

Annual Report and Accounts 2002

TeleCity*

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What does TeleCity do? :>>



What does TeleCity do?

TeleCity operates nine state-of-the-art technical facilities across six European markets. These facilities offer secure, controlled environments staffed by highly skilled engineers, for businesses who want to outsource all, or part, of the management of their technical infrastructure. In addition to the cost benefits and improved levels of physical security available to customers, TeleCity offers a wide range of managed IT services through carefully

selected technical partners. These managed services address the growing requirements from customers for more advanced solutions and are a logical development from our core, traditional offering of colocation. The presence of over 70 Tier-1 and Tier-2 network service providers offers multiple and diverse levels of national and global connectivity options.

TeleCity solutions:

- Server colocation
- Managed bandwidth and connectivity
- Migration services
- Managed storage
- Network monitoring and maintenance
- Data back-up, mirroring and recovery
- Managed security

The world inside TeleCity...

TeleCity provides solutions which are fundamental to our customers' ability to offer continued, trouble-free service to their end users. We are an integral part of our customers' business infrastructure and we underpin a significant part of Europe's network-related services provision.

There's a whole world inside a TeleCity data centre, as is demonstrated by the activities of our broad customer base. Every day huge volumes of data are transmitted in the form of movies downloaded, e-mails delivered, web pages viewed, database entries retrieved, voice calls routed and e-transactions completed.

TeleCity customers include:

- Telecoms providers, carriers
- Internet Exchanges (i.e. peering points/NAPS)
- Web hosts, ISPs, ASPs, MSPs
- Online gaming companies
- Mobile phone operators
- Online businesses, e-commerce
- Internet content providers
- System Integrators
- Public sector
- Corporate enterprises

2002

"2002 was a year of transition and progress for TeleCity. Whilst market conditions remained volatile, the Company was able to consolidate its position as a leading player in the colocation industry.

Through reconfiguration of the organisation, sharpened focus in sales and marketing and tight cost control, the company has been able to show significant improvement in its financial results whilst continuing to deliver award-winning service."

Michael Hepher, Chairman



Chairman's statement

"TeleCity provides services to nearly 300 clients across Europe and has become an integral part of many of our customers' business and consumer services."

2002 was another volatile year for the technology sector, characterised by uneven growth and further business failures. Throughout the period, TeleCity managed to maintain stable revenues of the order of £6m per quarter. By restructuring the organisation and controlling costs, it has achieved significant improvement in EBITDA performance, reducing the loss to £0.8m in Q4 2002 from £2.6m in the same period of 2001. Progress has been such that the forecast timeframe for TeleCity to become the first independent, European colocation provider to reach EBITDA profitability has been brought forward to the first quarter of 2003.

TeleCity was delighted to receive the ISPA's 2003 award for Best Colocation Provider – an indication that, whilst headcount has been reduced in the year as part of the cost saving measures, this has not been at the expense of customer service.

The appointment of Rick Hudson as Chief Executive in June allowed me to revert to my original non-executive Chairman role. Rick's experience at Netscalibur, and particularly at Cable & Wireless, has brought strong strategic input and detailed market knowledge to TeleCity. Further key appointments have been made which reflect the pan-European ambitions of the Company. Under the revised organisational structure, the country managers are directly responsible for, and incentivised by, their quarterly

EBITDA performance. The structure has brought rapid benefits in the financial performance of the sites, and has also encouraged the local teams to be highly proactive in pursuing revenue earning opportunities as well as cost saving measures. The country managers now report directly to Rick.

Activity levels stabilised across all of our geographic markets following the dramatic slowdown witnessed in the previous year. Sales performance increased sharply towards the end of the year reflecting our more focused sales and marketing effort. We also managed to diversify our client base and service portfolio. This brings benefits in terms of reducing the reliance on a few sectors or a small number of clients and increases the scope for selling value-added services.

TeleCity now provides services to nearly 300 clients across Europe and, far from being simply an operator of high-tech data centres, it has become an integral part of many of our customers' business and consumer services. TeleCity clients operate in sectors as diverse as online banking, healthcare and broadcasting, as well as in the traditional markets of telecommunications and internet service provision.

An essential part of the Company's drive towards an EBITDA positive and cash generative position has been the successful negotiation of exits from leases no longer required. The satisfactory conclusion of negotiations with regard to the Munich site completes our exit from all surplus properties.

