings | 22 | **(52,776)** | (51,750) |
| **Total equity attributable to equity shareholders** | | **64,313** | 64,459 |
| Minority interest | 22 | **145** | 16 |
| **Total equity** | | **64,458** | 64,475 |

The financial statements were approved by the Board of Directors on 30 August 2006 and signed on its behalf by:

D McIntyre
Director

# Morse plc
## Consolidated cash flow statement for the year ended 30 June 2006

| | Note | Year ended 30 June 2006 £'000 | Year ended 30 June 2005 £'000 |
|---|---|---|---|
| ***Cash flows from operating activities*** | | | |
| Profit before tax | | **5,996** | 2,909 |
| Adjustments for: | | | |
| Depreciation and amortisation | | **3,769** | 4,319 |
| Financial income | | **(971)** | (1,954) |
| Financial expenses | | **353** | 685 |
| Share of loss of jointly controlled entities and associates | *12* | **401** | 551 |
| Loss on sale of property, plant and equipment | | **239** | 36 |
| Impairment of goodwill | *10* | **2,293** | - |
| Exceptional loss on sale of discontinued operations | *26* | **7,058** | - |
| Operating profit before changes in working capital and provisions | | **19,138** | 6,546 |
| Decrease in inventories | | **673** | 4,612 |
| (Increase)/decrease in trade and other receivables | | **(2,821)** | 5,169 |
| Decrease in trade and other payables | | **(15,015)** | (17,692) |
| (Decrease)/increase in provisions | | **(154)** | 3,271 |
| **Cash generated from operations** | | **1,821** | 1,906 |
| Interest received | | **971** | 1,954 |
| Interest paid | | **(353)** | (685) |
| Tax paid | | **(3,518)** | (782) |
| ***Net cash from operating activities*** | | **(1,079)** | 2,393 |
| **Cash flows from investing activities** | | | |
| Acquisition of property, plant and equipment | *11* | **(2,157)** | (1,750) |
| Proceeds from sale of property, plant and equipment | | **66** | 68 |
| Acquisitions of subsidiary in the period, net of cash acquired | | **-** | (21,043) |
| Payment of deferred consideration on acquisitions | | **(51)** | (13) |
| Proceeds from sale of property, plant and equipment to joint venture | | **-** | 214 |
| Loan issued to associate | *12* | **-** | (91) |
| Investment in joint venture | *12* | **(700)** | (302) |
| Disposal of subsidiary, net of cash disposed | 26 | **(1,099)** | - |
| **Net cash from investing activities** | | **(3,941)** | (22,917) |
| ***Cash flow from financing activities*** | | | |
| Proceeds from issue of shares | 22 | **407** | 87 |
| Repayment of loan notes on previous acquisitions | | **(61)** | (88) |
| Proceeds from other loans | | **62** | 913 |
| *Payment of dividend to minority interest* | *22* | ***(60)*** | (88) |
| Dividends paid | 9 | **(5,754)** | (5,176) |
| **Net cash from financing activities** | | **(5,406)** | (4,352) |
| Net decrease in cash and cash equivalents | | **(10,426)** | (24,876) |
| *Opening cash and cash equivalents* | *17* | **37,646** | 62,543 |
| Effect of exchange rate fluctuations on cash held | | **43** | (21) |
| **Closing cash and cash equivalents** | *17* | **27,263** | 37,646 |

# Morse plc
## Notes to the financial statements
## for the year ended 30 June 2006

## 1 Accounting policies

**Basis of preparation**

Morse plc is a company incorporated in the UK.

The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the "Group") and equity account the Group's interest in associates and jointly controlled entities. The parent company financial statements present information about the Company as a separate entity and not about its group.

The Group financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs"). The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 91 to 99.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these group financial statements and in preparing an opening IFRS balance sheet at 1 July 2004 for the purposes of the transition to Adopted IFRSs. In respect of financial instruments, the Group's policy, as permitted under IFRS 1, has been to adopt IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) from 1 July 2005. Comparatives have therefore not been restated to reflect the requirements of IAS 32 and IAS 39 and continue to be presented in accordance with UK GAAP. Note 30 sets out the impact of the adoption of IAS 32 and IAS 39 at 1 July 2005.

Judgements made by the Directors, in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 31.

**Transition to Adopted IFRSs**

The Group is preparing its financial statements in accordance with Adopted IFRSs for the first time and consequently has applied IFRS 1. An explanation of how the transition to Adopted IFRSs has affected the reported financial position, financial performance and cash flows of the Group is provided in note 34.

In addition to exempting companies from the requirement to restate comparatives for IAS 32 and IAS 39, IFRS 1 grants certain exemptions from the full requirements of IFRSs in the transition period. The following exemptions have been taken in these financial statements:

a) Business combinations: Morse plc has taken the exemption from restating business combinations occurring before the date of transition, 1 July 2004.

b) Share-based payments: Morse plc has applied IFRS 2 only to share options and awards granted after 7 November 2002 that had not vested at 1 January 2005.

c) Financial instruments: Morse plc has taken the exemption from applying IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) to the comparative information to be presented in the Group's first IFRS financial statements and has adopted IAS 32 and IAS 39 with effect from 1 July 2005. As such, the 2005 comparative information relating to financial instruments continues to be presented under the current UK GAAP FRS 13 basis. Note 30 sets out the impact of the adoption of IAS 32 and IAS 39 at 1 July 2005.

d) Fair value or revaluation as deemed cost: Morse plc has not taken the option to restate items of property, plant and equipment to their fair value at 1 July 2004, being the date of transition. Morse plc has elected for all items to take their cost or revalued amount as shown previously under FRS 15 as their deemed cost under IFRS.

e) Cumulative translation differences: Morse plc has taken the option to deem the cumulative level of translation differences relating to foreign operations held within reserves to £nil at 1 July 2004.

**Measurement convention**

The financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value; derivative financial instruments and financial instruments classified as fair value through the profit or loss. Non-current assets and disposal groups held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

## 1 Accounting policies (continued)

### Basis of consolidation

Subsidiaries are those entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date control commences until the date that control ceases. Intra-group balances and any unrealised gains and losses or income and expenditure arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

An associate is an undertaking in which the Group has a long-term interest, usually from 20% to 50% of the equity voting rights, and over which it exercises significant influence. A joint venture is an undertaking in which the Group has a long-term interest and over which it exercises joint control. The Group's share of the profits less losses of associates and of joint ventures are included in the consolidated profit and loss account, and its interest in their net assets is included in investments in the consolidated balance sheet.

### Revenue

Revenue represents the values of goods delivered and services provided within the Group's ordinary activities net of value added tax and excluding intra-group sales. Revenue comprises sales of hardware, software, consulting services and maintenance/support services.

Revenue recognition occurs when persuasive evidence of an arrangement exists, despatch has occurred, the fee is determinable and collectability is probable.

*Hardware and installation*
Hardware sales are recognised on despatch, unless significant installation work is required or customer specific conditions must be met, in which case revenues are recognised on installation or acceptance by the customer.

*Consulting services*
Revenues include sales of services that are delivered over extended periods of time and recognised on a percentage completion basis over the period that the service is delivered. Profits on fixed price contracts are taken in proportion to the cost of work performed on each contract relative to the estimated total cost of completing the contract. Revenues derived from variations on contracts are recognised only when they have been agreed by the customer. Full provision is made for estimated losses on all contracts in the year in which they are first foreseen.

The gross amount due from customers for contract work is included within trade and other receivables and the gross amount due from suppliers is included within trade and other payables.

*Sales of software*
Revenue from the sale of software product licences at the time the software licence is granted is recognised in accordance with the contract, typically at the time of supply of the software product to the customer.

*Maintenance & support*
Revenues from maintenance and support services are recognised over the period that the services are provided. Payments in advance of services are recorded in the balance sheet as deferred income.

## 1 *Accounting policies (continued)*

**Property, plant and equipment**

The cost of the tangible fixed assets, net of estimated residual value and impairment, is depreciated in equal annual instalments over the estimated useful lives of the assets. The residual values of assets or group of like assets and the useful economic lives of assets are reviewed annually.

The rates of depreciation are as follows:

| | |
|---|---|
| Leasehold improvements: | Shorter of ten years and the unexpired expected term of the lease. |
| Fixtures and fittings: | Four years. |
| Motor vehicles: | Four years. |
| Office equipment: | Four years except for computer equipment, which is depreciated by 40% in the year of acquisition and thereafter in equal annual instalments over the next two years. |

**Intangible assets and goodwill**

All business combinations are accounted for by applying the purchase method. Goodwill arising on the acquisition of subsidiaries, associates and jointly controlled entities represents the excess of the cost of acquisition over the fair value to the Group of the net assets and any contingent liabilities acquired.

In respect of business combinations prior to 1 July 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired. (Identifiable intangibles are those which can be sold separately or which arise from legal rights regardless of whether those rights are separable).

In respect of acquisitions prior to 1 July 2004, goodwill is included on the basis of deemed cost, which represents the amount recorded under UK GAAP, (which was broadly comparable, save that only separable intangibles were recognised and goodwill was amortised).

In accordance with IFRS 3, goodwill has been frozen at its net book value at 1 July 2004, is allocated to cash-generating units and is not amortised, but instead is subject to annual impairment reviews. Goodwill is stated at cost or deemed cost less accumulated impairment losses. Any impairment losses are recognised immediately in the income statement. Negative goodwill arising on an acquisition is recognised in the income statement.

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period to which it relates.

Other intangible assets acquired by the Group are stated at cost less accumulated amortisation.

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of the intangible assets unless such lives are indefinite. Intangible assets with indefinite lives are systematically tested for impairment at each balance sheet date.

## 1 Accounting policies (continued)

### Intangible assets and goodwill (continued)

Other intangible assets are amortised from the date they are available for use or acquired. The estimated useful lives are as follows:

| | |
|---|---|
| Trade names | Ten years |
| Customer relationship backlog | One year |
| Maintenance contracts | Six years |
| Follow on consulting | Eight years |
| Intellectual property | Seven years |

### Subsequent expenditure

Subsequent expenditure on capitalised tangible and intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

### Impairment

The carrying amounts of the Group's assets, other than deferred tax assets, are reviewed at each year-end to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

For goodwill and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows and that are largely independent of the cash inflows from other assets or groups of assets.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been de-recognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

### *Calculation of recoverable amount*

The recoverable amount of the Group's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed on initial recognition of these financial assets). Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

## 1 Accounting policies (continued)

### Impairment (continued)

***Reversal of impairment***

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after an impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If a fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss the impairment loss is reversed through the profit or loss.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### Non-current assets held for sale and discontinued operations

On initial classification as held for sale, non-current assets and disposal groups are measured at the lower of the previous carrying amount and the fair value less costs to sell, with any adjustments taken to profit or loss. The same applies to gains and losses on subsequent re-measurement. In accordance with IFRS 5 the above policy is effective from 1 July 2004.

Non-current assets (and disposal groups) are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable within one year and the asset (or disposal group) is available for immediate sale in its present condition.

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale, that has been disposed of, has been abandoned or that meets the criteria to be classified as held for sale. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Discontinued operations are presented on the income statement (including the comparative period) as a column analysing the post tax profit or loss of the discontinued operation and the post tax gain or loss recognised on the re-measurement to fair value less costs to sell or on disposal of the assets/disposal groups constituting discontinued operations.

## 1 Accounting policies (continued)

**Derivatives and other financial instruments**

The Group's financial instruments comprise debtors, creditors, other borrowings and bank borrowings.

The Group uses a limited number of derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates. The Group does not hold or issue derivative instruments for speculative purposes.

The Group uses foreign exchange forward contracts to manage the financial risks of changes in foreign currency exchange rates. The Group does not apply hedge accounting and changes in the value of derivative financial instruments are recognised in the income statement as they arise. Derivative financial instruments are recognised at fair value. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

**Foreign currencies**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates the fair value was determined.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated at an average rate for the period where this rate approximates to the foreign exchange rates ruling at the dates of the transactions. Exchange differences arising from this translation of foreign operations are taken directly to the translation reserve. They are released into the income statement upon disposal.

The Group has taken advantage of relief available in IFRS 1 to deem the cumulative translation differences for all foreign operations to be zero at the date of transition to IFRS, 1 July 2004.

**Taxation**

The tax charge for the periods presented comprises current and deferred tax. Taxation is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of prior periods.

# Morse plc
## Notes to the financial statements
### *for the year ended 30 June 2006 (continued)*

## 1 Accounting policies (continued)

### Taxation (continued)

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amount for financial reporting purposes and those for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes; initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

### Leases

Operating leases and rentals paid under operating leases are charged to the income statement on a straight-line basis over the period of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

### Net financing costs

Interest income and interest payable is recognised in the profit or loss as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive the payment is established.

### Pension costs

Payments made to defined contribution schemes are charged to the income statement as they accrue. Assets of the schemes are not included within the financial statements of the Group.

### Share-based compensation

The share option programme allows Group employees to acquire shares of the ultimate parent company; these awards are granted by the ultimate parent. Share options have been granted to Monitise Ltd employees under the Monitise share option plan. Options granted under the Group's share option schemes are equity settled.

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

### Interest in own shares

The assets and liabilities of the Group ESOP trusts are recognised in the financial statements where there is de facto control of those assets and liabilities. The Company's own shares held in ESOP trust are deducted from shareholders' funds until they vest unconditionally with employees.

## 1 Accounting policies (continued)

### Cash and cash equivalents

The Group manages its short-term liquidity through holding of cash and highly liquid interest bearing deposits. For the purpose of the cash flow statement only deposits with a maturity period of three months or less are shown as cash and cash equivalents. Bank overdrafts that are repayable on demand are shown as cash and cash equivalents.

### Provisions

Provision is made where the Group has a present legal or contractual obligation as a result of past events and it is probable that an outflow of economic benefit will be required to settle the obligation.

A provision for restructuring is recognised when the Group has a detailed formal plan for the restructuring that has been communicated to affected parties.

### Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less associated transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on a weighted average basis and includes expenditure incurred in bringing the inventories to their present location and condition. Net realisable value is the amount that can be realised from the sale of inventories in the normal course of business after allowing for the costs of realisation.

### Trade receivables

Trade and other receivables are stated at their nominal amount (discounted if material) less impairment losses.

### Trade payables

Trade and other payables are stated at cost.

### Dividends

Dividends receivable are recognised when the Group's right to receive payment is established. Dividends payable to the Company's shareholders are recognised as a liability and deducted from shareholders' equity in the period in which the shareholders' right to receive payment is established.

## Morse plc

### Notes to the financial statements
### for the year ended 30 June 2006 (continued)

### 1 Accounting policies (continued)

**Adopted IFRS not yet applied**

The Group has not applied the following Standards and Interpretations that have been issued but are not yet effective:

- IFRS 6 "Exploration for and Evaluation of Mineral Resources".
- IFRS 7 "Financial Instruments: Disclosures" (and consequential amendments to IAS 1, IFRS 1 and IFRS 4).
- IFRIC 4 "Determining whether an arrangement contains a lease".
- IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds".
- IFRIC 6 "Liabilities arising from Participation in a Specific Market – Waste Electrical and Electronic Equipment".
- IFRIC 7 "Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies".

The Group will apply the above standards and interpretations in the financial statements for the year ending 30 June 2007 and subsequent periods. The standards and interpretations that may impact the financial statements are as follows:

- IFRS 7 "Financial Instruments: Disclosures" introduces new disclosures in relation to financial instruments. Implementation of these will not affect the balance sheet or income statement as the standard and related amendments are concerned with disclosure.
- IFRIC 4 "Determining whether an arrangement contains a lease". Management does not expect adoption of this to have a significant impact on the Group's financial statements but will continue to review this.
- IFRIC 6 "Liabilities arising from Participation in a Specific Market – Waste Electrical and Electronic Equipment". Management does not expect adoption of this to have a significant impact on the Group's financial statements but will continue to review this.

**Segmental information**

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

# Morse plc

## Notes to the financial statements
## for the year ended 30 June 2006 (continued)

## 2 Segmental reporting

### Segmental analysis

The Group's primary reporting format is business segments and its secondary format is geographical segments. The business segment reporting format reflects the Group's management and internal reporting structure.

### Business segments

The following tables present revenue, expenditure and certain asset information regarding the Group's business segments for the years ended 30 June 2006 and 2005.

**Year ended 30 June 2006**

| | Technology & Integration £'000 | Business Consulting £'000 | Management Consulting £'000 | Europe £'000 | Software £'000 | Group £'000 | Total Continuing £'000 | Discontinued Operations (Europe) £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|---|---|
| ***Revenue*** | | | | | | | | | |
| Sales to external customers | 140,744 | 79,062 | 14,092 | 56,786 | 6,272 | - | 296,956 | 70,164 | 367,120 |
| Inter-segment sales | 4,175 | 3,194 | - | 14 | - | - | 7,383 | - | 7,383 |
| Segmental revenue | 144,919 | 82,256 | 14,092 | 56,800 | 6,272 | - | 304,339 | 70,164 | 374,503 |
| Operating profit/(loss) before exceptional items | 2,558 | 5,820 | 2,187 | 3,386 | (1,911) | (4,266) | 7,774 | (1,247) | 6,527 |
| Exceptional trading balance releases | 13,131 | - | - | - | - | - | 13,131 | - | 13,131 |
| Exceptional restructuring costs and impairment | (3,626) | (310) | - | - | - | - | (3,936) | (2,885) | (6,821) |
| Operating profit/(loss) | 12,063 | 5,510 | 2,187 | 3,386 | (1,911) | (4,266) | 16,969 | (4,132) | 12,837 |
| Net finance income | | | | | | | | | 618 |
| Share of loss of jointly controlled entities and associates | | | | | | | | | (401) |
| Exceptional loss on sale of discontinued activities | | | | | | | | | *(7,058)* |
| Taxation | | | | | | | | | (1,825) |
| **Profit for the year** | | | | | | | | | 4,171 |

| | Business Consulting £'000 | Management Consulting £'000 | Europe £'000 | Software £'000 | Technology & Integration and Group £'000 | Total Continuing £'000 | Discontinued Operations (Europe) £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|---|
| ***Assets and liabilities*** | | | | | | | | |
| Segment assets | 57,937 | 18,439 | 28,845 | 3,959 | 60,763 | 169,943 | 34,400 | 204,343 |
| Investment in a joint venture | - | - | - | - | 255 | 255 | - | 255 |
| Total assets | 57,937 | 18,439 | 28,845 | 3,959 | 61,018 | 170,198 | 34,400 | 204,598 |
| Segment liabilities | 11,570 | 3,113 | 17,319 | 1,287 | 78,675 | 111,964 | 28,176 | 140,140 |
| Total liabilities | 11,570 | 3,113 | 17,319 | 1,287 | 78,675 | 111,964 | 28,176 | 140,140 |
| Other segment information | | | | | | | | |
| *Capital expenditure:* | | | | | | | | |
| Property, plant and equipment | 1,480 | 63 | 196 | 21 | 282 | 2,042 | 115 | 2,157 |
| Intangible fixed assets | - | - | - | - | - | - | - | - |
| Non-cash costs | | | | | | | | |
| Depreciation | 744 | 157 | 306 | 55 | 854 | 2,116 | 648 | 2,764 |
| Amortisation | 1,005 | - | - | - | - | 1,005 | - | 1,005 |

## 2 Segmental reporting (continued)

**Year ended 30 June 2005**

| | Technology & Integration £'000 | Business Consulting £'000 | Management Consulting £'000 | Europe £'000 | Software £'000 | Group £'000 | Total Continuing £'000 | Discontinued Operations (Europe) £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | | | |
| Sales to external customers | 188,522 | 60,369 | 12,474 | 43,423 | 4,440 | - | 309,228 | 120,303 | 429,531 |
| Inter-segment sales | 1,350 | 1,834 | - | 4,866 | - | - | 8,050 | 58 | 8,108 |
| Segmental revenue | 189,872 | 62,203 | 12,474 | 48,289 | 4,440 | - | 317,278 | 120,361 | 437,639 |
| Operating profit/(loss) before exceptional items | 1,155 | 5,336 | 2,265 | 3,258 | (919) | (5,015) | 6,080 | 2,183 | 8,263 |
| Exceptional trading balance releases | - | - | - | - | - | - | - | - | - |
| Exceptional restructuring costs and impairment | (3,043) | (2,213) | - | - | - | - | (5,256) | (816) | (6,072) |
| Operating profit/(loss) | (1,888) | 3,123 | 2,265 | 3,258 | (919) | (5,015) | 824 | 1,367 | 2,191 |
| Net finance income | | | | | | | | | 1,269 |
| *Share of loss of jointly controlled* entities and associates | | | | | | | | | (551) |
| Taxation | | | | | | | | | (1,700) |
| ***Profit for the year*** | | | | | | | | | *1,209* |

| | Business Consulting £'000 | Management Consulting £'000 | Europe £'000 | Software £'000 | Technology & Integration and Group £'000 | Total Continuing £'000 | Discontinued Operations (Europe) £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|---|
| **Assets and liabilities** | | | | | | | | |
| Segment assets | 50,645 | 17,298 | 46,457 | 1,909 | 101,919 | 218,228 | 19,329 | 237,557 |
| Investment in a joint venture | - | - | - | - | 401 | 401 | - | 401 |
| Total assets | 50,645 | 17,298 | 46,457 | 1,909 | 102,320 | 218,629 | 19,329 | 237,958 |
| Segment liabilities | 10,227 | 2,803 | 38,541 | 1,216 | 104,746 | 157,533 | 15,950 | 173,483 |
| Total liabilities | 10,227 | 2,803 | 38,541 | 1,216 | 104,746 | 157,533 | 15,950 | 173,483 |
| *Other segment information* | | | | | | | | |
| Capital expenditure: | | | | | | | | |
| *Property, plant and equipment* | 341 | 422 | 374 | - | 498 | 1,635 | 115 | 1,750 |
| Intangible fixed assets | - | - | - | - | - | - | - | - |
| Non-cash costs | | | | | | | | |
| Depreciation | 659 | 82 | 554 | 156 | 1,527 | 2,978 | 243 | 3,221 |
| *Amortisation* | *1,099* | - | - | - | - | *1,099* | - | *1,099* |

The assets and liabilities of Technology & Integration and of Group are managed collectively (for example, cash is managed on this basis) and are therefore not capable of any meaningful separation.

Discontinued operations for the year ended 30 June 2006 comprise Morse Germany and Morse Austria, which were part of the Europe business until their disposal on 24 July 2006. The assets and liabilities of these operations have been classified on the 2006 balance sheet as being held for sale.

Discontinued operations for the year ended 30 June 2005 comprise Morse France, Morse Germany and Morse Austria, which were part of the Europe business until their disposal. The assets and liabilities of Morse France have been classified on the 2005 balance sheet as being held for sale.

The Technology & Integration segment comprises Morse Group Limited.

The Business Consulting segment was created from the consulting business of Morse UK together with the consultancy businesses of Diagonal following its acquisition in August 2004. It has three main lines of business: Diagonal Consulting Global (covering our Oracle, SAP, enterprise service management and information management capability); Delphis (which specialises in providing resources at the infrastructure layer, mainly to the banking sector); and Marshall-Wilkins (an IT recruitment business).

The Management Consulting segment comprises four businesses: CSTIM, Morse SI, SkillsHub and Morse Transaction Services.

The European segment comprises the operations in Spain and Ireland.

The software segment comprises Monitise Limited and Diagonal Solutions Limited (Wisdom™).

# Morse plc
## Notes to the financial statements for the year ended 30 June 2006 (continued)

## 2 Segmental reporting (continued)

### Geographic segments

The following tables present revenue and asset information for the geographical segments for the years ended 30 June 2006 and 2005.

| *2006* | UK £'000 | Europe £'000 | Rest of world £'000 | Total continuing £'000 | Discontinued operations (Europe) £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Revenue** | | | | | | |
| **Sales to external customers** | **229,522** | **57,752** | **9,682** | **296,956** | **70,164** | **367,120** |
| **Inter-segment sales** | **7,369** | **14** | **-** | **7,383** | **-** | **7,383** |
| **Total** | **236,891** | **57,766** | **9,682** | **304,339** | **70,164** | **374,503** |
| 2005 | | | | | | |
| Revenue | | | | | | |
| Sales to external customers | 256,447 | 46,874 | 5,907 | 309,228 | 120,303 | 429,531 |
| Inter-segment sales | 3,184 | 4,866 | - | 8,050 | 58 | 8,108 |
| Total | 259,631 | 51,740 | 5,907 | 317,278 | 120,361 | 437,639 |
| **Year ended 30 June 2006** | | | | | | |
| **Segment assets** | **141,098** | **26,270** | **2,575** | **169,943** | **34,400** | **204,343** |
| **Investment in a joint venture** | **255** | **-** | **-** | **255** | **-** | **255** |
| **Total assets** | **141,353** | **26,270** | **2,575** | **170,198** | **34,400** | **204,598** |
| **Other segmental information** | | | | | | |
| **Capital expenditure:** | | | | | | |
| **Property, plant and equipment** | **1,846** | **196** | **-** | **2,042** | **115** | **2,157** |
| **Intangible fixed assets** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Depreciation** | **1,810** | **306** | **-** | **2,116** | **648** | **2,764** |
| **Amortisation** | **1,005** | **-** | **-** | **1,005** | **-** | **1,005** |
| Year ended 30 June 2005 | | | | | | |
| Segment assets | 171,771 | 44,857 | 1,600 | 218,228 | 19,329 | 237,557 |
| Investment in a joint venture | 401 | - | - | 401 | - | 401 |
| Total assets | 172,172 | 44,857 | 1,600 | 218,629 | 19,329 | 237,958 |
| Other segmental information | | | | | | |
| Capital expenditure: | | | | | | |
| Property, plant and equipment | 1,261 | 374 | - | 1,635 | 115 | 1,750 |
| *Intangible fixed assets* | - | - | - | - | - | - |
| Depreciation | 2,424 | 554 | - | 2,978 | 243 | 3,221 |
| *Amortisation* | 1,099 | - | - | 1,099 | - | 1,099 |

In the year ending 30 June 2006 revenue comprised £167,720,000 (2005:£239,487,000) of goods revenue and £199,400,000 (2005: £190,044,000) of services revenue.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 3 Exceptional items

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Trading balance releases | **13,131** | - |
| Impairment of goodwill | **(2,293)** | - |
| Restructuring costs | **(4,528)** | (6,072) |
| Loss on sale of discontinued operation | **(7,058)** | - |
| | **(748)** | (6,072) |

The trading balance credit has arisen from our normal business review of these balances. With the changing shape of our business and in particular the reduced level of infrastructure business (a reduction of approximately £300 million since its peak) credit balances are no longer being created at the same level as they are released. In accordance with normal accounting practices these releases are made when confirmed with the appropriate counterparty. In the year ended 30 June 2006 an amount of £13,131,000 (2005: £1,100,000) has been credited to the income statement. This has been highlighted because of the magnitude of the release in this period.

The completion of sale of Morse GmbH on 24 July 2006 has indicated the need for an impairment of £2,293,000 in the carrying value of the goodwill and this is included in the results.

Restructuring costs of £4,528,000 incurred in the year ended 30 June 2006 related mainly to headcount reductions in the United Kingdom and Germany and property costs in the United Kingdom, and were incurred as a part of the restructuring in these countries. Restructuring costs of £4,353,000 (2005: £2,782,000) have been paid in the year.

On 12 July 2005 Morse plc announced the disposal of its business in France, Morse SAS, for a maximum consideration of €1,000,000 (approximately £690,000) comprising an initial consideration of €1 and a further €1,000,000 (approximately £690,000) payable in cash in the period to 30 June 2007, if the business achieves certain financial targets. The sale of the business resulted in an exceptional loss of £7,058,000 in the period to 30 June 2006.

