Morse plc

(registered no. 3108179)

Annual report and accounts
for the year ended 30 June 2004

Financial highlights

- Group turnover of £390.0 million (2003: £351.3 million)
- Return to revenue growth (4% organic, 7% from acquisitions)
- Profit before tax, goodwill amortisation and exceptional items of £9.5 million (2003: £12.5 million)
- Loss before taxation of £12.4 million (2003: £14.1 million) after goodwill amortisation of £18.6 million (2003: £22.0 million). Morse's policy is, in general, to write-off goodwill over three years.
- Conversion of operating profit to cash at 84%
- Exceptional restructuring costs of £3.4 million (2003: £4.6 million)
- Net cash balance at 30 June 2004 of £62.0 million (2003: £75.3 million) following £12.0 million gross acquisition expenditure and £3.4 million restructuring cost
- Basic earnings per share before goodwill amortisation and exceptional items of 4.9p (2003: 6.7p)
- Proposed final dividend of 2.35p per share (2003: 2.15p per share) resulting in a total dividend for the year up 8% at 3.4p per share (2003: 3.15p per share)

Business highlights

- Significant progress in evolution of the Group from reseller to European technology integrator
- Good progress made with Techsol, the German storage solution and computer supply business, acquired in December 2003
- Acquisition of first strategic consultancy, CSTIM, in April 2004
- Acquisition of Diagonal Plc, following the year end, which will extend and enhance Morse's service offering
- Turnover in UK and Ireland up 7% at £256.6 million, including £2.9 million from CSTIM
- Turnover in Germany up 57% at £70.5 million, including £23.2 million from Techsol
- Turnover in Spain up 47% at £23.2 million

Chairman's statement

I am pleased to report the Group's return to revenue growth for the year ended 30 June 2004. In recent years, when trading conditions were particularly difficult, we had focused on maintaining good cash generation, producing underlying operating profits and safeguarding a strong financial position. This enabled us to benefit directly from the more stable trading conditions we saw in the last financial year and, in addition to delivering organic growth, we have also been able to take advantage of opportunities to expand the Group through acquisitions, consistent with our established strategy of broadening our infrastructure, software and services offering.

Group turnover for the year to 30 June 2004 was £390.0 million (2003: £351.3 million), of which £133.5 million came from Continental European operations (2003: £111.9 million). Our overall gross margin was 19.4% (2003: 19.8%). Profit before taxation, goodwill amortisation and exceptional items was £9.5 million (2003: £12.5 million). The Group generated a net cash inflow from operations of £2.9 million (2003: £16.0 million). The net cash balance at 30 June 2004 was £62.0 million (2003: £75.3 million), after funding current and deferred gross acquisition expenditure of £12.0 million and other non-operating net cash outflows of £4.2 million. After exceptional items of £3.4 million (2003: £4.6 million) and goodwill amortisation of £18.6 million (2003: £22.0 million), which, in general, we write-off over three years, the loss before taxation was £12.4 million (2003: £14.1 million).

Ahead of what we saw as likely changes in the reseller market, our strategy over the last four years has been to grow our services offering to complement the historic strength of our infrastructure business in order to deliver integrated IT solutions to customers across the UK and Ireland, and Continental Europe. Our focus is on defining and delivering complex IT infrastructure and software solutions that are tailored to customers' requirements, by drawing on Morse's in-house IT services and consultancy capabilities and its strong partnerships with the leading technology providers.

In pursuing this strategy, Morse has evolved significantly from its original retail outlet in High Holborn, London, through basic corporate reselling, to value-added reselling and, more recently, to European technology integration.

In 1999, the Group's revenue was based 96% on reselling with 87% of turnover based in the UK and 56% linked to one hardware manufacturer. The Group has now evolved into a better balanced and more sustainable business. Including Diagonal Plc, on a proforma basis, the business now realises 40% of turnover and 50% of gross profit from its services operations, with only 24% of turnover linked to any one hardware manufacturer.

The evolution of the Group, whilst not complete, has progressed significantly over the last year. It has enabled Morse to broaden its offering to customers across infrastructure, software, services and management consultancy and thereby secure closer, higher 'value-added' relationships with customers.

During the year we acquired two companies and, following the year-end, we completed the acquisition of Diagonal Plc. In December 2003 we acquired Systematics Technology Solutions GmbH ('Techsol') in Germany to expand our customer franchise, enhance our market presence in a market where scale is an important factor, and provide a broader offering. Before the acquisition, Techsol had been performing poorly and was loss-making. We purchased the Group for €1 with the knowledge that we would have to restructure the Group substantially.

In April 2004 the Group acquired CSTIM, a specialist management consultancy to the investment management industry. This was the first strategic consultancy the Group had acquired and therefore represented an important step forward in strengthening our vertical expertise. As the business and projects we undertake for customers become increasingly sophisticated, we recognise the need for a greater degree of sector/domain knowledge and know-how and this acquisition has helped us provide our customers with a broader offering within the finance sector.

In July 2004 we announced a recommended cash and share offer for Diagonal Plc ("Diagonal"), a leading UK IT consulting services business, which valued the issued share capital at approximately £50.2 million and which was declared wholly unconditional on 27 August 2004.

The acquisition of Diagonal will accelerate the development of our services offering and represents a further enhancement of Morse's ability to offer complete IT solutions. The acquisition will provide us with a leading UK-based SAP consultancy business. SAP is a key application which is currently outside Morse's services portfolio and, with over 40 existing Morse customers operating SAP applications, there is a significant opportunity to extend the services Morse currently provides to them. The customer bases of Morse and Diagonal's SAP consultancy business are complementary with very little direct overlap.

There is a very good fit between the two businesses and the combination of Diagonal's delivery expertise with Morse's strengths in sales and marketing should provide new opportunities for the Diagonal businesses, including its SAP consultancy business. In addition, Partners for Change Limited, Diagonal's change management business, is consistent with Morse's strategy and enables the development of deeper relationships with customers, as was the case with the acquisition of CSTIM. Diagonal's Security business will also represent an important addition to Morse's service portfolio by addressing the growing market for information security solutions. Diagonal's Solutions business complements and enhances Morse's existing applications business, bringing expertise principally in Microsoft applications in contrast to Morse's primary existing expertise in Java.

On a proforma basis, Morse's existing services offering combined with Diagonal's operations would lead to a total of 40% of turnover and 50% of gross margin. The proforma basis is based on the Morse plc year ended 30 June 2004 results and Diagonal's financial statements for the year ended 28 November 2003.

We were encouraged to see an increase in the number of enquiries we received concerning complex projects. One of the key areas in which we are seeing increasing opportunities is with businesses which are both sizeable and international but which do not traditionally have substantial in-house IT capability. This trend seems to be true of most vertical sectors as organisations look to use technology to support and facilitate the development of their business. This started to feed through into increased sales during the year, although the trading pattern itself remained lumpy.

Overall, we believe the IT industry as a whole is still burdened with over-capacity, increasing commoditisation and an inappropriate cost base. However, we continue to take action to mitigate these effects and ensure that Morse remains ahead of the curve as confidence continues to return to the market.

Although the market remains very competitive and hard to predict, trading conditions have stabilised and the outlook remains positive. Whilst we do not expect a further improvement in market conditions in the immediate term, the current financial year has started in line with our expectations and we anticipate business during the next year to compare favourably against 2004.

The Group's progress has been made possible by the dedication and expertise of its staff. I would like to take this opportunity to thank them for their professionalism, and to welcome our new colleagues from Techsol, CSTIM and Diagonal into the Group.

Richard Lapthorne, Chairman
31 August 2004

Operating review

This year was characterised by a return to growth across most sectors. With a more encouraging trading environment, we have been able to make selective investments to put Morse in an advantageous position as new business opportunities arise across the market. We re-organised the management and reporting of the business by geographic regions and sector verticals and continued to develop our own proprietary methodologies and new intellectual property, to work in alliance to capitalise on the skills and expertise of our technology partners to broaden our businesses and to increase our vertical expertise.

One of our main areas of focus is to build a much deeper level of sector expertise in the finance, telecommunications, public sector and commercial markets. While our core technology integration proposition has led to strong customer relationships in these industries, we recognise that to make an even more significant contribution we have to improve our credibility and capability to advise them on critical strategic projects. The acquisition of CSTIM represents an important step forward in this strategy. CSTIM's exceptional market reputation for the high calibre of its consultants, its reputation for thought leadership, and its boardroom-level relationships within the finance industry have transformed the Group's ability to deliver solutions into this sector. Our accepted offer for Diagonal Plc since the financial year-end also marks an important step forward in this respect.

While we have seen significant new customer wins during the past 12 months, our ambitions to develop close relationships as trusted advisers depends on our ability to effectively manage long-term clients. Such relationships are able to flourish because of our professionalism, credibility and the trust placed in us by them.

United Kingdom and Ireland
Turnover in the UK and Ireland for the year ended 30 June 2004 increased by 7% to £256.6 million, including sales of £2.9 million from CSTIM.

Trading during the year showed stabilisation and improvement in most areas, although as our business has evolved to be focused on project work (as opposed to product sales), spending patterns have been difficult to predict. As the Chairman noted, new opportunities continue to arise among large, well-established companies which have traditionally relied less on technology for business efficiency. We have been encouraged by a number of important wins in businesses of this size.

Our regional operations have continued to make progress, and we have been particularly pleased with the performance of our Irish operation since we acquired our first foothold in this market two years ago.

At the year-end we employed 898 people in the UK and Ireland, including 63 from CSTIM. This is a net increase of 85 compared with the previous year and reflects the continued downsizing of unprofitable business streams and aggressive recruitment in high-demand areas such as value-added resourcing.

Germany
Sales in Germany increased by 57% to £70.5 million, including sales of £23.2 million from our new acquisition, Techsol. The business recorded an operating loss of £0.2 million (2003: £1.3 million loss), of which £0.9 million was incurred in the four-month period from acquisition to 31 March 2004 as the Techsol business was restructured and integrated. The £0.9 million is not included as an exceptional item.

At our full-year results last year we noted that the German market was consolidating and indicated that we were looking for suitable acquisitions to increase our presence there. We announced the acquisition of Techsol in December 2003, and it has brought our German operations a much broader customer franchise and a substantial increase in scale. As we expected, the business required substantial restructuring to bring it to profitability, and the programme we implemented immediately after acquisition allowed it to reach a break-even run rate by 30 June 2004.

During this process, headcount in the combined business was reduced by 72 to 178. The integration of Techsol with Morse Germany was well-executed and is allowing us to accelerate the roll-out of our full technology integration model to provide customers in the geography with a combination of hardware, software and services. Although we are not yet seeing the revenues we want from this business, we believe it is well-positioned to capitalise on the return to stability of the German market.

At the year-end, Morse Germany employed 178 people (2003: 112), following the integration and restructuring of Techsol.

France
Sales in France fell by 23% to £39.7 million with the business incurring an operating loss of £2.1 million (2003: £0.9 million loss) before exceptional costs of £0.4 million.

Market conditions in France have remained volatile. We continue to support the management team as they pursue a strategy of developing a more balanced infrastructure portfolio, a more coherent service offering and a more broadly based customer franchise. They have achieved substantial progress in all three of these areas, but performance was constrained as a result of the impact of the restructuring plan carried out in June 2003.

Overall, we believe we have provided the foundations of a more robust, sustainable and profitable business for the future.

At the year-end, staff numbers in Morse France had been reduced to 140 (2003: 159).