The profit and loss account for the year to 31 December 2002 is dominated by the exceptional charges that reflect the degree of change the management has effected upon the business.

Michael Hepher, Chairman

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"Before exceptional items the EBITDA loss for the year was £5.3m, which compares to £13.1m in 2001. This has been achieved through management's vigorous approach to cost reduction."



Chairman's statement cont'd

Turnover for the year, before exceptional items, totalled £23.8m (2001: £25.1m). Before exceptional items, turnover has remained relatively constant as the benefit of new business won was offset by some customer failures, most noticeably KPNQwest. It is encouraging that there have been no material customer failures in the second half of 2002.

Before exceptional items, the EBITDA loss for the year was £5.3m, which compares to £13.1m in 2001. This includes an EBITDA loss of £0.8m in Q4, reduced from £1.2m in Q3, which has been achieved through management's vigorous approach to cost reduction. In addition to the site rationalisation programme, headcount for the Company at the end of 2002 was 174 compared to 262 at the end of 2001. The full benefit of these actions is being seen in the early months of 2003, enabling a confident forecast of an EBITDA positive result for Q1 2003.

Following asset impairment reviews at certain of the continuing sites, the Board took a decision to write down certain impaired assets. The exceptional item, £26.2m, therefore includes the write off of impaired fixed assets of £17.8m, asset write-downs and lease termination premiums in sites now closed of £8.0m and redundancy costs of £1.9m, less exceptional revenue £1.2m. The exceptional revenue in 2002 relates to the early termination of a customer contract for colocation space. With the completion of the Company's rationalisation strategy, no further exceptional items are anticipated.

The cash balance of £6.5m is ahead of our forecasts, reflecting continuing good working capital management. The combination of the current cash balance and the improved sales performance of the last six months enables the Board to be confident that TeleCity is fully funded through to a cash generative position. Although it is not required to

support the current business plan, a £0.7m loan facility has also been secured as contingency against renewed economic uncertainty or other factors impacting projected sales performance or short-term revenues.

In August 2002, the Board accepted the resignation of Les Johns as Sales and Marketing Director. Under the new structure, responsibility for sales and marketing has been devolved to the country management teams.

In March 2003, the Board announced the resignation of Martyn Ellis from his position as the Group's Finance Director. Martyn has been a key member of the Board for a number of years, and was heavily involved in the flotation of the Company, the successful rights issue and the recent restructuring activities. Martyn leaves TeleCity to become Finance Director of Nestor Healthcare plc, and we thank him for his contribution and wish him every success in his new role. I am pleased to report the appointment of Josh Joshi as Group Finance Director and Board member.

TeleCity has remained focused on the opportunities to consolidate its leadership position in the colocation sector. At the end of 2002, TeleCity has a highly competitive cost base, a new organisational structure taking it into new markets and, through its investment in key management resources, the leadership team to take the Company to its next phase of development.

Whilst the service, quality and flexibility of TeleCity have always positioned the Company very positively in competitive situations, the issues of profitability and financial stability have also been a concern for some potential customers. The real success of 2002 is that TeleCity has worked hard to address the financial position, whilst adapting to the market and retaining its positive qualities. It has been a tough and challenging year, but all the effort and achievements leave TeleCity well positioned moving into 2003.

"The new devolved management model and stringent cost control has led to improved gross margins at the same time as SG&A expenses have been reduced."

Market Conditions

The market for colocation in 2002 returned to growth, albeit at a significantly reduced level compared to original forecasts made in 1998 and 1999. In September 2002, TeleCity commissioned market research company Ovum to perform an assessment of the market demand for colocation in the countries in which TeleCity operates across Europe. Encouragingly, the study showed that market demand is growing overall at around 30% per annum and that a significant proportion of the demand – around 50% – comes as part of the IT outsourcing value chain. This is a sector as yet relatively untapped by TeleCity.

2002 saw a number of colocation providers exit the market and the failure of some high profile users such as KPNQwest. It is still the case that there is some over-supply in the market compared to demand, although considering the independent colocation industry as a whole, the prospect of reaching the important break even capacity levels has been brought forward – probably to 2003.

We believe that as the hosting sector reaches a new stage of operational maturity, future demand will be characterised by a number of key themes:

- increased diversification in the use of specialist data centre facilities, extending the focus beyond telecommunications provision to the broader corporate outsourcing arena;
- increased demand for total solutions and managed services, in addition to the traditional demand for secure space and connectivity;
- the need to provide diversity, back-up and disaster recovery;
- continued and increasing value being attributed to providers who can serve customers in multiple geographic markets.