The tax effect of the exceptional items is a credit of £2,825,000 (2005: charge of £1,084,000).

## 4 Earnings per share

Basic earnings per share (EPS) is calculated by dividing the earnings attributable to Ordinary shareholders by the weighted average number of Ordinary shares in issue during the year, excluding those held in the Employee Benefit Trusts (note 5) which are treated as cancelled.

For diluted earnings per share, the weighted average number of Ordinary shares in issue is adjusted to assume conversion of all dilutive potential Ordinary shares.

Reconciliations of the earnings and weighted average number of shares used in the calculation are set out below:

| | 2006 Earnings £'000 | 2006 Weighted average number of shares (thousands) | 2006 Per share amount pence | 2005 Earnings £'000 | 2005 Weighted average number of shares (thousands) | 2005 Per share amount pence |
|---|---|---|---|---|---|---|
| **Basic EPS** | | | | | | |
| Profit attributable to Ordinary shareholders | **3,982** | **151,827** | **2.6** | 1,105 | 145,452 | 0.8 |
| Effect of dilutive securities options | - | **2,128** | - | - | 1,316 | - |
| Effect of deferred consideration to be issued within one year | - | **1,745** | - | - | - | - |
| **Diluted EPS** | **3,982** | **155,700** | **2.6** | 1,105 | 146,768 | 0.8 |

The number of potentially dilutive options that are currently non diluting are 4,328,991 (2005: 6,632,623).

## 4 Earnings per share (continued)

### Continued operations

Basic earnings per share of 9.7p (2005: loss 0.2p) for continuing operations is calculated from the net profit attributable to equity holders of the parent from continuing operations of £14,780,000 (2005: loss £390,000) divided by the weighted average number of shares. Diluted earnings per share is calculated by dividing the profit of £14,780,000 (2005: loss £390,000) by the diluted number of shares per the table on page 57.

### Discontinued operations

Basic loss per share of 7.1p (2005: earnings per share 1.0p) for discontinued operations is calculated from the net loss attributable to equity holders of the parent from discontinuing operations of £10,798,000 (2005: profit £1,495,000) divided by the weighted average number of shares. Diluted loss per share is calculated by dividing the loss of £10,798,000 (2005: profit £1,495,000) by the diluted number of shares per the table on page 57.

To provide a comparable measure of performance per share from the normal operations of the business, a supplementary EPS has been calculated in addition to the disclosure required by IAS 33 with the following adjustments to the basic and diluted EPS.

| | **2006 Earnings £'000** | **2006 Weighted average number of shares (thousands)** | **2006 Per share amount pence** | 2005 Earnings £'000 | 2005 Weighted average number of shares (thousands) | 2005 Per share amount pence |
|---|---|---|---|---|---|---|
| **Basic EPS** | **3,982** | **151,827** | **2.6** | 1,105 | 145,452 | 0.8 |
| Exceptional items | **748** | **-** | **0.5** | 6,072 | - | 4.2 |
| Tax on exceptional items | **2,825** | **-** | **1.9** | (1,084) | - | (0.8) |
| **Adjusted basic EPS** | **7,555** | **151,827** | **5.0** | 6,093 | 145,452 | 4.2 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Diluted EPS** | **3,982** | **155,700** | **2.6** | 1,105 | 146,768 | 0.8 |
| Exceptional items | **748** | **-** | **0.5** | 6,072 | - | 4.2 |
| Tax on exceptional items | **2,825** | **-** | **1.8** | (1,084) | - | (0.8) |
| **Adjusted diluted EPS** | **7,555** | **155,700** | **4.9** | 6,093 | 146,768 | 4.2 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 5 Information regarding employees, Directors and their interests

### (a) *Directors' remuneration*

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Aggregate emoluments | **1,533** | 1,258 |
| Gains made on exercise of options | **-** | 9 |
| Group contributions to defined contribution schemes | **54** | 36 |
| | **1,587** | 1,303 |

In 2006 five Directors (2005: four) had benefits accruing to them under defined contribution schemes.

More detailed disclosures of Directors' remuneration are made in the Remuneration Committee report (on page 35).

### (b) Employees

| | **2006** | 2005 |
|---|---|---|
| | **Number** | Number |
| **Average monthly number of persons employed *(including Directors)* by the Group during the year:** | | |
| Management and administration | **290** | 348 |
| Sales and technical staff | **1,330** | 1,322 |
| | **1,620** | 1,670 |

### (c) Staff costs (including Directors)

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Wages and salaries | **84,895** | 79,986 |
| Social security costs | **10,257** | 11,620 |
| Other pension costs | **1,336** | 2,036 |
| | **96,488** | 93,642 |

# Morse plc
# Notes to the financial statements for the year ended 30 June 2006 (continued)

## 5 Information regarding employees, Directors and their interests (continued)

### (d) Employee Share Schemes

| | Options outstanding over 10p Ordinary shares at 30 June 2005 | Exercise price | Period during which options exercisable | Options outstanding over 10p Ordinary shares at 30 June 2006 |
|---|---|---|---|---|
| Employee Option Scheme | 824,911 | £2.50 | Apr 2000-Mar 2009 | 544,778 |
| Unapproved Executive Option Scheme | 310,000 | £2.50 | Mar 2002-Mar 2009 | 182,000 |
| Unapproved Executive Option Scheme | 197,369 | £2.275 | Sep 2002-Sep 2009 | 135,571 |
| Delphis EBT Share Option Scheme | 583,613 | £nil | May 2001-May 2006 | 409,623 |
| Sharesave Option Scheme 3 | 63,085 | £1.06 | Nov 2004-Apr 2005 | - |
| International Sharesave Option Scheme 3 | 52,665 | £1.06 | Nov 2004-Apr 2005 | - |
| Unapproved and Approved Executive Share Option Scheme 2000 | 393,181 | £1.96 | Apr 2005-Apr 2012 | 19,133 |
| Unapproved and Approved Executive Share Option Scheme 2000 | 512,674 | £1.12 | Oct 2005-Oct 2012 | - |
| Unapproved and Approved Executive Share Option Scheme 2000 | 1,060,628 | £1.04 | Jul 2006-Jul 2013 | - |
| Sharesave Option Scheme 4 | 381,780 | £0.90 | Jan 2006-Jun 2006 | 87,570 |
| International Sharesave Option Scheme 4 | 155,984 | £0.90 | Jan 2006-Jun 2006 | 17,044 |
| Sharesave Option Scheme 5 | 86,852 | £1.028 | Jan 2007-Jun 2007 | 55,628 |
| International Sharesave Option Scheme 5 | 3,312 | £1.028 | Jan 2007-Jun 2007 | - |
| Unapproved and Approved Executive Share Option Scheme 2000 | 235,638 | £1.358 | Jul 2007-Apr 2014 | - |
| Unapproved and Approved Executive Share Option Scheme 2000 | 231,667 | £1.375 | Jul 2007-Apr 2014 | 231,667 |
| Sharesave Option Scheme 6 | 749,042 | £0.91 | Feb 2008-Jul 2008 | 437,484 |
| Morse plc Long Term Incentive Plan | 1,125,000 | £nil | Dec 2007-Dec 2008 | 875,000 |
| Unapproved and Approved Executive Share Option Scheme 2000 | 511,667 | £0.89 | Jul 2008-Apr 2015 | 461,667 |
| Morse LTIP Scheme | - | £nil | Sep 2008-Sep 2009 | 282,500 |
| Morse LTIP Scheme | - | £nil | Sep 2008-Sep 2009 | 75,000 |
| Morse LTIP Scheme | - | £nil | Sep 2008-Sep 2009 | 50,000 |
| Unapproved and Approved Executive Share Option Scheme 2000 | - | £0.93 | Jul 2009-Mar 2016 | 200,000 |
| Sharesave Option Scheme 7 | - | £0.73 | Feb 2009-Jul 2009 | 1,000,524 |
| Unapproved and Approved Executive Share Option Scheme 2000 | - | £1.09 | Jul 2009-Mar 2016 | 19,000 |
| Morse LTIP Scheme | - | £nil | Mar 2009-Mar2010 | 444,444 |
| Morse LTIP Scheme | - | £nil | Mar 2009-Mar 2010 | 214,953 |
| Unapproved and Approved Executive Share Option Scheme 2000 | - | £1.07 | Jul 2009-Mar 2016 | 102,800 |

# Notes to the financial statements for the year ended 30 June 2006 (continued)

## 5 Information regarding employees, Directors and their interests (continued)

### (d) Employee Share Schemes (continued)

| | Options outstanding over 10p Ordinary shares at 30 June 2005 | Exercise price | Period during which options exercisable | Options outstanding over 10p Ordinary shares at 30 June 2006 |
|---|---|---|---|---|
| **Monitise Options** | | | | |
| Monitise Share Option Plan | - | £0.0001 | Date of listing or sale of business to Oct 2015 | 45,000 |
| Monitise Share Option Plan | - | £0.0001 | Date of listing or sale of business to Apr 2016 | 10,000 |

The above Monitise share options are for Monitise Group Limited shares and not Morse plc shares

**Diagonal Options**

| | Options outstanding over 10p Ordinary shares at 30 June 2005 | Exercise price | Period during which options exercisable | Options outstanding over 10p Ordinary shares at 30 June 2006 |
|---|---|---|---|---|
| Diagonal Long Term Incentive Plan | 279,606 | £nil | Mar 2007-Mar 2014 | 194,563 |
| Diagonal Employee Share Option Scheme | 261,184 | £1.26 | Mar 2007-Mar 2014 | 234,807 |
| Claritas Share Option Scheme | 6,563 | £1.67 | Oct 2002-Oct 2009 | 6,563 |
| Diagonal Sharesave Option Scheme 5 Years | 375 | £18.00 | May 2005-Oct 2005 | - |
| Diagonal Sharesave Option Scheme 5 Years | 675 | £5.00 | May 2006-Oct 2006 | 675 |
| Diagonal Sharesave Option Scheme 3 Years | 7,112 | £1.87 | May 2005-Oct 2005 | - |
| Diagonal International Sharesave Option Scheme 3 Years | 11,176 | £1.87 | May 2005-Oct 2005 | - |
| Diagonal Sharesave Option Scheme 5 Years | 27,966 | £1.87 | May 2007-Oct 2007 | 10,266 |
| Diagonal Sharesave Option Scheme 3 Years | 274,586 | £0.88 | May 2006-Oct 2006 | 63,352 |
| Diagonal International Sharesave Option Scheme 3 Years | 94,500 | £0.88 | May 2006-Oct 2006 | 47,250 |
| Diagonal Sharesave Option Scheme 5 Years | 100,784 | £0.88 | May 2008-Oct 2008 | 100,784 |
| Diagonal Sharesave Option Scheme 3 Years | 94,752 | £0.90 | May 2007-Oct 2007 | 73,840 |
| Diagonal Sharesave Option Scheme 5 Years | 36,332 | £0.90 | May 2009-Oct 2009 | - |

Diagonal Plc option schemes relate to option plans in place in Diagonal Plc at the time of acquisition by Morse plc. The schemes have retained the same terms and conditions as before but are now options for Morse plc shares.

The Morse Group operates its share schemes in conjunction with Employee Benefit Trusts. At the year end the Morse Employee Benefit Trust held 268,165 shares (2005: 268,165) in the Company of which nil (2005: nil) have share options held over them. The Delphis Employee Benefit Trust holds 712,656 shares (2005: 823,041) of which 409,623 (2005: 583,613) have share options held over them. The Diagonal Employee Benefit Trust holds 151,524 shares (2005: 151,524) shares all of which have share options held over them.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 5 *Information regarding employees, Directors and their interests (continued)*

### (e) Share based payments

The fair value of the Share Option Scheme and the Performance Related Share Option Scheme plans are estimated as at the date of grant using a Black-Scholes model.

The following table gives the assumptions made during the year ended 30 June 2006:

***Share options granted to LTIP schemes***

| | | | | | | |
|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of Share options | Grant of share options |
| Date of grant | December 2004 | September 2005 | September 2005 | September 2005 | March 2006 | March 2006 |
| Number of instruments granted | 1,125,000 | 410,000 | 75,000 | 50,000 | 444,444 | 214,953 |
| Exercise price | £nil | £nil | £nil | £nil | £nil | £nil |
| Share price at date of grant | £0.96 | £0.99 | £0.98 | £0.86 | £1.09 | £1.07 |
| Contractual life (years) | 4 | 4 | 4 | 4 | 4 | 4 |
| Vesting conditions | Shareholder return and EPS growth in real terms. | Shareholder return and EPS growth in real terms. | Shareholder return and EPS growth in real terms. | Shareholder return and EPS growth in real terms. | Shareholder return and EPS growth in real terms. | Shareholder return and EPS growth in real terms. |
| Expected volatility | 47.9% | 45.3% | 45.3% | 45.3% | 43.9% | 43.8% |
| Expected option life at grant (years) | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Risk free interest rate | 4.47% | 4.21% | 4.21% | 4.21% | 4.44% | 4.73% |
| Dividend yield | 3.54% | 3.79% | 3.83% | 4.36% | 3.49% | 3.55% |
| Fair value per granted instrument *determined at grant date* | £0.84 | £0.86 | £0.84 | £0.73 | £0.96 | £0.95 |