Spain
In Spain, turnover increased by 47% to £23.2 million and the business recorded an operating profit of £1.6 million (2003: £1.0 million), after taking into account the cost of investing in a wider product portfolio.

This was another strong performance from Morse Spain as it continues to develop into a broadly based technology integration company. The size and complexity of projects undertaken rose considerably during the year, and this is reflected in the increase in gross margin to 21% (2003: 20%). When we acquired ISASA – now Morse Spain – in 2001, its business was almost entirely confined to the Barcelona region. Its growth has resulted in a business that now has an equally strong position in Madrid, and we are exploring ways of further developing our presence in Spain.

At the year-end, headcount in Spain had increased to 86 (2003: 60).

Sector verticals

Finance
Turnover in this sector for the year ended 30 June 2004 was £189.8 million (2003: £152.1 million).

Spending in retail finance accounted for a larger proportion of sales than wholesale banking, and trading with retail banks continues to grow more rapidly owing to continued consolidation in the market and the requirement for compliance with new regulations. We have witnessed an improvement in sentiment within our traditional investment banking base as, for the first time in several years, they begin to consider projects justified by competitive advantage. This has yet to feed through fully into their spending patterns.

This pattern is not consistent across Europe, with economic conditions leading to subdued trading in this sector in both France and Germany. We have, nonetheless, continued to win new business in the Continental European market, such as a Murex software banking implementation for Helaba-Landesbank Hessen Thüringen.

As noted above, the acquisition of CSTIM is paving the way for a new level of engagement in the finance sector. AXA Investment Managers, with which CSTIM is defining a strategic operating model for administration and back-office functions, is typical of this new stream of business.

An exciting development, which is expected to enter its pilot stage in the coming months, is our mobile commerce solution, mobileATM™, which is being developed in conjunction with LINK Interchange Network Ltd (operator of LINK, the world's busiest shared ATM network). This is intended to provide some of the functionality of the physical ATM to the mobile channel and will help ensure Morse is well placed to take advantage of opportunities in the emerging mobile commerce market.

Telecommunications
Turnover in this sector for the year ended 30 June 2004 was £57.6 million (2003: £75.4 million).

We continue to see opportunities in multi-channel content delivery, and our own mobileATM™ and MChex initiatives are making progress. As we noted in our interim results to 31 December 2003, we expect further growth to come from the mobile commerce sector and increased investment in 3G.

By contrast, the trend among established telecommunications businesses remains focused on reducing operational expenditure. For example, we have played a major role in helping Cable & Wireless take out £10.0 million from its IT operating costs by consolidating its server and storage infrastructure. Conditions also remain subdued in Continental Europe.

Commercial
Turnover in this sector for the year ended 30 June 2004 was £120.7 million (2003: £110.1 million).

Morse's commercial sector includes industries such as media, pharmaceuticals, retail, manufacturing, professional services organisations, energy and utilities. These commercial enterprises face many different challenges and opportunities. We engage with them according to customer requirements, from improving technology utilisation to ensuring constant availability of services to the business.

We believe prospects for this sector are encouraging in all geographies in which we operate, and we have already witnessed a considerable increase in our solutions business with established customers.

Public sector
Turnover in this sector for the year ended 30 June 2004 was £21.9 million (2003: £13.7 million).

Morse focused on the public sector market two years ago and this is an encouraging performance. In Continental Europe our main presence in this market is in France, but we now have a strong foothold in the UK with a significant number of customers. We have been awarded Prime Contractor status for the S-Cat catalogue and are a sub-contractor to PC World Business and IBM for the G-Cat catalogue.

One of the most notable contracts we were awarded was a new information management system for the House of Commons Library. Given the significant investment needed to win public sector tenders, we intend to concentrate for the time being on increasing our penetration with our existing customers.

Processes and people
At the year-end, Group headcount stood at 1,302 (2003: 1,144). Like everyone else in the industry, we face considerable challenges as we look to reduce our cost base while not compromising our capability to provide what our customers demand. With recent and planned acquisitions, the opportunities for consolidation and cost savings are significant, and we are working to improve and streamline processes across the Group to continuously improve our performance.

Duncan McIntyre, Chief Executive

Financial review

In the year to 30 June 2004 revenues increased to £390.0 million and profits before tax, goodwill amortisation and exceptional items decreased to £9.5 million. Net cash at 30 June 2004 was £62.0 million.

	2004 Sales	Operating Profit*	2003 Sales	Operating Profit*
UK & Ireland	256.6	8.2	239.5	10.4
France	39.7	(2.1)	51.2	(0.9)
Germany	70.5	(0.2)	44.8	(1.3)
Spain	23.2	1.6	15.8	1.0
	390.0	**7.5**	**351.3**	**9.2**

* Operating profit before exceptional restructuring costs and goodwill amortisation

Overall, the results for the year reflect a relative stabilisation of demand for enterprise technology. That said, the market dynamics still trend towards project-based business and a skew towards the end of each calendar quarter. As these trends continue, the lumpiness in the business continues to create sizeable swings in working capital requirements. The results of our businesses in the UK, Germany and Spain reflect this relative stabilisation. The French market, however, remains more volatile than the others and we continue to broaden our offering and customer base with a view to restoring the business to profitability.

Gross margins in the business overall have remained relatively steady year on year (19.4% this year compared with 19.8% in 2003) with some impact from large hardware-orientated deals in the mix, as was seen in the first half of the year. Gross margins in the UK and France have fallen in the year, primarily due to a rise in infrastructure sales in the UK and weaker market conditions in France. In Spain and Germany gross margins increased as the proportion and size of the service contracts continued to increase in Spain and due to rebate targets being hit and the positive influence on margins from the acquisition of Techsol in Germany.

The operating results reflect a combination of the gross margin movements and the investment in developing our businesses, the full benefits of which have yet to be realised. In the year investments in developing the businesses included the addition of product lines in all markets, the development of our mobility solutions for the Telco and Finance sectors, and the excess costs carried in the Techsol business in Germany prior to the restructuring being formalised.

Headcount and resources

Headcount at the year-end was 1,302 which compares to 1,144 at 30 June 2003. This increase comprised reductions in the core business operation offset by acquisitions, as well as increases in headcount in the professional services business in Spain and in value-added resourcing in the UK services business. In response to increased demand from UK financial services clients, value-added resourcing was the main area of recruitment for the Group during the year and to ensure we remain well placed to service demand, we increased our pay scales in this area accordingly. All staff performance is regularly reviewed, and our compensation plans are based strictly on the merit of the individual.

Headcount across the Group can be summarised as follows:

Headcount at 30 June 2003	1,144
Acquisitions	198
UK	35
Spain	26
Base total	1,403
Total headcount reductions	(101)
Headcount at 30 June 2004	1,302

Restructuring costs
In the year to 30 June 2004 we have continued our approach to cost management which is characterised by an ongoing effort to target areas where efficiency can be improved as the shape of the market evolves rather than attempting to impose a one-off adjustment to the cost base.

However, during the year, the Group incurred restructuring costs of £3.4 million, which primarily comprised the cost of reducing headcount in Germany as we restructured and integrated the Techsol business with our existing German operation.

In addition to this, the German business incurred costs of £0.9 million which resulted from the Techsol business carrying excess resources until the restructuring plans were formalised in the March quarter. This £0.9 million has not been treated as exceptional.

Earnings per share
In accordance with FRS 14, the basic and diluted loss per share after goodwill amortisation and exceptional items was 11.9p (2003: loss per share was 13.3p).

Basic earnings per share, excluding the charge for goodwill amortisation and exceptional items, were 4.9p versus 6.7p for the previous year. In general, goodwill arising from acquisitions is amortised over three years.

Dividend
The Board continues to pursue a progressive dividend policy with dividend cover set at a level to enable the Group to fund its medium-term growth and development requirements.

At the half-year we announced a dividend of 1.05p per share (2003: 1.0p per share) and, in recognition of the improved underlying performance of the Group as a result of more stable trading conditions, we are pleased to propose a final dividend of 2.35p per share (2003: 2.15p per share). This would result in a total dividend for the year of 3.4p per share, up 8% on last year (2003: 3.15p per share).

The final dividend will be paid on 9 November 2004 to shareholders on the register as at the close of business on 8 October 2004.

Cashflow
Cash generated from operations was strong again in the year with £6.3 million being generated before exceptional restructuring costs.

Although respectable, the ratio of conversion of operating profit to cash at 84% is lower than in recent years, reflecting the fact that the business has now stabilised after falls in the level of sales in the past two years. Working capital ratios continue to be managed tightly.

Non-operating cash outflows in the year totalled £20.5 million. The principal elements of these outflows were gross acquisition payments of £12.0 million, dividends of £4.2 million, purchase of fixed assets of £2.0 million and tax payments of £2.3 million.

The net cash outflows in the year resulted in net cash balances of £62.0 million at 30 June 2004, the movements being as follows:

	£ million
Cash generated from operations	6.3
Restructuring costs	(3.4)
Gross acquisition costs	(12.0)
Dividends, tax, fixed assets	(8.5)
Financing and other	4.3
Decrease in net cash	(13.3)
Net cash as at 30 June 2003	75.3
Net cash as at 30 June 2004	62.0
Comprising:	
Cash	66.1
Overdraft	(3.6)
Loan notes	(0.5)
	62.0

Taxation

The tax charge of £3.1 million on a loss before tax of £12.4 million is higher than the UK rate of 30% because of non-deductible costs, particularly the amortisation of goodwill and the effect of unrelieved losses in France and Germany, offset by the benefit of credits resulting from the resolution of prior-year tax positions.

Acquisitions

In December 2003 the Group acquired Techsol, a German storage and computer supply company for €1. The acquired business reported turnover for the year to 31 December 2003 of €88.8 million and operating losses of €7.9 million. The primary financial cost of the acquisition was the cost of restructuring the business. This restructuring was successfully completed by 30 June 2004 such that the business traded at a marginal profit before restructuring costs in the quarter to 30 June 2004. The cost of the restructuring was the main element of the exceptional cost of £3.4 million disclosed in the financial statements. Additionally, during the period since acquisition, the business incurred operating costs of £0.9 million as a result of it carrying excess resources and property in the period prior to the formalisation of the restructuring plan. Our German business now has a strong base from which to move forward.

In April 2004 the Group acquired 100% of the share capital of CSTIM Limited, a leading provider of specialist management consultancy to the investment management industry, for an initial cash consideration of £5.85 million. Additional consideration of up to £9.5 million may be payable on the achievement of certain financial performance targets through to December 2008, resulting in a potential maximum total consideration of £15.35 million. The additional potential consideration of £9.5 million would be satisfied by up to a maximum of 6.9 million new Morse shares.

Accounting Policies

The financial statements have been prepared on the basis of consistent accounting policies in line with those used in the previous financial year, except for the adoption of UITF abstract 38 'Accounting for ESOP trusts'.

Gavin James
Finance Director
31 August 2004

Profiles: the Board

Richard Lapthorne
Non-Executive Chairman
Age 61. Richard joined Morse in 1998 and was Vice Chairman of BAe until 1999. He is Non-Executive Director and Chairman of Cable & Wireless, Non-Executive Chairman of Avecia Ltd and Non-Executive Director of Oasis (Abu Dhabi).

Duncan McIntyre
Chief Executive Officer
Age 45. 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.