Results

Turnover for the year, before exceptional items, totalled £23.8m. The exceptional turnover in 2002 of £1.2m relates to the early termination by a customer of a contract for colocation space. Exceptional revenue in 2001 of £7.5m related to the one-off sale of storage equipment. Through the year, quarterly revenue was maintained at a relatively constant £6m, despite the impact of some notable business failures like KPNQwest, with whom TeleCity had contracts worth approximately £2m per annum. The Company's reliance on a small number of large customers' contracts is now much reduced.

The implementation of the new devolved management model and stringent cost control of both direct and indirect costs has meant that gross margins have improved from 21% of pre-exceptional turnover in Q4 of 2001 to 40% for Q4 of 2002, at the same time as SG&A expenses have been reduced by 23% over the same period. This has meant that TeleCity has been able to improve EBITDA performance to a loss of £0.8m in Q4 2002 and an annual loss of £5.3m, compared to the loss of £2.6m in Q4 2001 and an annual loss for 2001 of £13.1m.

Rick Hudson, Chief Executive



operating review cont'd

"54% of our contracted revenue comes from clients for whom we provide service in multiple countries. 55% comes from clients taking service outside their 'home' country."

We see 2002 as a "re-set" year in which a number of tough decisions have been taken in order to ensure the long-term future of the company. This approach is reflected in the level of exceptional charges in 2002, which totalled £26.2m. The net reduction of the workforce as part of the restructuring programme by some 88 employees over the year – not all triggering redundancy payments – resulted in exceptional costs of £1.9m. A rigorous asset impairment exercise resulted in the write-down of £17.8m of assets, reflecting a prudent assessment of the present value of TeleCity site assets in the current market conditions. The exit from surplus leases, together with the cost of financing rent-free periods for tenants wishing to sublet facilities we no longer require, created exceptional costs of £8.0m.

The cash balance at the end of 2002 stood at £6.5m – ahead of our forecasts, reflecting continued stringent cash management, tight debtor control and a policy of payment in advance for services provided.

TeleCity's original 'raison d'être' was to enable telecommunications companies and internet service providers to expand quickly into new regions and cities. Whilst this remains a significant element of the business, the extent to which TeleCity has been able to adapt and to address new markets is reflected in the take up of new services. Historically, labour-based services were not a major requirement of our telecommunications client base. Increasingly we expect these additional value-added services to be reflected in our future business and will further improve the £ per sq foot productivity.

Customers

At the end of 2002, TeleCity had 280 contracted customers representing a net increase over 2001 of over 35%. The reliance on a few major clients has changed. At the start of 2001, the top ten clients of TeleCity represented over 60% of the contracted revenue of the company. As the Company enters 2003, the top ten clients represent around 40% of the base.

The mix of TeleCity's client base also developed during 2002. At the start of 2001, 90% of TeleCity's revenue derived from customers in the Carrier and ISPs sectors. By the end of 2002, the contract base has diversified to include enterprise, content providers and other e-businesses, with the reliance on the "alternate carrier market" in particular, much reduced.

We estimate that approximately half of the colocation demand in Europe originates from companies requiring service in more than one country. In the case of TeleCity, 54% of our contracted revenue comes from clients for whom we provide service in multiple countries, and 55% of our revenue base comes from clients taking service outside their "home" country.

A fundamental tenet of TeleCity's market positioning is the quality of service delivered to our customers. A regular customer survey, completed directly after year-end, obtains customer feedback regarding our performance in the preceding year. The results from the 2002 survey were encouraging. 96% of customers who responded confirmed that they would buy the same service again from TeleCity, 88% advised that they felt TeleCity provided value for money and 98% said they would be willing to recommend TeleCity to others. Whilst we are delighted with this response we are not complacent and issues raised by the survey will receive prompt attention in 2003.



operating review cont'd

"The 185,000 sq ft of available space remains a primary asset. The focus for the sales and marketing strategy in 2003 is to continue to increase utilisation levels whilst providing additional managed services."

Operations

Of the nine operational data centres, six are profitable at the EBITDA level. At the end of 2002 TeleCity had approximately 300,000 sq ft of fitted space, with a further 75,000 sq ft available for expansion at different sites. Approximately 115,000 sq ft has been sold (38%), leaving around 185,000 sq ft of available inventory. Two operational sites, Edinburgh and Munich, were closed during the year and additional space made operational in Paris.