***Employee share scheme 2000***

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of share options |
| Date of grant | April 2003 | December 2003 | April 2004 | April 2005 | September 2005 | March 2006 | March 2006 |
| Number of instruments granted | 1,519,428 | 287,184 | 231,667 | 511,667 | 200,000 | 19,000 | 102,800 |
| Exercise price | £1.04 | £1.36 | £1.38 | £0.89 | £0.93 | £1.09 | £1.07 |
| Share price at date of grant | £1.04 | £1.36 | £1.38 | £0.89 | £0.87 | £1.09 | £1.07 |
| Contractual life (years) | 10 | 10.5 | 10.25 | 10 | 10 | 10 | 10 |
| Vesting conditions | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. | Growth in EPS of RPI plus 5%. |
| Expected volatility | 63.2% | 60.1% | 58.6% | 55.5% | 57.4% | 54.2% | 54.2% |
| Expected option life at grant (years) | 6 | 6 | 6 | 6 | 6 | 6 | 6 |
| Risk free interest rate | 4.18% | 4.73% | 4.93% | 4.51% | 4.25% | 4.40% | 4.39% |
| Dividend yield | 3.03% | 2.32% | 2.33% | 3.93% | 4.31% | 3.49% | 3.55% |
| *Fair value per granted instrument* determined at grant date | £0.50 | £0.67 | £0.67 | £0.36 | £0.34 | £0.45 | £0.44 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 5 Information regarding employees, Directors and their interests (continued)

### (e) Share based payments (continued)

**Save As you Earn Schemes**

| | | | |
|---|---|---|---|
| Nature of the arrangement | Grant of share options | Grant of share options | Grant of share options |
| Date of grant | November 2003 | December 2004 | December 2005 |
| Number of instruments granted | 164,626 | 841,078 | 1,050,473 |
| Exercise price | £1.03 | £0.91 | £0.73 |
| Share price at date of grant | £1.21 | £0.99 | £0.95 |
| Contractual life (years) | 3.5 | 3.5 | 3.5 |
| Vesting conditions | 3 years service | 3 years service | 3 years service |
| Expected volatility | 61.2% | 53.60% | 45.30% |
| Expected option life at grant (years) | 3.5 | 3.5 | 3.5 |
| Risk free interest rate | 4.84% | 4.48% | 4.42% |
| Dividend yield | 2.60% | 3.43% | 3.95% |
| Fair value per granted instrument determined at grant date | £0.56 | £0.36 | £0.35 |

***Diagonal schemes***

| | | | | | | |
|---|---|---|---|---|---|---|
| Nature of the arrangement | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of share options | Grant of share options |
| Date of grant | March 2004 | March 2004 | March 2003 | March 2003 | March 2004 | March 2004 |
| Number of instruments granted | 333,680 | 284,333 | 100,784 | 444,252 | 115,723 | 36,332 |
| Exercise price | £nil | £1.26 | £0.88 | £0.88 | £0.90 | £0.90 |
| *Share price at date of grant* | £1.22 | £1.22 | £1.10 | £1.10 | £1.13 | £1.13 |
| Contractual life (years) | 10 | 10 | 5.5 | 3.5 | 3.5 | 5.5 |
| Vesting conditions | 3 years service | 3 years service | 3 years service | 3 years service | 3 years service | 5 years service |
| Expected volatility | 58.9% | 58.9% | 63.5% | 67.2% | 58.4% | 58.9% |
| Expected option life at grant (years) | 6 | 6 | 5.5 | 3.5 | 3.5 | 5.5 |
| Risk free interest rate | 4.67% | 4.67% | 4.06% | 3.81% | 4.58% | 4.66% |
| Dividend yield | 2.62% | 2.62% | 2.86% | 2.86% | 2.83% | 2.83% |
| Fair value per granted instrument *determined at grant date* | £1.04 | £0.57 | £0.57 | £0.54 | £0.51 | £0.57 |

In accordance with IFRS 2, the 45,000 Monitise share options granted on 1 November 2005 and the 10,000 Monitise share options granted on 18 April 2006 per note (5d) have not been fair valued.

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur.

The expected volatility reflects the assumption that the recent historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

No other features of the options granted were incorporated into the measurement of fair value.

The Directors consider that the value of Diagonal shares can be calculated on the same basis as the Morse plc shares as the nature of Diagonal shares are consistent with those of Morse plc.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 6 Operating profit/(loss)

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| **Operating profit/(loss) is stated after charging:** | | |
| Auditors' remuneration: | | |
| - Audit fee | **393** | 385 |
| - Non-audit fees | **201** | 178 |
| - Management consultancy fees | **-** | - |
| Net foreign currency differences | **121** | 44 |
| Operating lease rentals: | | |
| - plant and machinery | **1,296** | 2,226 |
| - other | **3,334** | 4,211 |
| Research and development | **1,332** | 284 |
| Depreciation of property, plant and equipment | **2,764** | 3,221 |
| Amortisation of intangible assets | **1,005** | 1,156 |
| Loss on disposal of tangible fixed assets | **239** | 36 |

The Company audit fee for the year was £36,000 (2005: £35,000).

Non-audit fees paid to auditors relate to taxation advice and in the year ended 30 June 2005 services in relation to acquisitions. In addition to the non-audit fees above, £375,000 was capitalised in the year ended 30 June 2005 in relation to the acquisition of Diagonal. The auditors do not provide management consultancy services to the Group.

## 7 Finance income and expense

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Bank interest income | **351** | 438 |
| Other interest income | **614** | 1,516 |
| Interest from associate | **6** | - |
| Financial income | **971** | 1,954 |
| Bank loans and overdrafts interest expense | **(154)** | (660) |
| Other loans interest expense | **(199)** | (25) |
| Financial expenses | **(353)** | (685) |

Included within other interest receivable is interest earned from cash invested in Open Ended Investment Companies (further details provided in note 20).

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 8 *Tax on ordinary activities*

**Corporation tax**

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| United Kingdom corporation tax at 30% (2005: 30%) | **3,978** | 1,757 |
| Adjustment to corporation tax provision from prior years | **(2,927)** | (772) |
| Overseas tax on profit for the year | **895** | 852 |
| Current tax | **1,946** | 1,837 |
| Deferred tax (note 14) | **(121)** | (137) |
| Total tax charge | **1,825** | 1,700 |

The tax charge is higher than the UK rate of 30% because of non-deductible costs, primarily the amortisation of goodwill, and certain exceptional costs, offset by the benefit of credits resulting from the resolution of prior year tax positions.

The prior year tax credits are in relation to the German and French businesses which are no longer likely to crystalise

*Reconciliation of the Group's current tax charge to the United Kingdom statutory rate:*

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Profit before tax | **5,996** | 2,909 |
| Tax on profit before tax at 30% (2005: 30%) | **1,800** | 873 |
| Effects of: | | |
| Expenses not deductible for tax purposes including amortisation of intangible assets | **1,135** | 1,637 |
| Loss not deductible on sale of France | **2,117** | - |
| Profit and loss items not taxable | **(524)** | - |
| Losses of overseas undertakings not available for relief | **462** | 606 |
| Losses of overseas undertakings utilised in the period | **(45)** | (581) |
| Difference between UK and overseas standard tax rates | **(193)** | (63) |
| Adjustments to tax charge in respect of previous periods | **(2,927)** | (772) |
| Total tax charge | **1,825** | 1,700 |

As at 30 June 2006 the Group has overseas tax losses estimated at £14,200,000 (2005: £25,000,000) against which no deferred tax asset has been recognised due to uncertainty over the availability of future profits from which the future reversal of the underlying timing differences can be deducted. The tax losses for the year ended 30 June 2006 relate to Morse GmbH which was disposed of on 24 July 2006 (note 29).

## 9 Dividends paid and proposed

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| *Declared and paid during the year:* | | |
| Equity dividend on ordinary shares: | | |
| *Final dividend for 2005; 2.6p (2004: 2.35p)* | **3,921** | 3,095 |
| Interim dividend for 2006: 1.2p (2005: 1.15p) | **1,833** | 1,708 |
| Under provision from previous years | **-** | 373 |
| | **5,754** | 5,176 |
| *Proposed for approval at AGM* | | |
| (not recognised as a liability as at 30 June) | | |
| *Equity dividend on Ordinary shares:* | | |
| Final dividend for 2006: 2.7p (2005: 2.6p) | **4,141** | 3,921 |

## 10 Goodwill and other intangible fixed assets

| | Intellectual property £'000 | *Customer* relationship backlog £'000 | Maintenance contracts £'000 | Follow-on consulting £'000 | Trade names £'000 | *Goodwill* £'000 | *Total* £'000 |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| At 1 July 2004 | - | - | - | - | - | 25,393 | 25,393 |
| *Acquisitions* | - | 376 | 399 | 5,521 | 1,847 | 29,625 | 37,768 |
| At 1 July 2005 | - | 376 | 399 | 5,521 | 1,847 | 55,018 | 63,161 |
| Reclassified to assets held for sale | - | - | - | - | - | (3,850) | (3,850) |
| Additions | 445 | - | - | - | - | - | 445 |
| **At 30 June 2006** | **445** | **376** | **399** | **5,521** | **1,847** | **51,168** | **59,756** |
| **Amortisation** | | | | | | | |
| At 1 July 2004 | - | - | - | - | - | - | - |
| Charge for the year | - | 313 | 57 | 574 | 155 | - | 1,099 |
| At 1 July 2005 | - | 313 | 57 | 574 | 155 | - | 1,099 |
| Charge for the year | - | 63 | 66 | 690 | 186 | - | 1,005 |
| Impairment charge | - | - | - | - | - | 2,293 | 2,293 |
| Reclassified to assets *held for sale* | - | - | - | - | - | (2,293) | (2,293) |
| **At 30 June 2006** | **-** | **376** | **123** | **1,264** | **341** | **-** | **2,104** |
| **Net book value** | | | | | | | |
| **At 30 June 2006** | **445** | **-** | **276** | **4,257** | **1,506** | **51,168** | **57,652** |
| At 30 June 2005 | - | 63 | 342 | 4,947 | 1,692 | 55,018 | 62,062 |
| At 30 June 2004 | - | - | - | - | - | 25,393 | 25,393 |

Other intangible assets total £6,484,000 (2005: £7,044,000). Other intangible assets acquired in the year ended 30 June 2006 totalled £445,000 (2005: £8,143,000).

## 10 Goodwill and other intangible fixed assets (continued)

**Impairment testing of indefinite lived goodwill**

Goodwill acquired through business combinations has been allocated to the cash-generating units of Morse Spain, Morse Ireland, MT&I, Morse GmbH, Business Consulting and Management Consulting for impairment testing. These are the lowest level of cash-generating units that can be reliably and separately identified.

No impairment is required, except in the case of Morse GmbH (£2,293,000) which was sold on 24 July 2006.

The recoverable amounts of these cash-generating units have been determined based on a value in use calculation. Senior management have based these calculations on current approved budgeted cashflows in perpetuity. The discount rate applied to cash flow projections is a pre-tax rate of 13% (2005: 13%).

Key assumptions used in value in use calculation for all cash-generating units for 30 June 2006 and 30 June 2005 are:

- Budgeted revenue – the basis used to determine the value assigned to the budgeted revenue is long-run market growth forecasts;
- Budgeted gross margin – the basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved for the year immediately before the budgeted year, adjusted for expected long-run market pricing trends.

The following companies have significant carrying amounts of goodwill:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Business Consulting | **29,625** | 29,625 |
| Management Consulting | **13,105** | 13,105 |
| MT&I | **5,717** | 5,717 |
| Morse Ireland | **2,169** | 2,169 |
| Morse Spain | **552** | 552 |
| Morse GmbH | **-** | 3,850 |
| | **51,168** | 55,018 |

The remaining amortisation periods of the intangible assets held as at 30 June 2006 are as follows:

| | |
|---|---|
| Maintenance contracts | 4 years, 2 months |
| Follow on consulting | 6 years, 2 months |
| Trade names | 8 years, 2 months |
| Intellectual property | 7 years |

Goodwill is not being amortised.

Intellectual Property Rights transferred represent core elements of the accumulated knowledge and technical know-how built up whilst developing our mobile banking solution. On commencement of service, the intangible asset is to be amortised over management's estimate of a 7 year useful life.

Amortisation is charged to distribution expenses.

# Morse plc
# Notes to the financial statements for the year ended 30 June 2006 (continued)

## 11 Property, plant and equipment

| | Leasehold improvements £'000 | Office equipment £'000 | Fixtures and fittings £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 July 2004 | 2,359 | 11,213 | 8,023 | 455 | 22,050 |
| Additions | 315 | 1,258 | 165 | 46 | 1,784 |
| *Transfers to joint ventures* | - | (529) | - | - | (529) |
| Acquisitions | 11 | 1,518 | 323 | 21 | 1,873 |
| *Disposals* | (4) | (1,016) | (99) | (164) | (1,283) |
| Reclassified to assets held for sale | (405) | (885) | (638) | (82) | (2,010) |
| At 1 July 2005 | 2,276 | 11,559 | 7,774 | 276 | 21,885 |
| Additions | 1 | 1,134 | 1,189 | 22 | 2,346 |
| Exchange differences | 14 | 83 | 23 | - | 120 |
| Reclassified to assets held for sale | - | (2,004) | (723) | (9) | (2,736) |
| Disposals | (363) | (1,187) | (3,054) | (134) | (4,738) |
| **At 30 June 2006** | **1,928** | **9,585** | **5,209** | **155** | **16,877** |
| **Depreciation** | | | | | |
| At 1 July 2004 | 1,583 | 8,571 | 6,416 | 365 | 16,935 |
| Disposals | (1) | (958) | (62) | (158) | (1,179) |
| Charge for the year | 197 | 1,970 | 979 | 75 | 3,221 |
| Reclassified to assets held for sale | (231) | (646) | (553) | (53) | (1,483) |
| At 1 July 2005 | 1,548 | 8,937 | 6,780 | 229 | 17,494 |
| Disposals | (332) | (1,109) | (2,871) | (121) | (4,433) |
| Charge for the year | 201 | 2,120 | 405 | 38 | 2,764 |
| Exchange differences | 11 | 70 | 16 | - | 97 |
| Reclassified to assets held for sale | - | (2,004) | (647) | (9) | (2,660) |
| **At 30 June 2006** | **1,428** | **8,014** | **3,683** | **137** | **13,262** |
| **Net book value** | | | | | |
| **At 30 June 2006** | **500** | **1,571** | **1,526** | **18** | **3,615** |
| At 30 June 2005 | 728 | 2,622 | 994 | 47 | 4,391 |
| At 30 June 2004 | 776 | 2,642 | 1,607 | 90 | 5,115 |

*In relation to the year ended 30 June 2006 the difference between the additions above of £2,346,000 and capital expenditure per the cash flow statement of £2,157,000 are capital accruals of £189,000.*

## 12 Investments

| **Cost and net book value** | **£'000** |
|---|---|
| **Interests in joint ventures** | |
| Cost at 1 July 2004 | 335 |
| Share of retained loss | (551) |
| Additions in the year | 617 |
| Cost at 1 July 2005 | 401 |
| Share of retained loss | (401) |
| Additions in the year | 700 |
| Reclassification of investment to intellectual property | (445) |
| **Net book value at 30 June 2006** | **255** |
| **Investment in associates** | |
| Cost at 1 July 2004 | 22 |
| Provisions charged in the year | (14) |
| Loan to associate | 105 |
| Cost at 1 July 2005 | 113 |
| Interest on loan | 6 |
| Disposal in the year | (119) |
| **Net book value at 30 June 2006** | **-** |
| **Total net book value of investments at 30 June 2006** | **255** |
| Total net book value of investments at 30 June 2005 | 514 |
| Total net book value of investments at 30 June 2004 | 357 |

The joint ventures (note (iv) of the Company financial statements) have assets of £1,262,876 (2005: £943,022), liabilities of £3,129,110 (2005: £2,146,981), revenues of £nil (2005: £nil), and expenses of £802,000 (2005: £1,102,000).