Gavin James
Finance Director
Age 41. Gavin joined Morse in 1998 as Finance Director. Following qualification as a chartered accountant with Arthur Young in 1987, Gavin gained 11 years' commercial finance experience and was Group Finance Director of Menvier-Swain Group plc from 1995 to 1998.

Phil Coll
Continental European Director
Age 45. Phil joined Morse in 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
UK Country Director
Age 37. 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.

Eric Barton
Non-Executive Director
Age 59. Eric joined Morse in 1995. He is a Non-Executive Director of Telecity plc and Acal plc, and was a Director of 3i plc between 1986 and 1999.

Bill Passmore
Non-Executive Director
Age 63. Bill joined Morse in 1995. He is a Non-Executive Chairman of Artisan Software Tools Ltd, Quester VCT5 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 59. Colin joined Morse in 2000. He is Deputy Chairman and co-CEO of Hutchison 3G UK and has over 20 years' experience of the telecommunications industry. He was Technical Director for ten years and later main board director of Orange plc, responsible for establishing its Continental European business.

Lee Cameron
Company Secretary
Age 33. Lee joined Morse in 1998 following his call to the Bar of England and Wales. He became Company Secretary in 2000 and the Group's Head of Legal in 2001.

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Financial calendar

Ex-dividend date	**6 October 2004**
Record date	**8 October 2004**
Annual General Meeting	**2 November 2004**
Dividend payment date	**9 November 2004**

Directors' Report

for the year ended 30 June 2004

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 2004.

Principal activity

The Group's principal activity during the year was the selling and implementing of IT solutions.

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 3-4, Operating Review on pages 5-7 and Financial Review on pages 8-10.

Results and dividends

The results of the Group are set out on page 29. The Directors propose the payment of a final dividend of 2.35p per Ordinary share (2003: 2.15p), which in addition to the interim dividend of 1.05p per Ordinary share (2003: 1.0p per share), amounts to a dividend for the full year of 3.4p per Ordinary share (2003: 3.15p per Ordinary share).

Directors and their interests

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

E Barton	(Senior Non-Executive)
D Beresford	(appointed 29 August 2003)
P Coll	
G James	
R Lapthorne	(Non-Executive Chairman)
D McIntyre	(Chief Executive Officer)
W Passmore	(Non-Executive)
C Tucker	(Non-Executive)

Directors' beneficial interests in the share capital (including share options) of the Company are given in the Directors' Remuneration Report on page 23. 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 31 August 2004. 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, Walter Passmore and Philip Coll, whose profiles are given on page 11, will retire and offer themselves for re-election.

Political and charitable contributions

During the year the Group made various charitable contributions totalling £22,874 (2003: £14,774). The Group made no political donations (2003: £nil).

Post balance sheet event

On 13 July 2004 Morse plc announced that it had reached agreement with the directors of Diagonal Plc on the terms of a recommended cash and share offer ("the Offer") to be made on behalf of Morse plc for Diagonal Plc. The Offer was made by way of an offer document posted on 3 August 2004 and following approval by Morse plc shareholders at an Extraordinary General Meeting on 25 August 2004, was declared wholly unconditional on 27 August 2004 with Morse plc having received acceptances in respect of 75.81 per cent of the issued Ordinary share capital of Diagonal Plc by the first closing date (3.00pm on 25 August 2004). Full acceptance of the Offer would result in Morse plc having to pay approximately £28.1 million in cash and having to issue approximately 17.8 million new shares in Morse plc. These shares will rank for the final proposed dividend in respect of the year ended 30 June 2004.

As a result of the Offer going wholly unconditional, since the balance sheet date, Diagonal Plc has become a majority-owned subsidiary of Morse plc.

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.

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 the terms and conditions agreed between the Group and its suppliers on an individual basis provided all trading terms and conditions have been complied with.

The Company does not have any trade creditors.

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 31 August 2004:

Shareholder	Number of shares held	% of the issued share capital
3i Group plc group of companies	24,994,987	19.07%
UBS Global Asset Management	17,019,222	12.99%
Harris Associates	12,331,300	9.41%
AXA SA and subsidiaries	9,851,261	7.51%
UBS Global Asset Management Life Limited	7,281,496	5.56%
The Capital Group Companies	4,379,900	3.34%

See Remuneration Report for the table of Directors' Shareholdings.

Interests in own shares
The Company did not make any acquisitions of its own shares during the year.

Annual General Meeting
The Annual General Meeting of the Company will be held on 2 November 2004.

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

Approved by the Board of Directors on 31 August 2004 and signed on its behalf by:

Lee Cameron
Company Secretary

Corporate Governance Statement

Combined Code on Corporate Governance
The Board believes the Company has been in compliance with the provisions of the 1998 Combined Code during the year. The application of these provisions is set out below.

The Board of Directors
The Board has reserved certain matters for its review and approval, including overall strategy, financial strategy and planning, material acquisitions and disposals, investments, and capital projects.

The Board comprises four Executive Directors and four Non-Executive Directors. All Non-Executive Directors including the Chairman are considered by the Board to be independent for the purposes of the Combined Code. Eric Barton and Walter Passmore were appointed as Non-Executive Directors of the Company on 29 September 1995. Whilst they have both been Non-Executive Directors of the Company for more than nine years, their tenure as Non-Executive Directors of the Company since the Company listed its shares on the London Stock Exchange in March 1999 is only five years. They are considered by the Board to be independent for the purposes of the Combined Code and their range of other current Directorships and wide previous experience allows them to bring distinct and challenging views to Board discussions. The Board has nominated Eric Barton as Senior Independent Director

The balance between Executive and Non-Executive Directors has been reviewed by the Nominations Committee and the Board and a formal process for the appointment of new Directors has been established for identifying suitable candidates.

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 the Group's day-to-day business and is accountable to the Board for the financial and operational performance of the Group.

The Board believes that its style of involvement with the management 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 meets at least six times during the year and holds other meetings as necessary. All Directors have access to the Company Secretary who is responsible for ensuring Board procedures are followed. All Directors receive appropriate and timely information in advance of Board meetings.

A procedure exists for all Directors to take independent professional advice, if necessary, at the Company's expense.

The Board has established an appropriate training programme for new 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 during the period are required to seek re-election at the first AGM following their appointment.

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

Audit Committee
This Committee is responsible for overseeing the involvement of the Group's auditors in the planning and review of the Group's Annual Report and Accounts and Half-Year Report, 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. It sets guidelines designed to ensure 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.

In the normal course the Company will expect its auditors to provide audit and tax services subject to 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 should always be benchmarked by management to ensure value for money 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. Auditors will not receive management consultancy work.

The members of the Audit Committee are three Non-Executive Directors: Bill Passmore, Colin Tucker and Eric Barton, who chairs the Committee. Richard Lapthorne served on the Committee as a member until 21 July 2004.

Remuneration Committee
This Committee, in accordance with guidelines set by the Board, determines the Group's policy on remuneration of senior executives and controls the operation of share option schemes and the grant of options. It considers and approves specific remuneration packages for each Executive Director.

Remuneration of Non-Executive Directors is set by a committee of the Board consisting of two Executive Directors.

The members of the Remuneration Committee are three Non-Executive Directors: Eric Barton, Colin Tucker and Bill Passmore, who chairs the Committee. Richard Lapthorne served on the Committee as a member until 21 July 2004. The Remuneration Report appears on pages 19-27.

Nominations Committee
This Committee meets as required to initiate the selection process and the appointment of members of the Board.

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

Relations with shareholders
The Company recognises the importance of developing and maintaining relationships with its shareholders. There are regular dialogues with all shareholders including presentations following the Company's interim, preliminary and recent quarterly announcements. The Company uses the Annual General Meeting as an opportunity to communicate with its shareholders. The Chairmen of the Audit, Remuneration and Nominations Committees are also available to answer shareholders' questions at the Annual General Meeting.

Notice of the 2004 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 Combined Code. Separate resolutions on each substantially separate issue, in particular a proposal relating to the Report and Accounts, will be made at the Annual General Meeting.

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

Management structure
The Executive Directors meet to discuss strategic and operational matters. Additionally, within each country, the relevant country director and key executives meet regularly to discuss issues particular to that country.

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.

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 to the minimum possible. The Environmental Policy is regularly reviewed and, where necessary, revised to keep 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.

Statement of Directors' responsibilities

Company Law requires the Directors to prepare financial statements for each financial year giving a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss for that period. In preparing those financial statements, the Directors are required to:

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

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

Going concern

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

Internal control systems

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness on an ongoing 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 financial control 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 country, the relevant country director and key executives meet regularly to discuss issues particular to that country;
- 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 2003 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 and accords with the internal control guidance issued by the Turnbull Committee for Directors on the Combined Code. Further processes established by the Group are as follows:

- a risk matrix has been developed and approved by the Board to highlight and monitor potential business risk areas that exist in the organisation and, wherever possible, to quantify the risk and address the risk with a contingency/mitigation plan; and

- the risk matrix is under regular review by management in order to respond to changes in the business and adapt to new risk areas. Recommendations for amendments are advised to the Board via the Group's management reporting structure.

- The Company is the parent of a number of subsidiary companies and whilst each Group company applies internal controls through a network of reporting lines, the overall compliance of the Group is reviewed by the Board of the Company.

- Each business manager is responsible for their part of the organisation's internal control and risk management compliance and is required to certify that their part of the organisation has satisfactorily complied, and where there is any non-compliance, they are required to declare the non-compliance and propose suitable remedial action. Accountability is measured through the Company by assessing each manager's performance and the maintenance of reporting structures. The Board reviews such certificates at set intervals as part of its ongoing review of the Company's compliance with the guidance issued by the Turnbull Committee.

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. 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 Executives and Non-Executive Directors."

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 2 November 2004 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.

Its members, all Non-Executive Directors, are Bill Passmore (Chairman), Eric Barton (Senior Independent Non-Executive Director) and Colin Tucker. Richard Lapthorne served on the Committee as a member until 21 July 2004. All Non-Executive Directors were members of the Committee during the year ended 30 June 2004. The Chief Executive Officer may, upon request, also attend the meetings of the Committee except where his own remuneration is being considered.

During the year, advice has been sought from and reference made to published market studies from New Bridge Street Consultants LLP and others in relation to current market trends and best practice with regard to Directors' remuneration. The Committee has used New Bridge Street Consultants LLP to act as independent consultants during the year ended 30 June 2004 and plans to continue to use them to act as independent consultants in the year ending 30 June 2005. No other services are offered by New Bridge Street Consultants LLP to the Company.

When necessary and where applicable, the Committee has and will continue to consult with shareholders in order to solicit shareholders' views with regard to key remuneration issues.

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, 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 that 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 that performance during a fiscal year can be correctly rewarded. Base salaries are normally set at median market level with variable incentives (bonus and share incentive 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 July of each year 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. No increase was awarded in July 2004 (July 2003: nil).

The Executive Directors' base salaries in accordance with their service contracts would have been:

David Beresford (Note 1)	£140,000
Phil Coll	£175,000
Gavin James	£190,000
Duncan McIntyre	£300,000

Note 1. David Beresford's base salary would remain as £140,000.

However, base salary reductions applied in July 2003 remain in place and produce the following Executive Directors' salaries:

	Year ending 30 June 2005	Year ended 30 June 2004	% Base salary reductions applied
David Beresford (Note 1)	£140,000	£140,000	-
Phil Coll	£150,000	£150,000	14.3%
Gavin James	£162,000	£162,000	14.7%
Duncan McIntyre	£240,000	£240,000	20%

Note 1. David Beresford was appointed to the Board as UK Country Director on 29 August 2003.