Utilisation of 35 to 40% is typically the point at which sites become profitable on a stand-alone basis. However, other factors such as the level of additional ancillary services, site efficiency levels and the quality of the infrastructure all affect this breakeven point.

The fully built-out status of TeleCity's property portfolio is reflected in the level of capital expenditure for the year of £3.1m. This compares to £32.2m for the prior year. Capital expenditure requirements were limited to maintenance items, certain site improvements and investment in equipment required to deliver new services in response to customer demand.

As indicated by the results of the customer survey, quality of service has remained high throughout the year. Operational processes and procedures are very strong, supported by regular management reviews and stringent performance thresholds. We believe it is essential that TeleCity's core services are delivered in the same way at all of our sites in order to maximise operational efficiency and ensure customers benefit from a consistent, pan-European service.

Organisation

We took actions in 2002 to de-centralise the organisation, devolving responsibility for managing the P&L to country management teams. This was supported through the appointment of some new managers, implementation of revised incentive plans and the adoption of new administrative procedures. We have seen three immediate benefits of this approach; the local sales teams are empowered to be both proactive and reactive to the requirements of the local market place, a cost conscious culture has been reinforced and the Company has been able to make savings at the centre.

Total headcount at the end of 2002 stood at 174 with 119 in operations, 23 sales and marketing and 32 administrative staff. This compares to a total staff of 262 at the end of 2001.

Sales & Marketing

TeleCity's core value proposition is the ability to provide best-in-class facilities for clients' IT infrastructure, combined with the availability of extensive, diverse network connectivity and expert support.

TeleCity's market position is predicated on our experience, our service quality and our partnership approach. Whilst the nature of local sales generation campaigns varies slightly according to the needs of the local markets, they are all based on a common, pan-European strategy. Investments have been made to strengthen the sales and marketing teams, particularly in Germany, Sweden and the UK. Targeted sales and marketing plans have been developed for each local market.

The 185,000 sq ft of available space remains a primary asset. The focus for the sales and marketing strategy in 2003 is to continue to increase utilisation levels whilst selling additional managed services. This is especially so in those sites yet to become EBITDA positive. New prospects increasingly involve the provision of total solutions and managed services provided by TeleCity and its portfolio of partners.

We have been able to address new sectors – both through direct sales activity and through channels. We utilise a range of resellers and introduction agents for our core service portfolio and work with system integration partners as a channel to large and small corporate companies.

The improved focus of the sales and marketing effort is evident from the improvement in sales productivity. In Q4 of 2002, sales order intake was 70% higher than the average quarterly sales intake of the previous three quarters. This reflects the improving proportion of additional services sold and the extent to which TeleCity is increasingly able to provide total solutions rather than simple rack and suite space.

Outlook

I am confident that the management actions taken during 2002, whilst sometimes involving difficult decisions, have well positioned the company to capitalise on an improving market environment in 2003. We are not complacent. We have prudently budgeted for churn in the amount of space taken by TeleCity's traditional client base, knowing that some contracts were signed three years ago at the height of the dot-com boom and are now coming up for renewal.

However, with a forecast of profitability at the EBITDA level in Q1 2003, the continuation of our improved sales focus and the stabilising market, I believe 2003 will be a good year for TeleCity and will provide a solid platform for 2004.





Financial review

"The quarterly EBITDA loss before exceptional items has now fallen in consecutive quarters from £3.7m in Q2 2001 to £0.8m in Q4 2002."

Overview of results

Turnover in the year to 31 December 2002 of £25.0m included a one-off gain arising from the early termination of a major contract, amounting to £1.2m. In 2001, the turnover of £32.6m included £7.5m from the sale of equipment relating to one sales contract. The underlying turnover therefore reduced to £23.8m in 2002 from £25.1m in 2001, a decrease of 5%. This decrease is attributable to two major customer failures during 2002.

The Group's operating loss, including exceptional items was £40.7m in 2002, compared to £36.5m the previous year. The operating loss before exceptional items reduced to £14.5m from £21.2m; these figures include depreciation of £9.2m and £8.1m respectively. The EBITDA loss before exceptional items for the year therefore fell by £7.8m, reflecting the cost reduction measures taken in both 2002 and 2001. The quarterly EBITDA loss before exceptional items has now fallen in consecutive quarters from £3.7m in Q2 2001 to £0.8m in Q4 2002.