A list of principal Group companies can be found in note (iv) of the Company financial statements.

During the year a loan that had been made by the Group to mobileATM Limited, a joint venture, was waived in consideration for intellectual property of equivalent value. This loan was held by Monitise Group Limited at the time of the waiver and had previously been classified as an investment for the purposes of the consolidated financial statements.

The additions to joint ventures in the year ended 30 June 2005 of £617,000 were represented by £302,000 cash and £315,000 transfer of fixed assets.

Of the £105,000 loan to associate in the year ended 30 June 2005, £14,000 had been loaned in the year ended 30 June 2004 but had previously been classified within other debtors. The cash impact of the loan in the year ended 30 June 2005 was therefore £91,000.

## Notes to the financial statements for the year ended 30 June 2006 (continued)

### 13 Other financial assets

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Non-current | | |
| Loan at fair value | 119 | - |

*The financial asset in the year ending 30 June 2006 of £119,000 relates to an outstanding loan to a third party.* The loan is repayable in over one year with interest being charged at a fixed rate of 5% (subject to review).

### 14 Deferred tax

| | Provision for losses £'000 | Share options £'000 | Holiday pay accrual £'000 | Depreciation in excess of capital allowances £'000 | Total £'000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| At 1 July 2004 | - | 78 | 225 | 780 | 1,083 |
| *(Charge)/credit for the year (note 8)* | (346) | (47) | 102 | 173 | (118) |
| Acquisitions (note 27) | 421 | - | - | (6) | 415 |
| At 1 July 2005 | 75 | 31 | 327 | 947 | 1,380 |
| (Charge)/credit for the year (note 8) | (75) | 96 | - | (118) | (97) |
| **At 30 June 2006** | **-** | **127** | **327** | **829** | **1,283** |
| | **Customer backlog £'000** | **Maintenance contracts £'000** | **Follow on consulting £'000** | **Trade names £'000** | **Total £'000** |
| **Liabilities** | | | | | |
| At July 2004 | - | - | - | - | - |
| Acquisitions (note 27) | 106 | 89 | 1,121 | 447 | 1,763 |
| Credit for the year (note 8) | (88) | (13) | (116) | (38) | (255) |
| At 1 July 2005 | 18 | 76 | 1,005 | 409 | 1,508 |
| Credit for the year (note 8) | (18) | (14) | (140) | (46) | (218) |
| **At 30 June 2006** | **-** | **62** | **865** | **363** | **1,290** |

Deferred tax that relates to the same jurisdictions can be offset and has been presented on the balance sheet as a deferred tax liability of £57,000 (2005: £158,000). Other deferred tax balances are reflected on the balance sheet as an asset of £50,000 (2005: £30,000). The net deferred tax liability is £7,000 (2005: £128,000), as shown in the table above.

There is an unrecognised deferred tax asset of £4,260,000 (2005: £7,500,000) in respect of trading losses at 30 June 2006 (note 8).

The Group has an unrecognised deferred tax liability of £1,123,000 (2005: £835,000) in relation to unremitted overseas profits.

The Group anticipates sufficient profits to be made in the relevant geographic locations in order to utilise the deferred tax assets.

## Morse plc

## Notes to the financial statements
## for the year ended 30 June 2006 (continued)

### 15 Inventories

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Finished goods and goods for resale | **7,123** | 8,296 |

Cost of goods sold during the year amount to £157,830,000 (2005: £231,288,000).

### 16 Trade and other receivables

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Trade receivables | **58,911** | 71,269 |
| Other receivables and prepayments | **24,673** | 32,052 |
| | **83,584** | 103,321 |

### 17 Cash and cash equivalents

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Cash and cash equivalents disclosed as such on the balance sheet | **17,800** | 40,015 |
| Cash and cash equivalents included within assets and liabilities classified as held for sale | **9,463** | (2,369) |
| Cash and cash equivalents per cash flow statement | **27,263** | 37,646 |

### 18 Trade and other payables

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Trade payables due to associates | **7** | 4 |
| Trade payables | **47,402** | 82,435 |
| Other payables | **51,212** | 60,094 |
| | **98,621** | 142,533 |

Employer pension contributions payable to the pension scheme of £76,285 (2005: £103,823) are included within other payables.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 19 Provisions

| | Other £'000 | Property £'000 | Total £'000 |
|---|---|---|---|
| Balance at 1 July 2005 | 290 | 4,137 | 4,427 |
| Provisions made during the year | 184 | 3,015 | 3,199 |
| Provisions used during the year | (258) | (3,195) | (3,453) |
| Unwinding of discount | - | 100 | 100 |
| **Balance at 30 June 2006** | **216** | **4,057** | **4,273** |
| **Current 2006** | **167** | **1,454** | **1,621** |
| **Non-current 2006** | **49** | **2,603** | **2,652** |
| **Balance at 30 June 2006** | **216** | **4,057** | **4,273** |
| Current 2005 | 290 | 2,379 | 2,669 |
| Non-current 2005 | - | 1,758 | 1,758 |
| Balance at 30 June 2005 | 290 | 4,137 | 4,427 |

The property provision brought forward relates to the property previously vacated in the UK in prior periods. The provision is being utilised over the length of the lease. The property provision charged in the year relates to properties vacated in the UK.

Provisions have been discounted at a pre tax rate of 13% (2005: 13%).

Other provisions related to headcount reductions in the UK and Spain.

## 20 Financial risk management

Under the transitional provisions permitted under IFRS 1, the Group has taken advantage of the exemption contained in IFRS 1 whereby on first-time adoption of IFRS there is no requirement to apply IAS32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" on transition. Application of IAS 32 and IAS 39 from 1 July 2005 does not have a material impact on the Group's financial position or result.

The comparative information contained with this note has therefore been disclosed in accordance with that shown under UK GAAP whereas the current year information is shown under IFRS.

The Group has a committed borrowing facility of £10,000,000 (2005: £nil) which had not been used at the year end.

The Group does not trade in financial instruments.

### Interest rate risk

The Group finances its operations through a mixture of retained profits, cash and the availability of a borrowing facility. The Group's cash, other facilities and deposits are at floating rates. Management manage the interest rate risk on borrowing by using a combination of fixed and floating rates. Other current and non-current loans incur interest at a fixed rate, while other loan notes incur interest on a floating rate basis. No interest rate derivative contracts have been entered into. We will continue to monitor this position to ensure that the interest rate profile is appropriate for the Group.

## 20 Financial risk management (continued)

### Credit risk

There are no significant concentrations of credit risk within the Group. The maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date.

### Sensitivity analysis

In managing interest rate and currency risks the Group aims to reduce the impact of short-term fluctuations on the Group's earnings. Over the long-term however, permanent changes in foreign exchange and interest rates would have an impact on the consolidated results.

At 30 June 2006, it is estimated that a general increase of one percentage point in interest rates would increase the Group's profit before tax by approximately £138,000.

It is estimated that a general increase of one percentage point in the value of the Euro against other foreign currencies would have increased the Group's profit before tax by approximately £39,000 for the year ended 30 June 2006. A similar increase in the value of US Dollars and Singapore Dollars would reduce Group profit before tax by approximately £22,000 and £9,000 respectively. A decrease of 1% in the other currencies that the Group has exposure to would not have a significant impact on the results for the period.

### Net financial assets

The summarised net financial asset position of the Group is shown below:

| | **2006**<br>**£'000** | 2005<br>£'000 |
|---|---|---|
| Other current loans | **(350)** | (329) |
| Other non-current loans | **(625)** | (584) |
| Loan notes | **(380)** | (441) |
| Other financial liabilities | **(206)** | - |
| | **(1,561)** | (1,354) |
| Cash (note 17) | **27,263** | 37,646 |
| **Net financial assets** | **25,702** | 36,292 |

The other loans represent amounts borrowed against sales made on extended credit terms. The loan notes are all denominated in Sterling and represent part of the consideration arising as a result of the acquisition of Relational Concepts Limited, Hughes Rae Limited and Delphis (Holdings) Limited. The loan notes bear interest based on LIBOR. These amounts are repayable over a fixed term to coincide with receipts from customers and are secured on these receipts. Loan notes are disclosed within other payables. Other financial liabilities represent the fair valued amount of any outstanding forward contracts in place as at 30 June 2006.

## 20 Financial risk management (continued)

**Financial liabilities**
The Group's financial liabilities and analysis of ageing are as follows:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| In one year or on demand | **936** | 770 |
| Between one and two years | **275** | 292 |
| Between two and five years | **350** | 292 |
| | **1,561** | 1,354 |

The book value of financial liabilities is not significantly different from the fair value, considering the current terms of repayment.

**Interest rate profile**

The effective interest rate of loans and their maturity periods are as follows:

| | **Effective Interest Rate** | **Total £'000** | **0-1 Year £'000** | **1-2 Years £'000** |
|---|---|---|---|---|
| For the year ended 30 June 2006 | | | | |
| Cash and cash equivalents | **4.7%** | **27,263** | **27,263** | **-** |
| Borrowings: | | | | |
| Loan notes | **3.5%** | **380** | **380** | **-** |
| Other notes | **6%** | **975** | **350** | **625** |
| | | **1,355** | **730** | **625** |

**Interest rate management**
Financial liabilities accrue interest on the following basis:

| | **Fixed rate £'000** | **Floating Rate £'000** | **2006 Total £'000** | Fixed Rate £,000 | Floating Rate £'000 | 2005 Total £'000 |
|---|---|---|---|---|---|---|
| **Currency** | | | | | | |
| Sterling | - | **380** | **380** | - | 441 | 441 |
| Euros | **975** | **-** | **975** | 913 | - | 913 |
| | **975** | **380** | **1,355** | 913 | 441 | 1,354 |

The weighted average interest rate applicable to fixed rate liabilities is 6% and the weighted average period for which it is fixed is 30 months from 30 June 2006. The weighted average interest rate applicable to floating rate liabilities is based on LIBOR.

## 20 Financial risk management (continued)

***Fair values of financial assets and financial liabilities***

| | 2006 Book Value £'000 | 2006 Fair Value £'000 | 2005 Book Value £'000 | 2005 Fair Value £'000 |
|---|---|---|---|---|
| **Financial asset** | | | | |
| Cash and cash equivalents | **27,263** | **27,263** | 37,646 | 37,646 |
| **Financial liabilities** | | | | |
| Loan notes | **380** | **380** | 441 | 441 |
| Other loans | **975** | **975** | 913 | 913 |
| | **1,355** | **1,355** | 1,354 | 1,354 |
| **Derivatives** | | | | |
| Foreign exchange contracts | **206** | **206** | - | - |

**Cash and cash equivalents**

The carrying value approximates to fair value because of the short maturity of the instruments.

**Loan notes and other loans**

The fair value is based on estimated likely cash payments.

**Derivatives**

Foreign exchange contracts are valued at the spot rate of exchange on 30 June 2006.

**Fixed asset investments**

The net book value of the Group's fixed asset investments per note 12 approximates their fair value.

**Financial liabilities**

The net book value of financial liabilities is not significantly different from the fair value, considering the current terms of repayment.

## 20 Financial risk management (continued)

### Financial assets

The Group's cash deposits at the year end attract interest at a floating rate. They are denominated in the following currencies:

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Sterling | **10,028** | 16,284 |
| US Dollars | **2,631** | 6,921 |
| Euros | **13,060** | 13,930 |
| South African Rand | **310** | 222 |
| Australian Dollars | **282** | 89 |
| Malaysian Ringitts | **92** | 77 |
| Singapore Dollars | **860** | 123 |
| Cash | **27,263** | 37,646 |

The majority of cash has been invested during the year in a number of Open Ended Investment Companies' funds which usually offer rates of return in excess of those that can be earned on the money market but which are considered by the Group to have a sound credit rating and therefore constitute a low risk. The remaining cash earns interest at market interest rates.

On 1 July 2006 the Group invested £17,043,524 of their surplus funds in Open Ended Investment Companies. The Group has same day access to these funds.

### Currency and exchange rate risk management

A proportion of the Group's revenues and costs are denominated in currencies other than Sterling (principally in Euros and US Dollars). In order to reduce the exposure to foreign currency exchange rate fluctuations, the Group will try to purchase both goods and services in foreign currency to match the projected revenues in that trading currency. The Group also enters into forward contracts up to four months forward to reduce the exposure that arises on sales and purchases denominated in foreign currency.

## 20 Financial risk management (continued)

The table below shows the Group's principal 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 that are not denominated in the operating currency of the operating company involved.