The base salary reductions applied in July 2003 will be reviewed on a 6-month basis and will remain unless the Company is taken over upon which the salaries will automatically revert to their June 2003 levels or the Remuneration Committee and Board determines that trading has returned to more sustainable and consistent levels.

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 is triggered by achieving the agreed financial performance objectives of the Group and is paid against a combination of financial targets (80%) and personal objectives (20%). Bonus payments are non-pensionable and are payable after the Group's results have been audited. In respect of the year ended 30 June 2004, £190,000 of bonuses were paid to the Executive Directors of the Company (2003: nil). This represents 27% of the possible maximum bonuses available to Executive Directors. This reflects primarily the individual achievements of the Executive Directors and the reduced profitability of the group.

For the year ending 30 June 2005 any bonus payable will continue to be subject to meeting agreed financial targets. Bonus payments will also continue to reflect the established distribution of 80% against financial targets and 20% against personal objectives.

Executive Director packages in the year ended 30 June 2004 reflected a 50/50 split between fixed and variable elements at the target earnings level. The year ending 30 June 2005 will continue to see the total package reflecting a 50% fixed remuneration (base salary and benefits) and a 50% performance related bonus at the target level. Policy in relation to Executive Directors will continue to be reviewed in light of market practice and legislation.

Pensions
The Company operates a defined contribution scheme (money purchase) which is operated for Executive Directors and employees. The Company contribution rate is 5% of base salary for Duncan McIntyre, David Beresford and Phil Coll and 6% of base salary for Gavin James. In July 2003, following a thorough review of market practice, the Remuneration Committee recommended to increase the Company contributions for Executive Directors to an annual level of 14%. The Board has no intention to introduce this change until market conditions improve and trading returns to more sustainable levels.

Share Incentive Schemes

Executive share incentives are considered to be a key part of management retention and motivation over a 3 to 5 year term. 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. Option grants under the Executive Share Option Schemes are subject to the achievement of defined performance criteria for the Company.

With the introduction of the Unapproved and Approved versions of the Executive Share Option Schemes 2000, all option grants are 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 prices index in the 3 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 retesting in a fourth consecutive financial year. A number of option grants were also made shortly before the Stock Exchange Listing in 1999, which contained no specific performance conditions. These options were granted to key managers in order to incentivise and retain those key individuals leading up to and following the listing.

The adjusted basic earnings per share (EPS) after goodwill amortisation and exceptional items was chosen as the performance measure for options as it is a recognised and accepted measure of the Company's overall progress by shareholders. It affords clarity and focus as a result of its relative ease of measurement.

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

The Unapproved and Approved Executive Share Option Schemes 2000 performance conditions were set at a level acceptable to the shareholders as appropriate in order to gain a high level of performance.

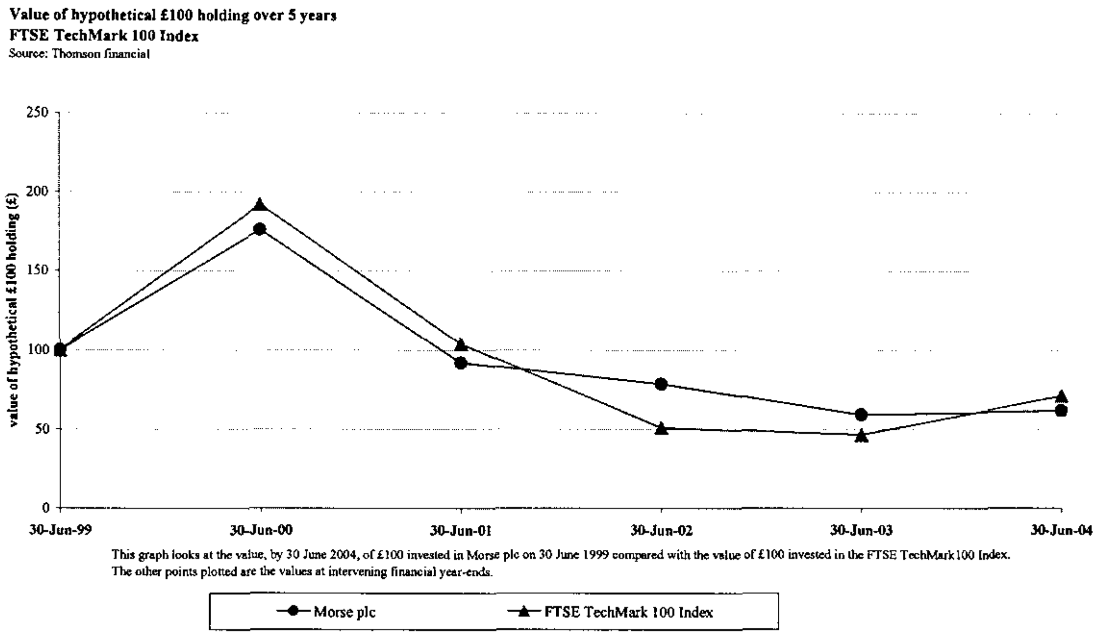
The Remuneration Committee may instruct the Company's Auditors to calculate the increase in the EPS over the performance period based on the Company's audited accounts for the relevant financial year-end.

The Remuneration Committee shall determine whether or not the performance conditions have been satisfied. The determination will be made as soon as practicable after the expiry of the performance period. If the Remuneration Committee determines that the performance condition has been satisfied in respect of any options, it will authorise the exercise of these options, subject to the rules of the scheme.

The level of the option grants each year is related to individuals' basic salaries and has ranged from an award equivalent (at current market prices) of 0.50 times salary to a maximum of twice-annual salary in a few cases.

Shareholder approval is being sought at the forthcoming AGM to establish a new Long-term Incentive Plan ("Plan") which the Remumeration Committee intends will form an integral part of the share-based incentive arrangement operated for the benefit of key senior executives (including Executive Directors). Further details of this new Plan can be found in the Notice of the AGM, which should be read in conjunction with (and with the relevant sections forming part of) this report.

The following graph shows the value by the end of June 2004 of £100 invested in Morse plc on 30 June 1999 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.



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 options, granted and outstanding, under each of the schemes are given in Note 5 to the financial statements.

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. As permitted by UITF17 'Employee share schemes' no charge has been made to the profit and loss account at the time of the grant for the discounted value.

Long-term Incentive Plan

As explained above, shareholder approval is being sought at the forthcoming AGM for the establishment of this new Plan.

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. Non-Executive 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.

Director	**Employing Company**	**Date of Contract**
E Barton	Morse plc	Feb 1999
D Beresford	Morse plc	Aug 2003
P Coll	Morse plc	Jan 2002
G James	Morse plc	Feb 1999
R Lapthorne	Morse plc	Jan 1999
D McIntyre	Morse plc	Feb 1999
W Passmore	Morse plc	Feb 1999
C Tucker	Morse plc	Mar 2000

Directors' Shareholdings

The Directors' and their families' beneficial interests in the share capital of the Company at 30 June 2004 are shown below:

		2004		2003
	Beneficial Ord shares of 10p	**Share options Ord shares of 10p**	Beneficial Ord shares of 10p	Share options Ord shares of 10p
R Lapthorne	**300,000**	-	300,000	-
E Barton (1)	**26,000**	-	26,000	-
G James	**363,292**	**656,386**	363,292	656,386
D McIntyre (2/3)	**5,903,181**	**1,023,776**	5,903,181	1,023,776
W Passmore	**20,000**	-	20,000	-
C Tucker	-	-	-	-
P Coll	**200**	**677,111**	200	691,609
D Beresford	-	**243,000**	-	243,000

Note 1 Additionally E Barton has a non-beneficial interest in 5,000 shares (2003: 8,300).
Note 2 Included in D McIntyre's beneficial shares are 704,468 (2003: 704,468) Ordinary shares held in trust for his minor children.
Note 3 D McIntyre's shareholding represents 4.50% of the total issued share capital.

There has been no change in the Directors' interests up to 31 August 2004.

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.

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, and are aligned with the interests of shareholders. 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. The Non-Executive Directors' fees reductions (10%) applied in July 2003 will remain unless the Company is taken over upon which the fee will automatically revert to their June 2003 levels or if the Board determines that trading has returned to more sustainable and consistent levels. Any reversion in the level of Non-Executives' fees will reflect the market position for Non-Executive appointments in companies of Morse's size.

There is no policy of paying Non-Executive Directors' remuneration in shares, and share options will not be granted to Non-Executive Directors. 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:

					2004		2003
Summary	**Base salary/ fees**	**Annual bonus**	**Benefits and allowances**	**Total exc pensions**	**Pension cont**	Total exc pensions	Pension cont
	£	**£**	**£**	**£**	**£**	£	£
R Lapthorne	**90,000**	**-**	**-**	**90,000**	**-**	100,000	-
D McIntyre	**240,000**	**70,000**	**14,829**	**324,829**	**12,000**	314,752	15,000
G James	**162,000**	**40,000**	**11,902**	**213,902**	**9,720**	201,820	11,400
M Coley (1)	**-**	**-**	**-**	**-**	**-**	316,585	7,500
P Coll (2)	**150,000**	**40,000**	**12,348**	**202,348**	**7,500**	187,269	8,750
D Beresford (3)	**117,205**	**40,000**	**6,762**	**163,967**	**5,858**	-	-
E Barton	**27,000**	**-**	**-**	**27,000**	**-**	30,000	-
W Passmore	**27,000**	**-**	**-**	**27,000**	**-**	30,000	-
C Tucker	**27,000**	**-**	**-**	**27,000**	**-**	30,000	-
Total	**840,205**	**190,000**	**45,841**	**1,076,046**	**35,078**	1,210,426	42,650

Note 1 M Coley resigned from the Board on 13 June 2003.

Note 2 In the year P Coll made a gain of £153,000 on exercise of Morse Group Company Share Option Plan share options. All shares have been sold.

Note 3 D Beresford was appointed to the Board on 29 August 2003.

Interests in Share Options

The interests of the Directors in Morse plc share options are set out below. Options to subscribe for 10p Ordinary shares of the Company held by the Directors are:

	Options held at 1 July 2003	Options granted during the year at £1.375p	Options exercised during the year	Options held at 30 June 2004	Earliest date of exercise	Expiry date
Duncan McIntyre						
Unapproved Executive Share Option Scheme	98,000 (1)	-	-	98,000	Mar 2002	Mar 2009
Unapproved Executive Share Option Scheme	128,947 (2)	-	-	128,947	Apr 2003	Apr 2010
Approved and Unapproved Executive Share Option Scheme 2000	506,329 (5)	-	-	506,329	Sep 2004	Sep 2011
Approved and Unapproved Executive Share Option 2000	280,000 (6)	-	-	280,000	Jul 2006	Jul 2013
Sharesave Option Scheme 4	10,500 (8)	-	-	10,500	Nov 2005	Apr 2006
Gavin James						
Unapproved Executive Share Option Scheme	64,000 (1)	-	-	64,000	Mar 2002	Mar 2009
Unapproved Executive Share Option Scheme	84,211 (2)	-	-	84,211	Apr 2003	Apr 2010
Approved and Unapproved Executive Share Option Scheme 2000	320,675 (5)	-	-	320,675	Sep 2004	Sep 2011

	Options held at 1 July 2003	Options granted during the year at £1.375p	Options exercised during the year	Options held at 30 June 2004	Earliest date of exercise	Expiry date
Sharesave Option Scheme 4	10,500 (8)	-	-	10,500	Nov 2005	Apr 2006
Approved and Unapproved Executive Share Option Scheme 2000	177,000(6)	-	-	177,000	Jul 2006	Jul 2013
P Coll						
Morse Group Company Share Option Plan	144,498 (4)	-	(134,498)	10,000	Mar 1999	Mar 2005
Unapproved Executive Share Option Scheme	56,000 (1)		-	56,000	Mar 2002	Mar 2009
Unapproved Executive Share Option Scheme	30,769 (3)	-	-	30,769	Sep 2002	Sep 2009
Unapproved Executive Share Option Scheme	36,842 (2)	-	-	36,842	Apr 2003	Apr 2010
Approved and Unapproved Executive Share Option Scheme 2000	250,000 (7)	-	-	250,000	Nov 2004	Nov 2011
Sharesave Option Scheme 4	10,500 (8)	-	-	10,500	Nov 2005	Apr 2006
Approved and Unapproved Executive Share Option Scheme 2000	163,000(6)	-	-	163,000	Jul 2006	Jul 2013
Approved and Unapproved Executive Share Option Scheme 2000	-	120,000 (9)	-	120,000	Jul 2007	Apr 2014

	Options held at 1 July 2003	Options granted during the year at £1.375p	Options exercised during the year	Options held at 30 June 2004	Earliest date of exercise	Expiry date
David Beresford * Approved and Unapproved Executive Share Option Scheme 2000	243,000 (6)	-	-	243,000	Jul 2006	Jul 2013

Note 1 Exercise price of £2.50	Note 6 Exercise price of £1.04
Note 2 Exercise price of £3.80	Note 7 Exercise price of £1.835
Note 3 Exercise price of £2.275	Note 8 Exercise price of £0.90
Note 4 Exercise price of 8.1p	Note 9 Exercise price of £1.375
Note 5 Exercise price of £1.185	

* David Beresford had options over 243,000 shares at the date of his appointment to the Board on 29 August 2003.

The market price of the Company's shares at the end of the year was £1.35 (2003: £1.30). During the year the market price ranged between £1.18 and £1.79.

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

Signed on behalf of the Board
Bill Passmore
Chairman of the Remuneration Committee
31 August 2004

W.S. Passmore

Independent auditors' report to the members of Morse plc

We have audited the financial statements on pages 29 to 60. We have also audited the information in the directors' remuneration report that is described as having been audited.

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 are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 17 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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

We review whether the statement on pages 15-18 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

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

Basis of the audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the directors' remuneration report to be audited 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 and the part of the directors' remuneration report to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group as at 30 June 2004 and of the loss of the group for the year then ended; and
- the financial statements and the part of the directors' remuneration report to be audited 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

31 August 2004

Consolidated profit and loss account for the year ended 30 June 2004

		2004			2003
	Note	**Existing operations £'000**	**Acquisitions £'000**	**Total continuing £'000**	Total continuing £'000
Turnover	*2*	**363,925**	**26,083**	**390,008**	351,343
Cost of sales		**(294,168)**	**(20,359)**	**(314,527)**	(281,775)
Gross profit		**69,757**	**5,724**	**75,481**	69,568
Distribution costs		**(45,443)**	**(4,210)**	**(49,653)**	(40,012)
Administrative expenses before goodwill amortisation and exceptional items		**(16,620)**	**(1,738)**	**(18,358)**	(20,391)
Amortisation of goodwill	*6, 12*	**(17,058)**	**(1,513)**	**(18,571)**	(22,014)
Exceptional items	*3*	**(1,259)**	**(2,111)**	**(3,370)**	(4,564)
Administrative expenses		**(34,937)**	**(5,362)**	**(40,299)**	(46,969)
Operating profit/(loss) before goodwill amortisation and exceptional items		**7,694**	**(224)**	**7,470**	9,165
Amortisation of goodwill	*6, 12*	**(17,058)**	**(1,513)**	**(18,571)**	(22,014)
Exceptional items	*3*	**(1,259)**	**(2,111)**	**(3,370)**	(4,564)
Operating loss	*2, 6*	**(10,623)**	**(3,848)**	**(14,471)**	(17,413)
Interest receivable and similar income	*7*			**2,853**	4,269
Interest payable and similar charges	*8*			**(813)**	(951)
Loss on ordinary activities before taxation				**(12,431)**	(14,095)
Taxation on loss on ordinary activities	*9*			**(3,058)**	(3,106)
Loss on ordinary activities after taxation				**(15,489)**	(17,201)
Dividends	*11*			**(4,478)**	(4,106)
Retained loss for the financial year	*24*			**(19,967)**	(21,307)

Consolidated profit and loss account for the year ended 30 June 2004 (continued)

	Note	2004	2003
Loss per share	*4*		
- basic		**(11.9p)**	(13.3p)
- diluted		**(11.9p)**	(13.3p)
Earnings per share before goodwill amortisation and exceptional items	*4*		
- basic		**4.9p**	6.7p
- diluted		**4.9p**	6.7p

There are no differences between the results shown above and those on a historical cost basis.

The results for both current and prior years are derived from continuing activities.

Consolidated statement of Group total recognised gains and losses for the year ended 30 June 2004

	Note	2004	2003
		£'000	£'000
Loss for the year		**(15,489)**	(17,201)
Translation difference in respect of net investment in overseas subsidiary undertakings	*24*	**42**	670
Total recognised losses in the year		**(15,447)**	(16,531)
Prior year adjustment on adoption of UITF 38 (see note 1)		**265**	
Total gain and losses since last annual report		**(15,182)**	

Balance sheets as at 30 June 2004

	Note	**Group 2004**	Group 2003 (As restated per note 1)	**Company 2004**	Company 2003
		£'000	£'000	**£'000**	£'000
Fixed assets					
Intangible fixed assets	*12*	**25,393**	25,495	**-**	-
Tangible fixed assets	*13*	**5,115**	6,637	**-**	-
Investments	*1, 14*	**357**	-	**107,160**	43,363
		30,865	32,132	**107,160**	43,363
Current assets					
Stocks	*15*	**12,324**	10,614	**-**	-
Debtors: falling due within one year	*16*	**108,173**	105,666	**9,165**	63,632
Debtors: falling due after one year	*17*	**7,041**	8,125	**-**	-
Cash at bank and in hand	*29*	**66,088**	80,578	**-**	470
		193,626	204,983	**9,165**	64,102
Creditors – amounts falling due within one year	*18*	**(167,099)**	(166,551)	**(4,045)**	(6,224)
Net current assets		**26,527**	38,432	**5,120**	57,878
Total assets less current liabilities		**57,392**	70,564	**112,280**	101,241
Creditors - amounts falling due after more than one year	*19*	**(8,542)**	(10,748)	**-**	-
Provisions for liabilities and charges	*20*	**(1,156)**	(2,071)	**-**	-
Total net assets		**47,694**	57,745	**112,280**	101,241
Capital and reserves					
Called up share capital	*22*	**13,108**	12,981	**13,108**	12,981
Share capital to be issued	*24*	**9,500**	1,008	**9,500**	1,008
Share premium account	*24*	**69,665**	68,899	**69,665**	68,899
Other reserves	*24*	**6,589**	5,761	**6,512**	5,605
Profit and loss account	*24*	**(51,168)**	(30,904)	**13,495**	12,748
Total shareholders' equity funds	*23*	**47,694**	57,745	**112,280**	101,241

The financial statements were approved by the Board on 31 August 2004 and signed on its behalf by:

D McIntyre
Director

G James
Director

Consolidated cash flow statement for the year ended 30 June 2004

	Note	2004 £'000	2003 £'000
Net cash inflow from operating activities	*27*	**2,919**	16,038
Returns on investments and servicing of finance			
Interest received		**2,853**	4,269
Interest paid		**(813)**	(951)
Net cash inflow from returns on investments and servicing of finance		**2,040**	3,318
Taxation		**(2,303)**	(4,968)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(2,009)**	(1,769)
Sale of tangible fixed assets		**67**	138
Net cash outflow from capital expenditure and financial investment		**(1,942)**	(1,631)
Acquisitions and disposals			
Consideration for acquisitions in the year		**(6,318)**	(7,725)
Payment of deferred consideration on previous acquisitions		**(3,167)**	(3,530)
Net cash acquired with subsidiary undertakings	*30*	**1,644**	243
Net cash outflow for acquisitions		**(7,841)**	(11,012)
Equity dividends paid		**(4,185)**	(4,130)
Net cash outflow before financing		**(11,312)**	(2,385)
Financing			
Issue of shares		**406**	106
Payment of loan notes on previous acquisitions		**(2,465)**	(26,602)
Purchase of own shares		**-**	(1,958)
Loans repaid	*29*	**(34)**	(69)
Net cash outflow from financing		**(2,093)**	(28,523)
Decrease in cash in the year	*28,29*	**(13,405)**	(30,908)

Notes to the financial statements for the year ended 30 June 2004

1 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 other than in respect of UITF abstract 38 'Accounting for ESOP trusts' which was adopted in the year and a prior year adjustment made. The accounting policies below cover items which are considered material in relation to the Group's financial statements:

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its principal subsidiary undertakings. Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method the results of companies acquired during the year are included in the consolidated financial statements from their respective dates of acquisition.

Turnover

Turnover 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. Turnover includes 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.

The revenue and costs associated with maintenance contracts are deferred and recognised over the term of the contract on a straight-line basis.

Goodwill

Purchased goodwill and goodwill arising on consolidation is capitalised and amortised on a straight-line basis over the Directors' estimate of its useful economic life. Goodwill represents the difference between the fair value of the consideration given on acquiring an entity and the aggregate of the fair value of the separately identifiable assets and liabilities.

On subsequent disposal or termination of a business, the profit or loss on disposal or termination is calculated after charging the unamortised amount of any goodwill.

Tangible fixed assets

The cost of the tangible fixed assets, net of estimated residual value, is depreciated in equal annual instalments over the estimated useful lives of the assets. 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, and the cost of significant enterprise systems applications, developments and enhancements which are capitalised and written off on a straight-line basis over a three year period.

Notes to the financial statements for the year ended 30 June 2004 (continued)

1 Accounting policies (continued)

Leased assets

Operating lease payments are charged to the profit and loss account in the period to which they relate.

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.

Interests in own shares

Adoption of UITF abstract 38 'Accounting for ESOP trusts' 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 should be deducted from shareholders' funds until they vest unconditionally with employees. Prior to the adoption of UITF 38, the company's own shares held by the ESOP trust were recognised as an asset on the balance sheet at the lower of cost and net realisable value. This standard has been adopted in these financial statements and all primary statements and notes relating to the accounts have been restated accordingly.

Compliance with UITF 38 has reduced the investments and shareholders' funds as previously stated at 30 June 2003 by £556,000, being £821,000 cost less £265,000 provision brought forward at 1 July 2003. The provision previously charged to the profit and loss account has been recognised in the consolidated statement of Group total gains and losses. There is no impact on the current year's profit or on cash flows.

Stocks

Stocks are valued at the lower of cost and net realisable value. Cost is determined on a moving average basis. Provision is made where necessary for slow-moving or obsolete stock.

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 FRS19. 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.

Foreign exchange

Transactions denominated in foreign currencies are translated to sterling at the actual exchange rate at the time of the transactions 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.