These exposures were as follows:

| Functional currency of Group's major operations | Net foreign currency monetary assets/(liabilities) 30 June 2006 | | | 30 June 2005 | | |
|---|---|---|---|---|---|---|
| | Sterling £'000 | Euro £'000 | US Dollar £'000 | Sterling £'000 | Euro £'000 | US Dollar £'000 |
| **Sterling** | - | (3,689) | 2,450 | - | 5,338 | 6,245 |
| **Euro** | 1 | - | - | 187 | - | 224 |

## 21 Called up share capital

| | 2006 Number | 2006 £'000 | 2005 Number | 2005 £'000 |
|---|---|---|---|---|
| **Authorised** | | | | |
| 10p Ordinary shares | **175,000,000** | **17,500** | 175,000,000 | 17,500 |
| **Allotted and fully paid** | | | | |
| 10p Ordinary shares | **153,380,176** | **15,338** | 151,063,102 | 15,106 |

See note 22 for the movements in allocated and fully paid share capital.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 22 Capital and reserves

| | Share Capital | Share capital to be issued | Share premium account | Capital redemption reserve | Other | Foreign currency translation reserve | Merger reserve | Total other reserves | Retained earnings | Minority interest | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Group** | | | | | | | | | | | |
| At 1 July 2004 | 13,108 | 9,500 | 69,665 | 168 | 277 | - | 6,144 | 6,589 | (48,520) | - | 50,342 |
| Retained profit for the year | - | - | - | - | - | - | - | - | 1,105 | - | 1,105 |
| Premium on issue of shares | - | - | 121 | - | - | - | - | - | - | - | 121 |
| Issue of shares on acquisition of subsidiary | 1,982 | (3,271) | - | - | - | - | 18,652 | 18,652 | - | - | 17,363 |
| Exercise of share options | 16 | - | - | - | - | - | - | - | (47) | - | (31) |
| Share options charge | - | - | - | - | - | - | - | - | 820 | - | 820 |
| Loss on translation of foreign subsidiaries | - | - | - | - | - | (85) | - | (85) | - | - | (85) |
| Release of reserve on exercise of share options | - | - | - | - | (68) | - | - | (68) | 68 | - | - |
| Dividends paid | - | - | - | - | - | - | - | - | (5,176) | - | (5,176) |
| Dividends paid to minority interest | - | - | - | - | - | - | - | - | - | (88) | (88) |
| Share of profit of minority interest | - | - | - | - | - | - | - | - | - | 104 | 104 |
| At 1 July 2005 | 15,106 | 6,229 | 69,786 | 168 | 209 | (85) | 24,796 | 25,088 | (51,750) | 16 | 64,475 |
| Retained profit for the year | - | - | - | - | - | - | - | - | 3,982 | - | 3,982 |
| Premium on issue of shares | - | - | 599 | - | - | - | - | - | - | - | 599 |
| Issue of shares on acquisition of subsidiaries | 167 | (2,426) | - | - | - | - | 2,208 | 2,208 | - | - | (51) |
| Exercise of share options | 65 | - | - | - | - | - | - | - | (82) | - | (17) |
| Loss on translation of foreign subsidiaries | - | - | - | - | - | 267 | - | 267 | - | - | 267 |
| Share options charge | - | - | - | - | - | - | - | - | 828 | - | 828 |
| Dividends paid | - | - | - | - | - | - | - | - | (5,754) | - | (5,754) |
| Dividend paid to minority interest | - | - | - | - | - | - | - | - | - | (60) | (60) |
| Share of profit of minority interest | - | - | - | - | - | - | - | - | - | 189 | 189 |
| **At 30 June 2006** | 15,338 | 3,803 | 70,385 | 168 | 209 | 182 | 27,004 | 27,563 | (52,776) | 145 | 64,458 |

The share capital issued at nominal value in the year relates to the exercise of share options (649,425 shares) and £2,375,000 of previously deferred consideration on the acquisition of CSTIM Limited (1,667,649 shares). On the exercise of share options, £407,000 (2005: £87,000) was received.

Share capital to be issued of £3,803,000 relates to the deferred consideration on the prior year acquisition of CSTIM Limited and is based on the business acquired achieving certain financial targets. £3,303,000 of the total share capital is to be issued within one year, the relevant targets having been settled, and £500,000 is to be issued after one year up to January 2008.

The premium arising on the exercise of 649,425 share options was £599,000 (2005: £121,000).

## 22 Capital and reserves (continued)

The capital redemption reserve is used to maintain the Company's capital following the purchase and cancellation of its own shares.

When share options are exercised using the Morse Employee Benefit Trust, the difference between market value of the shares and the exercise price of the options is charged to the profit and loss account reserve. Simultaneously, a transfer from other reserves to the profit and loss account reserve is made for the related charge recorded when the options were granted under the Morse Group company share option plan, or the Diagonal employee share plans.

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. Differences arising prior to the translation to IFRS (i.e. 1 July 2004) have not been recognised under the provisions of IFRS 1.

Merger relief on the £2,208,000 share premium arising on the 1,667,649 shares issued as consideration on the prior year acquisition of CSTIM Limited has been recognised in accordance with s131 of the Companies Act 1985.

## 23 Capital commitments

Monitise Group Limited, a subsidiary entity, had a capital commitment of £200,000 (2005: £nil) at the year end.

## 24 Operating lease commitments

| | **Land and buildings 2006 £'000** | **Other 2006 £'000** | Land and buildings 2005 £'000 | Other 2005 £'000 |
|---|---|---|---|---|
| **Group** | | | | |
| Annual non-cancellable commitments for operating leases which expire: | | | | |
| Within one year | **3,512** | **1,384** | 4,262 | 1,218 |
| Between 2 and 5 years | **8,040** | **1,018** | 8,157 | 694 |
| After 5 years | **2,484** | **-** | 3,234 | - |
| | **14,036** | **2,402** | 15,653 | 1,912 |

## 25 Assets and liabilities held for sale

On 12 July 2005 Morse plc announced the disposal of its business in France, Morse France SAS (note 26) and on 24 July 2006 Morse plc announced the disposal of its business in Germany and Austria, Morse GmbH and Morse IT Solutions Austria GmbH (note 29). As such the following assets and liabilities are classified as held for sale in the balance sheet.

| | **2006** | 2005 |
|---|---|---|
| | **£'000** | £'000 |
| Goodwill | **1,557** | - |
| Property, plant and equipment | **76** | 527 |
| Inventories | **505** | 198 |
| Trade receivables | **14,102** | 14,198 |
| Other receivables and prepayments | **8,697** | 4,406 |
| Cash and cash equivalents | **9,463** | - |
| **Assets held for sale** | **34,400** | 19,329 |
| Trade payables | **(14,935)** | (4,756) |
| Other payables | **(13,148)** | (8,782) |
| Cash and cash equivalents | **-** | (2,369) |
| Tax payable | **(93)** | (43) |
| **Liabilities held for sale** | **(28,176)** | (15,950) |
| **Net assets held for sale** | **6,224** | 3,379 |

## 26 *Disposal of a subsidiary*

On 12 July 2005 Morse plc announced its disposal of its business in France, Morse France SAS, for a *maximum consideration of €1 and a further €1.0 (approximately £690,000) million payable in cash in the* period to 30 June 2007 if the business achieves certain financial targets. The sale of the business incurred a loss of £7,058,000 analysed as follows:

| | ***£'000*** |
|---|---|
| **Assets** | |
| *Property, plant and equipment* | **527** |
| Inventories | **198** |
| Trade receivables | **14,198** |
| *Other receivables and prepayables* | **4,406** |
| Cash and cash equivalents | **86** |
| Trade payables | **(4,588)** |
| Other payables | **(8,782)** |
| Net assets on disposal | **6,045** |
| Costs of disposal | **1,013** |
| Loss on disposal of France | **7,058** |

The disposal of subsidiary, net of cash disposed of £1,099,000, per the consolidated cash flow statement *for the year ended 30 June 2006 comprises costs of disposal of £1,013,000 and cash and cash* equivalents of £86,000.

## 27 Acquisitions

The Group purchased Diagonal Plc, an IT consultancy services company on 27 August 2004 for a consideration of £45,715,000 before costs and this has been accounted for as an acquisition in the year ended 30 June 2005. All of the voting rights were acquired. The fair value table is presented below:

| | Book Value £'000 | Accounting policy alignment £'000 | Fair value £'000 |
|---|---|---|---|
| Goodwill (note 10) | 18,473 | (18,473) | - |
| Intangible fixed assets (note 10) | - | 8,143 | 8,143 |
| Property, plant and equipment (note 11) | 1,873 | - | 1,873 |
| Inventories | 812 | - | 812 |
| Trade receivables | 12,701 | - | 12,701 |
| Deferred tax asset | 415 | - | 415 |
| Trade payables | (12,645) | (273) | (12,918) |
| Deferred tax liability | - | (1,763) | (1,763) |
| Cash | 8,738 | - | 8,738 |
| Net assets acquired | 30,367 | (12,366) | 18,001 |
| Goodwill | | | 29,625 |
| Consideration | | | 47,626 |
| Consideration satisfied by: | | | |
| Cash | | | 28,350 |
| Share capital issued | | | 17,365 |
| Cost of acquisition | | | 1,911 |
| | | | 47,626 |

The book value of the assets and liabilities has been taken from the management accounts of Diagonal Plc as of 27 August 2004 (being the date of the acquisition).

The accounting policy adjustments are as follows:

- The immediate write off of goodwill on acquisition.
- The capitalisation of intangible assets on acquisition per IFRS 2 "Business Combinations".
- A holiday pay accrual as per IAS 19 "Employee Benefits".
- A deferred tax liability on the capitalisation of intangible assets.
- The costs of acquisition relate to the cost of professional fees, incurred in relation to the acquisition.

From the date of acquisition to 30 June 2005 the acquisition contributed £44,239,000 to revenue and £9,449,000 loss to loss before tax and interest.

Except for the acquisition costs, Diagonal Plc has not had a significant impact on the cash flow statement of Morse plc for the year ended 30 June 2005.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 28 Related party transactions

During the year ended 30 June 2006 the Group made sales of £93,062 (2005: £109,000) to its associate companies and made purchases of £28,344 (2005: £27,000) from them. As at 30 June 2006, this had resulted in outstanding trade debtor and trade creditor balances of £69,899 (2005: £75,000) and £6,956 (2005: £3,500) respectively. As at 30 June 2006 there was a loan outstanding to an associate company of £nil (2005: £105,000). An interest charge of £6,000 (£2005: £nil) was charged in the year to 30 June 2006.

During the year ended 30 June 2006 the Group made sales of £923,000 (2005: £nil) to its joint ventures. As at 30 June 2006, this had resulted in an outstanding trade debtor of £127,000 (2005: £nil).
Morse Group Limited has borne the costs of the Directors of Morse plc during the year.

Compensation of key management personnel is as follows:

| | **2006**<br>**£'000** | 2005<br>£'000 |
|---|---|---|
| Short term employee benefits | **2,939** | 2,294 |
| Share based payment | **174** | - |
| | **3,113** | 2,294 |

## 29 Post balance sheet events

On 24 July 2006 Morse plc announced the disposal of its business in Germany and Austria. Morse GmbH and Morse IT Solutions Austria GmbH were sold for a maximum consideration of €9,500,000 (£6,506,000). An initial consideration of €7,125,000 (£4,880,000) is payable in cash with €2,375,000 (£1,626,000) of deferred consideration payable in cash in 90 days, subject to the collection of Morse Germany's receivables. As such the result of this operation has been classified as discontinued in the income statements for the years ended 30 June 2005 and 30 June 2006 and its assets and liabilities have been classified as held for sale on the balance sheet as at 30 June 2006.

## 30 Adoption of IAS 32 and IAS 39

In accordance with the option allowed by IFRS 1 the Group has adopted IAS 32 and IAS 39 prospectively from 1 July 2005. The impact on the Group's opening balance sheet at 1 July 2005, by balance sheet category, is outlined below:

| | 30 June<br>2005<br>£'000 | Effect of IAS 32<br>and IAS 39<br>£'000 | 1 July<br>2005<br>£'000 |
|---|---|---|---|
| Trade and other receivables | 103,321 | - | 103,321 |

The revaluation of foreign exchange contracts to 1 July 2005 fair value had a £nil impact.

## 31 Accounting estimates and judgements

Details of significant accounting estimates and judgements have been disclosed under the relevant note or accounting policy for each area where disclosure is required. Principally, these are the valuation of acquired intangible assets (note 10), goodwill impairment testing (note 10) and provisions (note 19).

## 32 Reconciliation of net cash flow to movement in net funds

| | Group 2006 £'000 | Group 2005 £'000 |
|---|---|---|
| Decrease in cash in the year | **(10,426)** | (24,876) |
| Movement in other loans | **(62)** | (913) |
| Movement in loan notes | **61** | 88 |
| *Exchange rate fluctuations* | **43** | (21) |
| Movement in other financial liabilities | **(206)** | - |
| Change in net debt | **(10,590)** | (25,722) |
| Net funds at 1 July | **36,292** | 62,014 |
| **Net funds at 30 June** | **25,702** | 36,292 |

## 33 *Analysis of changes in net funds*

| | At 1 July 2005 £'000 | Cash Flows £'000 | Exchange rate fluctuations £'000 | Other movements £'000 | At 30 June 2006 £'000 |
|---|---|---|---|---|---|
| Cash at bank | 37,646 | **(10,426)** | **43** | - | **27,263** |
| Other loans | (913) | **(62)** | - | - | **(975)** |
| Loan notes | (441) | **61** | - | - | **(380)** |
| Other financial liabilities | - | - | - | **(206)** | **(206)** |
| Net funds | 36,292 | **(10,427)** | **43** | **(206)** | **25,702** |

Other movements relate to the forward contracts in place at 30 June 2006 which have been fair valued at that date.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 34 Explanation of transition to Adopted IFRSs

*As stated in note 1, these are the Group's first consolidated financial statements prepared in accordance with* Adopted IFRSs.