The results of overseas subsidiary undertakings are translated at the average exchange rate for the year. The assets and liabilities of such undertakings are translated at year-end exchange rates. Any resulting exchange differences are taken to reserves and are reported in the statement of total recognised gains and losses. Exchange differences arising on the Group's net investments in overseas subsidiary undertakings and on borrowings in foreign currency financing those investments are dealt with through reserves. Other exchange differences are taken to the profit and loss accounts.

Pension costs

All payments made by the Group are made to defined contribution schemes. Pension costs are charged to the profit and loss account as they accrue.

Notes to the financial statements for the year ended 30 June 2004 (continued)

2 Segmental reporting

(1) Classes of business

The Group has one class of business, that of selling IT solutions, and consequently does not prepare segmental information by class of business. In the prior year the group disclosed information separating its services and infrastructure performance. Following a change in the business structure and organisation, the business is now managed geographically and hence is reported as such.

(2) Geographic areas

Turnover and loss before interest and tax together with net assets/ (liabilities) by country of origin are set out below.

	Net assets/(liabilities)		Turnover		Loss before interest and tax	
	2004	2003 (As restated per note 1)	**2004**	2003	**2004**	2003
	£'000	£'000	**£'000**	£'000	**£'000**	£'000
United Kingdom & Ireland	**39,332**	47,953	**256,540**	239,462	**(6,468)**	(10,620)
Germany	**17,707**	15,294	**70,545**	44,845	**(3,833)**	(2,056)
France	**(13,384)**	(10,996)	**39,696**	51,238	**(2,527)**	(2,557)
Spain	**4,039**	5,494	**23,227**	15,798	**(1,643)**	(2,180)
	47,694	57,745	**390,008**	351,343	**(14,471)**	(17,413)

The analysis of turnover by geographic destination is not materially different from that by country of origin given above.

The effects of the acquisition of Techsol on the German segment and CSTIM on the United Kingdom and Ireland segment can be seen in note 30.

Notes to the financial statements for the year ended 30 June 2004 (continued)

3 Exceptional items

	2004 £'000	2003 £'000
Restructuring costs	**3,370**	4,564

Exceptional costs relating to headcount reductions in France and Germany were incurred during the year as part of the restructuring of the business. Restructuring costs of £3,420,000 have been paid during the year.

4 Earnings per share

Basic earnings per share 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 14) which are treated as cancelled.

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

	2004 Earnings £'000	**2004 weighted average number of shares (thousands)**	**2004 Per share amount pence**	2003 Earnings £'000	2003 weighted average number of shares (thousands)	2003 Per share amount pence
Basic/Diluted EPS*						
Loss attributable to Ordinary shareholders	**(15,489)**	**130,557**	**(11.9)**	(17,201)	129,084	(13.3)

* Since the conversion of potential Ordinary shares to Ordinary shares would decrease net basic loss per share they are not dilutive. Accordingly, adjusted diluted loss per share is the same as basic loss per share.

Notes to the financial statements for the year ended 30 June 2004 (continued)

4 Earnings per share (continued)

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 FRS 14 with the following adjustments to the basic and diluted EPS.

	2004 Earnings £'000	**2004 weighted average number of shares (thousands)**	**2004 Per share amount pence**	2003 Earnings £'000	2003 weighted average number of shares (thousands)	2003 Per share amount pence
Basic/ Diluted EPS *	**(15,489)**	**130,557**	**(11.9)**	(17,201)	129,084	(13.3)
Basic EPS	**(15,489)**		**(11.9)**	(17,201)		(13.3)
Goodwill amortisation	**18,571**		**14.2**	22,014		17.1
Exceptional items (net of tax)	**3,370**		**2.6**	3,813		2.9
Basic adjusted EPS excluding goodwill amortisation and exceptional items (net of tax)	**6,452**	**130,557**	**4.9**	8,626	129,084	6.7

* Since the conversion of potential Ordinary shares to Ordinary shares would decrease net basic loss per share they are not dilutive. Accordingly, adjusted diluted earnings per share is the same as basic earnings per share.

Notes to the financial statements for the year ended 30 June 2004 (continued)

5 Information regarding employees, Directors and their interests

(a) Directors' remuneration

	2004 £'000	2003 £'000
Aggregate emoluments	**1,076**	1,210
Gains made on exercise of options	**153**	242
Group contributions to defined contribution schemes	**35**	43
	1,264	1,495

In 2004 four Directors (2003: four) had benefits accruing to them under defined contribution schemes.

(b) Employees

	2004 Number	2003 Number
Average monthly number of persons employed (including Directors) by the Group during the year:		
Management and administration	**287**	283
Sales and technical staff	**952**	913
	1,239	1,196

(c) Staff costs (including Directors)

	2004 £'000	2003 £'000
Wages and salaries	**55,271**	50,169
Social security costs	**8,259**	7,641
Other pension costs	**980**	1,065
	64,510	58,875

Notes to the financial statements for the year ended 30 June 2004 (continued)

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

(d) Employee Share Schemes

	Options outstanding over 10p Ordinary shares at 30 June 2003	Exercise Price	Period during which options exercisable	Options outstanding over 10p Ordinary shares at 30 June 2004
Morse Group Company Share Option Plan	248,649	£0.004 - £0.14	Mar 1999-Mar 2005	25,013
Employee Option Scheme	1,633,477	£2.50	Apr 2000-Mar 2009	1,343,692
Unapproved Executive Option Scheme	598,000	£2.50	Mar 2002-Mar 2009	446,000
International Sharesave Option Scheme	1,350	£1.86	Feb 2003-Aug 2003	-
Unapproved Executive Option Scheme	445,163	£2.275	Sept 2002-Sept 2009	289,479
Unapproved Executive Option Scheme	682,436	£3.80	Apr 2003-Apr 2010	455,134
Unapproved and Approved Executive Share Option Scheme 2000	344,665	£4.15	Apr 2003-Apr 2010	304,605
Sharesave Option Scheme 2	12,462	£4.56	Jan 2004-Jun 2004	-
International Sharesave Option Scheme 2	13,343	£4.56	Jan 2004-Jun 2004	-

Notes to the financial statements for the year ended 30 June 2004 (continued)

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

(d) Employee Share Schemes (continued)

	Options outstanding over 10p Ordinary shares at 30 June 2003	Exercise price	Period during which options exercisable	Options outstanding over 10p Ordinary shares at 30 June 2004
Delphis EBT Share Option Scheme	919,097	£nil	May 2001-May 2006	1,012,826
Unapproved and Approved Executive Share Option Scheme 2000	2,410,316	£1.185	Sep 2004-Sep 2011	2,096,085
Sharesave Option Scheme 3	1,216,136	£1.06	Nov 2004-Apr 2005	931,339
International Sharesave Option Scheme 3	318,768	£1.06	Nov 2004-Apr 2005	274,992
Unapproved and Approved Executive Share Option Scheme 2000	250,000	£1.835	Nov 2004-Nov 2011	250,000
Unapproved and Approved Executive Share Option Scheme 2000	530,290	£1.96	Apr 2005-Apr 2012	479,014
Unapproved and Approved Executive Share Option Scheme 2000	864,574	£1.12	Oct 2005-Oct 2012	742,574
Unapproved and Approved Executive Share Option Scheme 2000	1,519,428	£1.04	Jul 2006-Jul 2013	1,210,428
Sharesave Option Scheme 4	665,490	£0.90	Jan 2006-Jun 2006	497,070
International Sharesave Option Scheme 4	227,630	£0.90	Jan 2006-Jun 2006	190,560
Sharesave Option Scheme 5	-	£1.028	Jan 2007-Jun 2007	118,250
International Sharesave Option Scheme 5	-	£1.028	Jan 2007-Jun 2007	20,356
Unapproved and Approved Executive Share Option Scheme 2000	-	£1.358	Jul 2007-Apr 2014	287,184
Unapproved and Approved Executive Share Option Scheme 2000	-	£1.375	Jul 2007-Apr 2014	231,667

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 (2003: 268,165) in the Company of which nil (2003: nil) have share options held over them. The Delphis Employee Benefit Trust holds 1,181,912 shares (2003: 1,214,221) of which 1,012,826 (2003: 919,097) have share options held over them.

Notes to the financial statements for the year ended 30 June 2004 (continued)

6 Operating loss

	2004 £'000	2003 £'000
Operating loss is stated after charging:		
Depreciation	**3,602**	3,391
Auditors' remuneration:		
- Audit fee	**252**	242
- Non-audit fees	**281**	237
- Management consultancy fees	**-**	-
Loss on exchange	**79**	102
Operating lease rentals – plant and machinery	**1,717**	1,222
– other	**3,291**	3,441
Amortisation of goodwill	**18,571**	22,014
Loss on disposal of tangible fixed assets	**86**	6

The Company audit fee for the year was £34,000 (2003: £34,000).

Non-audit fees paid to auditors relate to taxation advice and services in relation to acquisitions.

The auditors do not provide management consultancy services to the Group.

7 Interest receivable and similar income

	2004 £'000	2003 £'000
Bank interest	**416**	284
Other interest	**2,437**	3,985
	2,853	4,269

Included within other interest is interest earned from cash invested in Open Ended Investment Companies (note 21).

8 Interest payable and similar charges

	2004 £'000	2003 £'000
Bank loans and overdrafts	**702**	494
Other loans	**111**	457
	813	951

Notes to the financial statements for the year ended 30 June 2004 (continued)

9 Tax on ordinary activities

	2004 £'000	2003 £'000
United Kingdom corporation tax at 30% (2003: 30%)	**3,892**	3,358
Adjustment to corporation tax provision from prior years	**(992)**	(294)
Overseas tax on profit for the year	**545**	517
Current tax	**3,445**	3,581
Deferred tax	**(387)**	(475)
	3,058	3,106

The effective tax rate is higher than the UK rate of 30% because of non-deductible costs, primarily amortisation of goodwill and unutilised losses in France and in Germany. Taxation credit on exceptional items was £nil (2003: £751,000).

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

	2004 £'000	2003 £'000
Tax on pre tax loss at 30% (2003: 30%)	**(3,729)**	(4,229)
Effects of:		
Expenses not deductible for tax purposes including goodwill amortisation	**6,317**	7,070
Capital allowances in excess of depreciation	**222**	151
Losses of overseas undertakings not available for Relief	**1,903**	1,010
Difference between UK and overseas standard tax rates	**(276)**	(127)
Adjustments to tax charge in respect of previous periods	**(992)**	(294)
Current tax	**3,445**	3,581

As at 30 June 2004 the Group has overseas tax losses estimated at £25 million (2003: £10.2 million) 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.

Notes to the financial statements for the year ended 30 June 2004 (continued)

10 Profit of the Company for the financial year

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 £5,225,000 (2003: £4,576, 000).

11 Dividends

	2004 Pence per share	**2004 £'000**	2003 Pence per share	2003 £'000
Final proposed	**2.35**	**3,095**	2.15	2,802
Interim paid	**1.05**	**1,383**	1.0	1,304
	3.40	**4,478**	3.15	4,106

Dividends amounting to £9,620 (2003: £12,111) in respect of the Company's shares held by the Employee Benefit Trusts which have been waived are deducted in arriving at the aggregate of dividends proposed.

Notes to the financial statements for the year ended 30 June 2004 (continued)

12 Intangible fixed assets

	Group goodwill £'000
Cost	
At 1 July 2003	108,032
Additions (Note 30)	18,469
At 30 June 2004	**126,501**
Amortisation	
At 1 July 2003	82,537
Charge for the year	18,571
At 30 June 2004	**101,108**
Net book amount	
At 30 June 2004	**25,393**
At 30 June 2003	25,495

The cost of goodwill relating to the acquisition of Morse Group Limited in September 1995, of £31,662,000, is being amortised over its estimated useful life of ten years. Goodwill arising on all subsequent acquisitions is amortised on a straight-line basis from the date of acquisition over the Directors' estimate of the useful economic life of the goodwill, estimated in each case to be three years.

The Company has no intangible fixed assets.

Notes to the financial statements for the year ended 30 June 2004 (continued)

13 Tangible fixed assets

Group	Leasehold improvements £'000	Office equipment £'000	Fixtures and fittings £'000	Motor vehicles £'000	Group total £'000
Cost					
At 1 July 2003	2,304	9,794	8,839	475	21,412
Exchange differences	(24)	(131)	(55)	(14)	(224)
Additions	83	1,795	104	27	2,009
Acquisitions (note 30)	-	306	49	-	355
Disposals	(4)	(551)	(914)	(33)	(1,502)
At 30 June 2004	**2,359**	**11,213**	**8,023**	**455**	**22,050**
Depreciation					
At 1 July 2003	1,720	7,099	5,684	272	14,775
Exchange differences	(9)	(40)	(38)	(6)	(93)
Disposals	(315)	(501)	(516)	(17)	(1,349)
Charge for the year	187	2,013	1,286	116	3,602
At 30 June 2004	**1,583**	**8,571**	**6,416**	**365**	**16,935**
Net book amount					
At 30 June 2004	**776**	**2,642**	**1,607**	**90**	**5,115**
At 30 June 2003	584	2,695	3,155	203	6,637

The Company has no tangible fixed assets.

Notes to the financial statements for the year ended 30 June 2004 (continued)

14 Fixed asset investments

Cost and net book amount	Group (As restated per note 1) £'000	Company £'000
Interests in subsidiary undertakings		
At 1 July 2003	-	35,933
Additions in the year	-	15,720
Transfer from subsidiary undertaking	-	47,742
At 30 June 2004	-	99,395
Loans to subsidiary undertaking		
At 1 July 2003 and 30 June 2004	-	7,430
Trade investments		
Cost at 1 July 2003 and 30 June 2004	36	36
Provision at 1 July 2003 and 30 June 2004	(36)	(36)
Net book value at 1 July 2003 and 30 June 2004	-	-
Interests in joint ventures		
At 1 July 2003	-	-
Additions in the year	335	335
At 30 June 2004	335	335
Investment in associate		
At 1 July 2003	-	-
Acquired on acquisition of CSTIM Ltd (see note 30)	22	-
At 30 June 2004	22	-
Total fixed asset investments at 30 June 2004	357	107,160
Total fixed asset investments at 30 June 2003	-	43,363

During the year Morse Group Limited transferred to the Company its investments in Delphis Consulting plc, Hughes Rae Limited, Relational Concepts Limited, Grantham Sutch Associate Limited, and GSA Technical Services Limited.

The investment in associate of £22,000 refers to an investment acquired on the acquisition of CSTIM Limited (see note 30). The results of this company are not considered material to these accounts and consequently the holding has been accounted for as a trade investment.

The interest in joint ventures of £335,000 on 30 June 2004 represents the investment in Mobile ATM Limited, a company that provides mobile phone initiated transactions. The results of this company are not considered material to these accounts and consequently the holding has been accounted for as a trade investment.

Notes to the financial statements for the year ended 30 June 2004 (continued)

14 Fixed asset investments (continued)

Due to the adoption in the year of UITF abstract 38 'Accounting for ESOP trusts' a prior year adjustment has been made to make a deduction against shareholders funds of £556,000. This amount had previously been recognised as an asset on the balance sheet valued at cost less provision for impairment in value.

Notes to the financial statements for the year ended 30 June 2004 (continued)

14 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
Morse Group Limited	Sale of IT solutions and professional services	100%
Morse GmbH *	Sale of IT solutions and professional services	100%
Morse SA *	Sale of IT solutions and professional services	100%
Morse Integración de Sistemas SA * (formerly Integración de Sistemas Abiertos SA)	Sale of IT solutions and professional services	100%
Morse Spain SL *	Sale of IT solutions and professional services	100%
Morse Computer Group Limited *	Sale of IT solutions and professional services	100%
Morse Engineering Ltd *	Sale of IT solutions and professional services	100%
Morse Solutions Ltd *	Sale of IT solutions and professional services	100%
Appliance Technology Ltd *	Sale of IT solutions and professional services	100%
Morse Technology Solutions GmbH (formerly Systematics Technology Solutions GmbH) *	Sale of IT solutions and professional services	100%
Solve Management (PTY) Ltd *	Supply of Management Consultancy Services	100%
CSTIM Limited	Provision of advisory services to companies engaged in investment management	100%
Other trading undertakings		
MChex Ltd	Supply of services	81.33%
Mobile ATM Ltd	Supply of services	40.67%

* indirectly held through subsidiary companies

Notes to the financial statements for the year ended 30 June 2004 (continued)

All undertakings are registered and incorporated in England and Wales except Morse GmbH and Morse Technology Solutions GmbH which are registered and incorporated in Germany, Morse SA which is registered and incorporated in France, Morse Integraci6n de Sistemas SA and Morse Spain SL which are registered and incorporated in Spain, Morse Computer Group Limited, Morse Engineering Limited, Morse Solutions Limited and Appliance Technology Limited which are registered and incorporated in Ireland and Solve Management (PTY) Limited which is registered and incorporated in South Africa. A full list of the Company's subsidiaries will be given in the next annual return.

15 Stocks

	Group 2004 £'000	Group 2003 £'000	**Company 2004 £'000**	Company 2003 £'000
Finished goods and goods for resale	**12,324**	10,614	**-**	-

16 Debtors: amounts due within one year

	Group 2004 £'000	Group 2003 £'000	**Company 2004 £'000**	Company 2003 £'000
Trade debtors	**82,864**	81,973	**-**	-
Amounts due from Group undertakings	**-**	-	**8,923**	63,412
VAT recoverable	**222**	2	**-**	-
Other debtors	**3,062**	2,935	**242**	220
Prepayments and accrued income	**22,025**	20,756	**-**	-
	108,173	105,666	**9,165**	63,632

Included in other debtors is a deferred tax asset of £780,000 (2003: £393,000) in respect of depreciation in excess of capital allowances claimed to date.

17 Debtors: amounts due after more than one year

	Group 2004 £'000	Group 2003 £'000	**Company 2004 £'000**	Company 2003 £'000
Prepayments and accrued income	**7,041**	8,125	**-**	-

Prepayments and accrued income relates to maintenance contract costs that are recognisable in more than one year.

Notes to the financial statements for the year ended 30 June 2004 (continued)

18 Creditors: amounts falling due within one year

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Loan notes	529	580	529	580
Bank loans	-	34	-	-
Bank overdrafts	3,545	4,630	3	-
Trade creditors	98,759	91,305	-	-
Other creditors	4,257	9,903	269	2,832
Dividend proposed	3,095	2,802	3,095	2,802
Corporation tax	9,166	7,821	101	-
Other taxes and social security	2,736	7,675	-	-
Accruals and deferred income	45,012	41,801	48	10
	167,099	166,551	4,045	6,224

The bank overdraft is secured by a fixed charge over cash of the same amount. All bank overdrafts fall due within one year.

Loan notes 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. See note 21 for details on interest.

Included within other creditors is £nil (2003: £4,762,000) of deferred consideration in respect of businesses acquired.

Employer pension contributions payable to the pension scheme of £72,276 (2003: £98,629) are included within other creditors.

19 Creditors: amounts falling due after more than one year

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Other creditors	-	825	-	-
Accruals and deferred income	8,542	9,923	-	-
	8,542	10,748	-	-

The accruals and deferred income relates to maintenance contract revenue that is recognisable in more than one year.

Notes to the financial statements for the year ended 30 June 2004 (continued)

20 Provisions for liabilities and charges

	Onerous lease provision £'000
At 30 June 2003	**2,071**
Utilised during the year	**(915)**
At 30 June 2004	**1,156**

The onerous lease provision relates to the property previously vacated in the UK. The provision is being utilised on a straight line basis over the length of the lease, which expires in August 2005.

21 Financial risk management

The Group does not have any committed borrowing facilities, due to the cash balances that the Group holds being adequate to fund its current activities.
The Group does not trade in financial instruments.

Short-term debtors and creditors

Short-term debtors and creditors have been excluded from the following disclosures other than the currency risk disclosures.

Net funds and interest rate management

The summarised net funds position of the Group is shown below:

	2004 £'000	2003 £'000
Due within one year		
Loan notes	**(529)**	(580)
Bank loans and overdrafts	**(3,545)**	(4,664)
	(4,074)	(5,244)
Cash	**66,088**	80,578
Net funds	**62,014**	75,334

The currency and interest rate profile of the Group's financial assets and liabilities is detailed below.

Notes to the financial statements for the year ended 30 June 2004 (continued)

21 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:

	2004 £'000	2003 £'000
Sterling	**49,362**	70,176
US Dollars	**1,614**	3,473
Euros	**15,066**	6,929
South African Rand	**46**	-
Cash	**66,088**	80,578

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.

The fair value of cash is not significantly different to the book value.

On 1 July 2004 the Group invested £50 million of their surplus funds in Open Ended Investment Companies. The Group has same day access to these funds.

Trade investments are carried at £nil value (2003: £nil): (see note 14).

Financial liabilities

The Group's financial liabilities and analysis of ageing is as follows:

	2004 £'000	2003 £'000
In one year or on demand	**4,074**	10,006
In more than one year but not more than two years	-	825
	4,074	10,831

Financial liabilities accrue interest on the following basis:

	2004 Total £'000	2004 Floating Rate £'000	2004 No interest £'000	2003 Total £'000	2003 Floating Rate £'000	2003 No interest £'000
Currency						
Sterling	**529**	**529**	-	3,075	580	2,495
Euro	**3,545**	**3,545**	-	7,756	4,664	3,092
	4,074	**4,074**	-	10,831	5,244	5,587

The loan notes are all denominated in sterling and are subject to interest based on LIBOR.

Notes to the financial statements for the year ended 30 June 2004 (continued)

21 Financial risk management (continued)

The bank overdrafts are denominated in Euros. They are secured by a fixed charge over cash of the same amount and bear interest based on EURIBOR.

The book value of financial liabilities is not significantly different to the fair value.

The table below shows the Group's currency exposures. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating currency of the operating unit involved.

As at 30 June 2004, these exposures were as follows:

Functional currency of group operation	Net foreign currency monetary assets/(liabilities) £'000		
	Sterling	Euro	US Dollar
Sterling	-	3,844	4,222
Euro	3,566	-	-

Currency and exchange 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 hedges its income stream by purchasing 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. The decision to hedge is based on the size of exposure and the certainty of it arising.

At the year end the Group had trade debtors and bank and cash of £4,566,661 denominated in US Dollars, of which £4,248,494 were covered by forward contracts. The trade debtors and bank and cash covered by forward contracts have been translated at the forward contract rates and the resultant exchange differences taken to the profit and loss account. If the Group had not been covered by US Dollar forward contracts the unrecognised loss at the year end would have been £54,224, being the difference between the fair value of the forward contracts and the book value.