The accounting policies set out on page 45 to page 53 have been applied in preparing the financial statements for the year ended 30 June 2006, the comparative information presented in these financial statements for the year ended 30 June 2005 and in the preparation of an opening IFRS balance sheet at 1 July 2004.

In preparing its opening IFRS balance sheet, the Group has adjusted amounts previously reported in financial statements prepared in accordance with its old basis of accounting (UK GAAP). An explanation of how the transition from UK GAAP to adopted IFRSs has affected the Group's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

### Summary of IFRS impact

The impact on the profit for the year ended 30 June 2005 is detailed in the table below:

| | Notes | UK GAAP £'000 | Audited IFRS Adjustments £'000 | Audited IFRS £'000 |
|---|---|---|---|---|
| Group revenue | | 429,531 | - | 429,531 |
| Cost of sales | | (341,606) | - | (341,606) |
| *Gross profit* | | 87,925 | - | 87,925 |
| Distribution expenses | | (50,385) | (1,468) | (51,853) |
| Administrative expenses before goodwill amortisation and exceptional restructuring costs | | (27,288) | (521) | (27,809) |
| *Exceptional restructuring costs* | | (6,072) | - | (6,072) |
| Goodwill amortisation | a | (23,230) | 23,230 | - |
| Administrative expenses | | (56,590) | 22,709 | (33,881) |
| Operating profit before goodwill *amortisation and exceptional restructuring costs* | a | 10,252 | (1,989) | 8,263 |
| Exceptional restructuring costs | | (6,072) | - | (6,072) |
| *Goodwill amortisation* | a | (23,230) | 23,230 | - |
| Group operating (loss)/profit before net financing income | a | (19,050) | 21,241 | 2,191 |
| Financial income | | 1,954 | - | 1,954 |
| Financial expense | | (685) | - | (685) |
| Net financing income | | 1,269 | - | 1,269 |
| Share of loss of jointly controlled entities and associates | | (551) | - | (551) |
| (Loss)/profit before taxation | | (18,332) | 21,241 | 2,909 |
| Taxation for the period | b | (2,010) | 310 | (1,700) |
| (Loss)/profit for the period | | (20,342) | 21,551 | 1,209 |
| Attributable to: | | | | |
| Equity holders of the parent | | (20,446) | 21,551 | 1,105 |
| Minority interests | | 104 | - | 104 |
| | | (20,342) | 21,551 | 1,209 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 34 Explanation of transition to Adopted IFRSs (continued)

The impact on net assets for the year ended 30 June 2005 is detailed in the table below:

| | Notes | UK GAAP £'000 | Audited IFRS Adjustments £'000 | Audited IFRS £'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | c | 4,918 | (527) | 4,391 |
| Goodwill | e | 37,895 | 17,123 | 55,018 |
| Other intangibles | d | - | 7,044 | 7,044 |
| Investments | | 514 | - | 514 |
| Deferred tax assets | f | - | 30 | 30 |
| Total non-current assets | | 43,327 | 23,670 | 66,997 |
| **Current assets** | | | | |
| Inventories | g | 8,494 | (198) | 8,296 |
| Assets classified as held for sale | h | - | 19,329 | 19,329 |
| Trade and other receivables due within one year | i | 118,115 | (14,794) | 103,321 |
| Trade and other receivables due after more than one year | i | 4,832 | (4,832) | - |
| Total trade and other receivables | | 122,947 | (19,626) | 103,321 |
| Cash and cash equivalents | | 37,646 | 2,369 | 40,015 |
| Total current assets | | 169,087 | 1,874 | 170,961 |
| Total assets | | 212,414 | 25,544 | 237,958 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Interest bearing loans and borrowings | | (329) | - | (329) |
| Trade and other payables | k | (154,940) | 12,407 | (142,533) |
| Tax payable | l | (9,545) | 43 | (9,502) |
| Liabilities classified as held for sale | h | - | (15,950) | (15,950) |
| Provisions | j | - | (2,669) | (2,669) |
| Total current liabilities | | (164,814) | (6,169) | (170,983) |
| **Non-current liabilities** | | | | |
| Interest bearing loans and borrowings | | (584) | - | (584) |
| Trade and other payables | k | (3,959) | 3,959 | - |
| Deferred tax liability | m | - | (158) | (158) |
| Provisions | j | (4,427) | 2,669 | (1,758) |
| Total non-current liabilities | | (8,970) | 6,470 | (2,500) |
| **Net assets** | | 38,630 | 25,845 | 64,475 |
| **Capital and reserves** | | | | |
| Called up share capital | | 15,106 | - | 15,106 |
| Share capital to be issued | | 6,229 | - | 6,229 |
| Share premium account | | 69,786 | - | 69,786 |
| Other reserves | n | 25,173 | (85) | 25,088 |
| Retained earnings | n | (77,680) | 25,930 | (51,750) |
| **Total equity attributable to equity shareholders** | | 38,614 | 25,845 | 64,459 |
| Minority interest | | 16 | - | 16 |
| **Total equity** | | 38,630 | 25,845 | 64,475 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 34 Explanation of transition to Adopted IFRSs (continued)

The impact on net assets for the year ended 30 June 2004 is detailed in the table below:

| | Notes | UK GAAP £'000 | Audited IFRS Adjustments £'000 | Audited IFRS £'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | | 5,115 | - | 5,115 |
| Goodwill | | 25,393 | - | 25,393 |
| Investments | | 357 | - | 357 |
| Deferred tax assets | o | - | 1,083 | 1,083 |
| Total non-current assets | | 30,865 | 1,083 | 31,948 |
| **Current assets** | | | | |
| Inventories | | 12,324 | - | 12,324 |
| Trade and other receivables due within one year | p | 108,173 | 6,261 | 114,434 |
| Trade and other receivables due after more than one year | p | 7,041 | (7,041) | - |
| Total trade and other receivables | | 115,214 | (780) | 114,434 |
| Cash and cash equivalents | | 66,088 | - | 66,088 |
| Total current assets | | 193,626 | (780) | 192,846 |
| Total assets | | 224,491 | 303 | 224,794 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Interest bearing loans and borrowings | | (3,545) | - | (3,545) |
| Trade and other payables | q | (154,388) | (6,197) | (160,585) |
| Tax payable | | (9,166) | - | (9,166) |
| Provisions | r | - | (591) | (591) |
| Total current liabilities | | (167,099) | (6,788) | (173,887) |
| **Non-current liabilities** | | | | |
| Trade and other payables | | (8,542) | 8,542 | - |
| Deferred tax liability | | - | - | - |
| Provisions | r | (1,156) | 591 | (565) |
| Total non-current liabilities | | (9,698) | 9,133 | (565) |
| **Net assets** | | 47,694 | 2,648 | 50,342 |
| ***Capital and reserves*** | | | | |
| Called up share capital | | 13,108 | - | 13,108 |
| Share capital to be issued | | 9,500 | - | 9,500 |
| Share premium account | | 69,665 | - | 69,665 |
| Other reserves | | 6,589 | - | 6,589 |
| Retained earnings | s | (51,168) | 2,648 | (48,520) |
| **Total equity attributable to equity shareholders** | | 47,694 | 2,648 | 50,342 |
| Minority interest | | - | - | - |
| **Total equity** | | 47,694 | 2,648 | 50,342 |

## 34 Explanation of transition to Adopted IFRSs (continued)

**Explanatory notes relating to the IFRS adjustments applied to the consolidated financial statements for the years ended 30 June 2005 and 30 June 2004**

**(a) Total operating costs**

| | £'000 |
|---|---|
| Reversal of amortisation of goodwill | 23,230 |
| Holiday pay charge (IAS 19) | (70) |
| Adjustment to the amortisation of other intangibles | (1,099) |
| Share options charge (IFRS 2) | (820) |
| | 21,241 |

In accordance with IFRS 3, the goodwill amortisation charge recognised in the June 2005 financial statements of £23,230,000 has been reversed in order to freeze the goodwill value at the brought forward net book value as at 1 July 2004. The share-based payments charge of £820,000 has been computed in accordance with IFRS 2 using a Black-Scholes model.

A holiday pay accrual not previously required under UK GAAP has been calculated in accordance with IAS 19.

The amortisation of other intangible assets of £1,099,000 arises under IFRS 3 on the acquisition of Diagonal Limited (formerly Diagonal Plc).

**(b) Taxation**

| | £'000 |
|---|---|
| Deferred tax on intangible assets | 255 |
| Deferred tax asset under IAS 12 on employee benefits | (47) |
| Deferred tax asset under IAS 12 on the holiday pay accrual | 102 |
| | 310 |

**(c) Property, plant and equipment**
The adjustment of £527,000 represents the reclassification of fixed assets held by the French subsidiary disposed of in July 2005 to "assets and liabilities held for sale" (note h).

**(d) Other intangible assets**
A valuation as prescribed by IFRS 3 was performed on the goodwill arising on the acquisition of Diagonal Limited (formerly Diagonal Plc) and £6,380,000 of intangible assets were re-analysed from goodwill. The charge for amortisation in the period was £1,099,000. On these tangible assets a taxable assets benefit was generated of £1,763,000. The net increase in other intangible assets is therefore £7,044,000.

**(e) Goodwill**
Goodwill has been frozen at the brought forward written down value as at 1 July 2004 and this has been taken as the deemed cost. The UK GAAP amortisation charge for the year ended 30 June 2005 was reversed to increase goodwill and profit for the year by £23,230,000.

As per note (d) £6,380,000 has been re-analysed from goodwill to other intangible assets. The completion balance sheet at the acquisition of Diagonal Limited (formerly Diagonal Plc) has been adjusted by £273,000 to account for the holiday accrual required under IAS 19. This has resulted in an increase of goodwill at acquisition.

## 34 Explanation of transition to Adopted IFRSs (continued)

### (f) Deferred tax assets

| | £'000 |
|---|---|
| Deferred tax asset under IAS 12 on employee benefits | 31 |
| Deferred tax asset on a holiday pay accrual | 327 |
| *Reclassification from trade and other receivables due within one year* | 75 |
| Reclassification from trade and other receivables due after more than one year | 947 |
| | 1,380 |

*Deferred tax that relates to the same jurisdiction can be offset and has been presented on the balance sheet as a* deferred tax liability of £158,000. Deferred tax asset balances are reflected on the balance sheet of £30,000. The net liability is £128,000.

### (g) Inventories

The adjustment of £198,000 represents the reclassification of inventories held by the French subsidiary disposed of in July 2005 to "assets and liabilities held for sale".

### (h) Assets and liabilities classified as held for sale

The assets and liabilities of Morse France SAS have been reclassified on the balance sheet as "assets and liabilities held for sale".

The assets and liabilities held in France were as follows:

| | £'000 |
|---|---|
| **Assets** | |
| Fixed assets | 527 |
| Inventories | 198 |
| Trade and other receivables due within one year | 18,604 |
| | 19,329 |
| **Liabilities** | |
| Cash and cash equivalents | (2,369) |
| Trade and other payables | (13,538) |
| Income tax payable | (43) |
| | (15,950) |

### (i) Trade and other receivables

The reduction is caused by the reclassification of the receivables in Morse France SAS of £18,604,000 (note h) and the reclassification of the deferred tax asset of £75,000 due within one year and £947,000 due after more than one year (note f). A reclassification of £3,885,000 from debtors due after more than one year has also been made.

### (j) Provisions

*A reclassification of provisions from due over more than one year to due within one year has been made of* £2,669,000.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 34 Explanation of transition to Adopted IFRSs (continued)

### (k) Trade and other payables

| | £'000 |
|---|---|
| Holiday pay accrual (IAS 19) | (820) |
| Holiday pay accrual required on acquisition of Diagonal (note e) | (273) |
| Reclassification of trade and other payables from Morse France SAS | 13,538 |
| Dividend proposed | 3,921 |
| Reclassification of accruals and deferred income from falling due after one year to within one year | (3,959) |
| | 12,407 |

The holiday pay liability is accrued in accordance with IAS 19.

The trade and other payables of Morse France SAS of £13,538,000 have been reclassified (note h).

Dividends are recognised when approved in accordance with IAS 10.

### (l) *Income tax*
Income tax of £43,000 has been reclassified (note h).

### (m) Deferred tax liability
Per note (d) a deferred tax liability of £1,763,000 was generated on the acquisition of intangible assets of which £255,000 was released in the year giving a net adjustment of £1,508,000. All of the deferred tax that relates to the UK is presented on the balance sheet as a net liability of £158,000. Deferred tax asset balances are reflected on the balance sheet of £30,000.

### (n) *Retained earnings*

| | £'000 |
|---|---|
| Holiday pay accrual (IAS 19) - (note k) | (820) |
| Reversal of goodwill amortisation (IFRS 3) - (note e) | 23,230 |
| Amortisation of other intangible assets (note d) | (1,099) |
| Dividend proposed (note k) | 3,921 |
| Deferred tax on intangible assets (note m) | 255 |
| Deferred tax asset under IAS 12 on employee benefits (note f) | 31 |
| Deferred tax asset on the holiday accrual (note f) | 327 |
| Reclassification to other reserves from 1 July 2004 of translation differences arising from the translation of foreign subsidiaries | 85 |
| | 25,930 |

### (o) Deferred tax asset and trade receivables
An amount of £780,000 has been reclassified from trade and other receivables due within one year. The creation of a deferred tax asset under IAS 12 on employee benefits of £78,000 and holiday pay accrual of £225,000 gives a total adjustment of £1,083,000.

### (p) Trade and other receivables

| | £'000 |
|---|---|
| Deferred tax – reclassification to fixed assets (note o) | (780) |
| Reclassification of trade and other receivables due after one year to due within one year | 7,041 |
| | 6,261 |

## Morse plc
## Notes to the financial statements
## for the year ended 30 June 2005 (continued)

### 34 Explanation of transition to adopted IFRSs (continued)

#### (q) Trade and other payables

| | £'000 |
|---|---|
| Holiday pay accrual (IAS 19) | (750) |
| Dividend proposed | 3,095 |
| Reclassification of accruals and deferred income due after one year to due within one year | (8,542) |
| | (6,197) |

The holiday pay accrual is in accordance with IAS 19. Dividends are recognised when approved in accordance with IAS 10.

#### (r) Provisions

*Provisions of £591,000 have been reclassified from non-current liabilities to current liabilities.*

#### (s) *Retained Earnings*

| | £'000 |
|---|---|
| Holiday pay accrual (IAS 19) | (750) |
| Dividend proposed | 3,095 |
| Deferred tax (note o) | 78 |
| Deferred tax (note o) | 225 |
| | 2,648 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## Company balance sheet
## as at 30 June 2006

| | Note | Company 2006 £'000 | Company 2005 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | *iv* | **147,021** | 147,921 |
| | | **147,021** | 147,921 |
| **Current assets** | | | |
| Debtors | *v* | **25,218** | 22,765 |
| Cash at bank and in hand | | **-** | 10 |
| **Total current assets** | | **25,218** | 22,775 |
| **Creditors – amounts falling due within one year** | *vi* | **(42,229)** | (38,556) |
| **Net current liabilities** | | **(17,011)** | (15,781) |
| **Total net assets** | | **130,010** | 132,140 |
| **Capital and reserves** | | | |
| Called up share capital | *vii* | **15,338** | 15,106 |
| Share capital to be issued | *ix* | **3,803** | 6,229 |
| Share premium account | *ix* | **70,385** | 69,786 |
| Other reserves | | **27,372** | 25,164 |
| Profit and loss account | *ix* | **13,112** | 15,855 |
| **Total equity shareholders' funds** | *viii* | **130,010** | 132,140 |

The financial statements were approved by the Board of Directors on 30 August 2006 and signed on its behalf by:

D McIntyre

Director

## (i) Accounting policies

### Accounting convention

The financial statements are prepared under the historical cost convention and in accordance with the Companies Act 1985 and applicable accounting standards, using the following principal accounting policies which have been consistently applied. The accounting policies below cover items which are considered material in relation to the Company's financial statements.

As permitted by section 230 of the Companies Act 1985, the profit and loss account of the Company is not presented as part of these financial statements. The profit after taxation attributable to Morse plc for the year and dealt with in the financial statements of the Company was £3,011,000 (2005: £4,441,000).

The Company has adopted FRS 21 (IAS 10) "Events after the balance sheet date" for the first time in these accounts. The principle impact of this standard is on dividend recognition. Previously dividends were recognised in the period for which they were declared as relating to, now dividends are recognised during the period in which they are declared. The impact on the 2005 comparatives is to reduce the dividend creditor by £3,921,000 and the dividend recognised within the profit and loss account by the same amount.

The Company has adopted FRS 26 (IAS 39) "Financial Instruments and Measurement" and FRS 25 (IAS 32) "Financial Instruments: Disclosure and Presentation" for the first time in these accounts. This has had no impact on these accounts.

The Company has adopted FRS 28 "Corresponding amounts" for the first time in these accounts.

### Investments

Investments in subsidiary undertakings are stated at cost less provision for any impairment in value. Trade investments are held at cost less provision for any impairment in value.

### Associates and joint ventures

An associate is an undertaking in which the Company has a long-term interest, usually from 20% to 50% of the equity voting rights, and over which it exercises significant influence. A joint venture is an undertaking in which the Company has a long-term interest and over which it exercises joint control. The Company's share of the profits less losses of associates and of joint ventures is included in the consolidated profit and loss account and its interest in their net assets is included in investments in the consolidated balance sheet.

### Cash flow statement

The Company has taken advantage of the exemptions permitted by Financial Reporting Standard (FRS) No. 1 (Revised 1996) "Cash Flow Statement" not to produce a cash flow statement, on the basis that the cash flows of the Company are included within the consolidated Group cash flow statement of Morse plc, in its published financial statements.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## (i) Accounting policies (continued)

### Interests in own shares

Interests in own shares are accounted for in accordance with UITF abstract 38 "Accounting for ESOP trusts" which requires the assets and liabilities of the Group's ESOP trust to be recognised in the financial statements where there is defacto control of those assets and liabilities. The Company's own shares held in the ESOP trust are deducted from shareholders' funds until they vest unconditionally with employees.

### Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in future or a right to pay less tax in future have occurred at the balance sheet date, except as otherwise required by FRS 19. A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

### Taxation

The tax charge for the periods presented comprises current and deferred tax. Taxation is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of prior periods.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amount for financial reporting purposes and those for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes; initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

### Dividends

Dividends receivable are recognised when the Group's right to receive payment is established. Dividends payable to the Company's shareholders are recognised as a liability and deducted from shareholders' equity in the period in which the shareholders' right to receive payment is established.

## (i) Accounting policies (continued)

### Foreign exchange

Transactions denominated in foreign currencies are translated to Sterling at the actual exchange rate at the time of the transaction or, where forward foreign currency contracts have been taken out, at contracted rates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. These translation differences are dealt with in the profit and loss account.

### Cash

Cash comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

## (ii) Dividends paid and proposed

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Declared and paid during the year: | | |
| Equity dividend on ordinary shares: | | |
| Final dividend for 2005: 2.6p (2004: 2.35p) | **3,921** | 3,095 |
| Interim dividend for 2006: 1.2p (2005: 1.15p) | **1,833** | 1,708 |
| Under provision from previous years | **-** | 373 |
| | **5,754** | 5,176 |
| Proposed for approval at AGM (not recognised as a liability as at 30 June): | | |
| Equity dividend on ordinary shares: | | |
| Final dividend for 2006: 2.75p (2005: 2.6p) | **4,218** | 3,921 |

## (iii) Information regarding employees, Directors and their interests

### (a) Directors' remuneration

The cost of the Directors' emoluments are borne by Morse Group Limited, a subsidiary company, details of which can be found on page 35.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## (iii) Information regarding employees, Directors and their interests (continued)

### (b) Employees

| | 2006<br>Number | 2005<br>Number |
|---|---|---|
| **Average monthly number of persons employed (including Directors) by the Group during the year:** | | |
| Management and administration | 2 | 2 |
| Sales and technical staff | - | - |
| | 2 | 2 |

### (c) Staff costs (including Directors)

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Wages and salaries | 54 | 54 |
| Social security costs | - | - |
| Other pension costs | - | - |
| | 54 | 54 |

The Company has no pension costs.

## (iv) Fixed asset investments

| **Cost and net book amount** | **£'000** |
|---|---|
| **Interests in subsidiary undertakings** | |
| Cost at 1 July 2005 and 30 June 2006 | 147,021 |
| **Trade Investments** | |
| Cost at 1 July 2005 and 30 June 2006 | 36 |
| Provision at 1 July 2005 and 30 June 2006 | (36) |
| **Total net book value at 1 July 2005 and 30 June 2006** | - |
| **Interests in joint ventures** | |
| Cost at 1 July 2005 | 900 |
| Transferred to subsidiary | (900) |
| **Cost at 30 June 2006** | - |
| **Total net book value of investments at 30 June 2006** | **147,021** |
| Total net book value of investments at 30 June 2005 | 147,921 |

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## (iv) Fixed asset investments (continued)

The Company's principal undertakings included in the consolidated financial statements are as follows:

| Subsidiary undertakings | Principal activity | Percentage of *Ordinary shares* and voting rights held | *Country of* registration and incorporation |
|---|---|---|---|
| Morse Group Limited | Sale of IT solutions and professional services | 100% | England and Wales |
| Morse GmbH* | Sale of IT solutions and professional services | 100% | Germany*** |
| Morse Spain SL * | Sale of IT solutions and professional services | 100% | Spain |
| Morse Computer Group Limited * | Sale of IT solutions and professional services | 100% | Ireland |
| Morse Engineering Limited * | Sale of IT solutions and professional services | 100% | Ireland |
| Morse Solutions Limited * | Sale of IT solutions and professional services | 100% | Ireland |
| Appliance Technology Limited * | Sale of IT solutions and professional services | 100% | Ireland |
| CSTIM Management Consultancy (PTY) Limited* | Supply of management consultancy services | 100% | South Africa |
| CSTIM Limited | Provision of advisory services to companies engaged in investment management | 100% | England and Wales |
| Diagonal Consulting Limited* | Sale of IT solutions and professional services | 100% | England and Wales |
| Diagonal Solutions Limited* | Sale if IT solutions and professional services | 100% | England and Wales |
| SkillsHub Limited | Placement of external consultants in the financial services industry | 51% | England and Wales |
| Monitise Limited** | Supply of mobile phone initiated services | 85% | England and Wales |
| **Other trading undertakings** | | | |
| mobileATM Limited* | Supply of mobile phone initiated services | 50% | England and Wales |

* Indirectly held through subsidiary companies

** Monitise Limited was formed during the year ended 30 June 2006

*** Disposed of since year end

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## (v) Debtors

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Amounts due from Group undertakings | **25,173** | 22,679 |
| Other debtors | **45** | 86 |
| | **25,218** | 22,765 |

## (vi) Creditors: amounts falling due within one year

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Loan notes | **380** | 441 |
| Amounts due to Group undertakings | **41,234** | 37,348 |
| Other creditors | **471** | 620 |
| Corporation tax | **100** | 101 |
| Accruals and deferred income | **44** | 46 |
| | **42,229** | 38,556 |

## (vii) Called up share capital

| | 2006<br>Number | 2006<br>£'000 | 2005<br>Number | 2005<br>£'000 |
|---|---|---|---|---|
| **Authorised** | | | | |
| 10p Ordinary shares | **175,000,000** | **17,500** | 175,000,000 | 17,500 |
| **Allotted and fully paid** | | | | |
| 10p Ordinary shares | **153,380,176** | **15,338** | 151,063,102 | 15,106 |

## (viii) Reconciliation of movements in equity shareholders' funds

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Profit for the year | **3,011** | 4,441 |
| Dividends | **(5,754)** | (5,176) |
| Retained loss for the year | **(2,743)** | (735) |
| Issue of share capital | **3,039** | 20,771 |
| Movement in share capital to be issued | **(2,426)** | (3,271) |
| Net (reduction)/increase to equity shareholders' funds | **(2,130)** | 16,765 |
| Opening equity shareholders' funds | **132,140** | 115,375 |
| Closing equity shareholders' funds | **130,010** | 132,140 |

## (ix) Capital and reserves

| | Share *capital* | Share capital to *be issued* | Share premium *account* | Capital redemption *reserve* | *Other* | Foreign currency translation *reserve* | Merger *reserve* | Total other *reserves* | Retained *earnings* | *Total* |
|---|---|---|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Company** | | | | | | | | | | |
| At 1 July 2005 | 15,106 | 6,229 | 69,786 | 168 | 200 | - | 24,796 | 25,164 | 15,855 | 132,140 |
| Exercise of share options | 65 | - | - | - | - | - | - | | - | 65 |
| Profit for the year | - | - | - | - | - | - | - | - | 3,011 | 3,011 |
| Dividends | - | - | - | - | - | - | - | - | (5,754) | (5,754) |
| *Premium on issue of shares* | - | - | *599* | - | - | - | - | - | - | 599 |
| Issue of shares on acquisition of subsidiaries | 167 | (2,426) | - | - | - | - | £2,208 | 2,208 | - | (51) |
| **At 30 June 2006** | 15,338 | 3,803 | 70,385 | 168 | 200 | - | 27,004 | 27,372 | 13,112 | 130,010 |

The share capital issued at nominal value in the year relates to the exercise of share options (649,425 shares) and £2,375,000 of previously deferred consideration on the acquisition of CSTIM Limited (1,667,649 shares).

Share capital to be issued of £3,803,000 relates to the deferred consideration on the prior year acquisition of CSTIM Limited and is based on the business acquired achieving certain financial targets. £3,303,000 of the total share capital is to be issued within one year, the relevant targets having been settled, and £500,000 is to be issued after one year up to January 2008.

The premium arising on the exercise of 649,425 share options (note 21) was £599,000.

The capital redemption reserve is used to maintain the Company's capital following the purchase and cancellation of its own shares.

When share options are exercised using the Morse Employee Benefit Trust, the difference between market value of the shares and the exercise price of the options is charged to the profit and loss account reserve. Simultaneously, a transfer from other reserves to the profit and loss account reserve is made for the related charge recorded when the options were granted under the Morse Group company share option plan.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## (ix) Capital and reserves (continued)

*Merger relief on the £2,208,000 share premium arising on the 1,667,649 shares issued as consideration* on the prior year acquisition of CSTIM Limited has been recognised in accordance with s131 of the Companies Act 1985.

## (x) Post balance sheet events

On 24 July 2006 *Morse plc announced the disposal of its business in Germany and Austria.* Morse GmbH and Morse IT Solutions Austria GmbH were sold for a maximum consideration of €9,500,000 *(£6,506,000).* An *initial consideration of €7,125,000 (£4,880,000) is payable in cash with €2,375,000* (£1,626,000) of deferred consideration payable in cash in 90 days, subject to the collection of Morse Germany's receivables. This disposal has not had a significant impact on the investments held by the Company.

# Morse plc
# Notes to the financial statements
# for the year ended 30 June 2006 (continued)

## 5 year summary
## Year ended 30 June

| | Prepared under UK GAAP | | | Prepared under IFRS | |
|---|---|---|---|---|---|
| | *2002* £'000 | *2003* £'000 | *2004* £'000 | *2005* £'000 | *2006* £'000 |
| Turnover | 465,180 | 351,343 | 390,008 | 429,531 | **367,120** |
| Gross profit | 84,117 | 69,568 | 75,481 | 87,925 | **85,040** |
| Total operating profit * | 21,352 | 9,165 | 7,470 | 8,263 | **6,527** |
| Operating profit/(loss) | (2,765) | (17,413) | (14,471) | 2,191 | **12,837** |
| Net assets | 80,248 | 57,745 | 47,694 | 64,475 | **64,458** |

* *Before goodwill amortisation and exceptional items under UK GAAP*

* Before exceptional restructuring costs, impairment and exceptional trading balance releases under IFRS