Currency exposure

The sterling cash deposits, loan notes and overdrafts are all denominated in the local currency. The US Dollar cash deposits are held in the United Kingdom.

Notes to the financial statements for the year ended 30 June 2004 (continued)

22 Called up share capital

	Group and Company 2004 Number	Group and Company 2004 £'000	Group and Company 2003 Number	Group and Company 2003 £'000
Authorised				
10p Ordinary shares	**175,000,000**	**17,500**	175,000,000	17,500
Allotted and fully paid				
10p Ordinary shares	**131,077,270**	**13,108**	129,810,437	12,981

The share capital issued at nominal value in the year relates to the exercise of share options (579,940 shares) and consideration of £976,000 on the acquisition of Delphis (Holdings) Limited (686,893 shares). On the exercise of share options, £406,000 was received.

23 Reconciliation of movements in shareholders' funds

	Group 2004 £'000	Group 2003 (As restated per note 1) £'000	Company 2004 £'000	Company 2003 £'000
Loss for the year	**(15,489)**	(17,201)	**5,225**	4,576
Dividends	**(4,478)**	(4,106)	**(4,478)**	(4,106)
Retained (loss)/profit for the year	**(19,967)**	(21,307)	**747**	470
New share capital subscribed	**1,800**	872	**1,800**	872
Movement in share capital to be issued	**8,492**	-	**8,492**	-
Translation difference arising from translation of foreign subsidiaries	**42**	670	-	-
Exercise of share options	**(418)**	(780)	-	-
Acquisition of own shares	-	(1,958)	-	(1,958)
Net (reduction)/addition to shareholders' funds	**(10,051)**	(22,503)	**11,039**	(616)
Opening shareholders' funds (restated for prior year adjustment for £556,000 - see note 1)	**57,745**	80,248	**101,241**	101,857
Closing shareholders' funds	**47,694**	57,745	**112,280**	101,241

Notes to the financial statements for the year ended 30 June 2004 (continued)

24 Reserves

	Other Reserves							
	Capital redemption reserve	Other	Merger reserve	Total other reserves	Share Capital to be issued	Share premium account	Profit and loss account (As restated per note 1)	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Group								
At 1 July 2003 as previously stated	168	356	5,237	5,761	1,008	68,899	(30,348)	45,320
Prior year adjustment on adoption of UITF 38 (note 1)	-	-	-	-	-	-	(556)	(556)
At 1 July 2003 restated	168	356	5,237	5,761	1,008	68,899	(30,904)	44,764
Retained loss for the year	-	-	-	-	-	-	(19,967)	(19,967)
Premium on issue of shares	-	-	-	-	-	766	-	766
Issue of shares on acquisition of a subsidiary	-	-	907	907	8,492	-	-	9,399
Release of reserve on exercise of share options	-	(79)	-	(79)	-	-	79	-
Exercise of share options	-	-	-	-	-	-	(418)	(418)
Gain on translation of foreign subsidiaries	-	-	-	-	-	-	42	42
At 30 June 2004	**168**	**277**	**6,144**	**6,589**	**9,500**	**69,665**	**(51,168)**	**34,586**

	Other reserves							
	Capital redemption reserve £'000	Other £'000	Merger reserve £'000	Total other reserves £'000	Share Capital to be issued £'000	Share premium account £'000	Profit and loss account £'000	Total £'000
Company								
At 1 July 2003	168	200	5,237	5,605	1,008	68,899	12,748	88,260
Retained profit for the year	-	-	-	-	-	-	747	747
Premium on issue of shares	-	-	-	-	-	766	-	766
Issue of shares on acquisition of a subsidiary	-	-	907	907	8,492	-	-	9,399
At 30 June 2004	**168**	**200**	**6,144**	**6,512**	**9,500**	**69,665**	**13,495**	**99,172**

Notes to the financial statements for the year ended 30 June 2004 (continued)

24 Reserves (continued)

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.

Share capital to be issued relates to the deferred consideration on the acquisition of CSTIM Limited (see note 30).

The Group and Company have taken merger relief on the £907,000 premium arising on the 686,893 shares issued as consideration on the acquisition of Delphis (Holdings) Limited (see note 22) as required by s131 of the Companies Act 1985.

The premium on issue of 579,940 share options (see note 22) was £766,000.

25 Capital commitments

The Group had no capital commitments at the year end (2003: £nil). The Company had no capital commitments at the year end (2003: £nil).

26 Operating lease commitments

	Land and buildings 2004 £'000	**Other 2004 £'000**	Land and buildings 2003 £'000	Other 2003 £'000
Group				
Annual non-cancellable commitments for operating leases which expire:				
Within one year	**1,487**	**1,467**	1,076	331
Between 2 and 5 years	**3,634**	**712**	3,162	752
After 5 years	**787**	**-**	787	-
	5,908	**2,179**	5,025	1,083

The Company does not have any operating leases.

Notes to the financial statements for the year ended 30 June 2004 (continued)

27 Reconciliation of operating loss to net cash inflow from operating activities

	Group 2004 £'000	Group 2003 £'000
Operating loss	**(14,471)**	(17,413)
Depreciation	**3,602**	3,391
Amortisation of goodwill	**18,571**	22,014
Decrease in stocks	**549**	10,481
Decrease in debtors	**6,431**	327
Decrease in creditors and provisions	**(11,849)**	(2,768)
Loss on disposal of fixed assets	**86**	6
Net cash inflow from operating activities	**2,919**	16,038

28 Reconciliation of net cash flow to movement in net funds

	Group 2004 £'000	Group 2003 £'000
Decrease in cash in the year	**(13,405)**	(30,908)
Movement in loans	**34**	69
Movement in loan notes	**51**	15,685
Change in net debt	**(13,320)**	(15,154)
Net funds at 1 July	**75,334**	90,488
Net funds at 30 June	**62,014**	75,334

29 Analysis of changes in net funds

	At 1 July 2003 £'000	Cash flows £'000	Other changes £'000	At 30 June 2004 £'000
Cash at bank	80,578	(14,490)	-	**66,088**
Bank overdrafts	(4,630)	1,085	-	**(3,545)**
	75,948	(13,405)	-	**62,543**
Loan notes	(580)	2,465	(2,414)	**(529)**
Debt due within one year	(34)	34	-	**-**
	75,334	(10,906)	(2,414)	**62,014**

The amount of £2,414,000 in "other changes" represents the issue in the year of loan notes for Delphis (Holdings) Limited which had been deferred at the time of acquisition until predetermined targets had been met.

30 Acquisitions

The Group purchased two operations during the year, Systematics Technology Solutions GmbH for a consideration of €1 and CSTIM Limited for a maximum consideration of £15,350,000.

The purchase of Systematics Technology Solutions GmbH was made on 1 December 2003 and has been accounted for as an acquisition. The fair value table is presented below:

	Book value	Other significant adjustment	Accounting policy alignment	Fair value
	£'000	£'000	£'000	£'000
Intangible fixed assets	88	-	(88)	-
Tangible fixed assets	257	-	-	257
Stock	2,398	(139)	-	2,259
Debtors	6,070	(323)	-	5,747
Creditors	(12,480)	(76)	-	(12,556)
Net liabilities acquired	(3,667)	(538)	(88)	(4,293)
Provisional goodwill				4,593
Consideration				300
Consideration satisfied by:				
Costs				300
				300

The book value of the assets and liabilities have been taken from the management accounts of Systematics Technology Solutions GmbH on 1 December 2003 (being the date of the acquisition). The other significant adjustments were made to decrease debtors and stock to estimated net realisable values and to provide for unaccrued property costs.

The accounting policy alignment refers to the immediate expensing of capitalised software.

30 Acquisitions (continued)

The purchase of CSTIM Limited was made on 21 April 2004 and has been accounted for as an acquisition. The fair value table is presented below:

	Book value	Other significant adjustment	Accounting policy alignment	Fair value
	£'000	£'000	£'000	£'000
Investment	22	-	-	22
Intangible fixed assets	(57)	-	57	-
Tangible fixed assets	98	-	-	98
Debtors	2,367	(300)	-	2,067
Creditors	(1,787)	(200)	-	(1,987)
Cash	1,644	-	-	1,644
Net assets acquired	2,287	(500)	57	1,844
Provisional goodwill				13,876
Consideration				15,720
Consideration satisfied by:				
Cash				5,850
Share Capital to be issued				9,500
Costs				370
				15,720

The book value of the assets and liabilities have been taken from the management accounts of CSTIM Limited as of 21 April 2004 (being the date of the acquisition). The other significant adjustments were made to decrease debtors to estimated net realisable values and to provide for unaccrued property costs.

The accounting policy alignment of £57,000 is to immediately expense intangible assets.

The share capital to be issued of £9,500,000 for the acquisition of CSTIM Limited was based on the businesses acquired achieving certain financial targets; £4,200,000 of the total share capital is to be issued within one year, the relevant targets having been settled, and £5,300,000 is to be issued after one year.

From the dates of acquisition to the 30 June 2004 the acquisitions contributed £26,083,000 to turnover (Systematics Technology Solutions GmbH £23,218,000 and CSTIM Limited £2,865,000) and £2,335,000 to loss before tax and interest (Systematics Technology Solutions GmbH £2,978,000 loss and CSTIM Limited £643,000 profit).

In its last accounting reference period, prior to acquisition, for the 12 months to 31 December 2002 Systematics Technology Solutions GmbH made a loss after tax of £7,280,000. For the period since that date to the date of acquisition on 1 December 2003, Systematics Technology Solutions GmbH management accounts showed:

	£'000
Turnover	57,368
Operating loss	(4,989)
Loss before tax	(4,989)
Total recognised loss for the period	(4,989)

30 Acquisitions (continued)

In its last accounting reference period for the 12 months to December 2003, CSTIM Limited made a profit after tax of £750,000. For the period since that date to the date of acquisition on 21 April 2004 CSTIM Limited's management accounts showed:

	£'000
Turnover	2,244
Operating profit	4
Profit before tax	8
Total recognised loss for the period	31

31 Post balance sheet event

On 13 July 2004 Morse plc announced that it had reached agreement with the directors of Diagonal Plc on the terms of a recommended cash and share offer ("the Offer") to be made on behalf of Morse plc for Diagonal Plc. The Offer was made by way of an offer document posted on 3 August 2004 and following approval by Morse plc shareholders at an Extraordinary General Meeting on 25 August 2004, was declared wholly unconditional on 27 August 2004 with Morse plc having received acceptances in respect of 75.81 per cent of the issued ordinary share capital of Diagonal Plc by the first closing date (3.00pm on 25 August 2004). Full acceptance of the Offer would result in Morse plc having to pay approximately £28.1 million in cash and having to issue approximately 17.8 million new shares in Morse plc. These shares will rank for the final proposed dividend in respect of the year ended 30 June 2004.

As a result of the Offer going wholly unconditional, since the balance sheet date, Diagonal Plc has become a majority-owned subsidiary of Morse plc.

Five year summary (as restated, see note 1)

				Year ended 30 June	
	2000	**2001**	**2002**	**2003**	**2004**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Turnover	506,316	586,076	465,180	351,343	**390,008**
Gross profit	81,169	100,713	84,117	69,568	**75,481**
Operating profit before goodwill amortisation and exceptional items	31,470	35,215	21,617	9,165	**7,470**
Operating profit/(loss)	22,330	18,565	(2,765)	(17,413)	**(14,471)**
Net assets	74,478	85,403	80,248	57,745	**47,694**