Exceptional items

The exceptional items are summarised in the table below. The provisions against fixed assets include an amount of £7.1m in respect of the closure of the Edinburgh and Munich sites and £17.8m relating to an impairment review of certain of the Group's continuing sites. The impairment review arises from an assessment of the future cash flows expected from individual sites, compared with the net book value of the fixed assets at each site.

Exceptional items	£'000
Exceptional revenue	1,204
Provisions against fixed assets	(24,939)
Costs and provisions in respect of exiting property lease contracts	(870)
Redundancy costs incurred	(1,880)
Other	278
	(26,207)

The cost of exiting leases represents a provision for exiting the Munich lease in line with the agreement reached with the landlord to surrender the lease, together with adjustments to the provisions made last year for the London 3 and Manchester 2 sites, where sub-leases have been signed during 2002.

Net Interest receivable

Interest receivable on short-term deposits has fallen from £1.1m in 2001 to £0.4m in 2002 in line with the reduction in the Group's cash balances. The net interest receivable includes an amount payable of £121k in respect of a new finance lease and a charge of £147k relating to the effect of unwinding the discount on the provision for reinstatement costs.

Taxation

The tax effect of the unrecognised tax losses for the year amounted to £5.7m, bringing the cumulative total to £17.3m. These losses are carried forward to be offset against future taxable profits. In consultation with our advisers, we continually review the tax status of the Group and of each of the individual subsidiaries to ensure that the taxation position is appropriately managed and opportunities are taken for utilising losses where they arise.

Cash flow

Following the Rights Issue in September 2001, cash balances at the beginning of the year were £17.8m. At 31 December 2002 cash balances totalled £6.5m. Net cash outflow in the year from operations of £8.1m includes £2.3m relating to exceptional redundancy and lease exit costs. The major capital expenditure programme on the equipping of data centres was completed in 2001 and capital expenditure fell dramatically to £3.1m in 2002 from £32.2m in 2001. This figure includes final payments and retentions on the site fit-outs.

Future capital expenditure will be limited to essential upgrade expenditure. The proceeds from sale of fixed assets relates to the Edinburgh site which was sold during the year. Cash flow from financing includes £0.7m of professional fees relating to the Rights Issue which were paid in the early part of 2002. During the year, a new finance lease, amounting to £1.3m was taken out. This relates to the cost of the power infrastructure at the Frankfurt site.

The key element in the control of working capital continues to be the management of debtor balances. The Company maintains a very disciplined approach to credit control with all customers, and no material bad debts have been incurred during 2002. In order to secure space in our facilities customers are required to sign contracts, most often for a five year period, with payments made quarterly in advance. This is of significant comfort when market conditions for our customer base are difficult.

The combination of the current cash balance and the improved sales performance over the last six months enables the Board to be confident that TeleCity is fully funded through to a cash generative position. As noted in the Chairman's statement, a £0.7m loan facility has been secured. This facility, from the Company's major shareholder, 3i, acts as a cushion against renewed economic uncertainty or factors impacting projected sales performance or short-term revenues.

Treasury management

It is the Group's policy to raise finance when required for its capital expenditure and working capital requirements through a range of financial instruments comprising both equity shares and debt instruments.

At 31 December 2002, the Company had outstanding finance leases of £1.3m and a small loan of £0.1m. Otherwise, the Company was entirely financed through equity share capital. The Group holds cash and short-term deposits to manage its day-to-day liquidity requirements, and various items such as trade debtors and trade creditors that arise directly from its operations.

Martyn Ellis, Finance Director

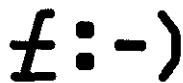
The Group has not entered into any derivative transactions related to interest rates. In the case of significant contracts denominated in currencies other than the functional currency of individual operating units, it is the Group's policy to enter into forward foreign currency contracts in order to hedge against currency fluctuations. No forward currency contracts were in place at 31 December 2002.

It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The most significant currency exposure risks faced by the Group in relation to its financial instruments are foreign currency risk, interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and these policies are summarised below.

Foreign currency risk

The Group faces currency exposures on the translation of the trading results and net assets of its overseas subsidiaries. Following a review of the options available in respect of the translation risks on trading results and net assets, the Group has not undertaken to hedge these exposures. The Group hedges against the risks arising from transactions in foreign currencies by entering into forward foreign currency contracts.



Interest rate risk

The Group's current exposure to interest rate risk is on cash and short-term deposits. A proportion of the short-term deposits may be held at fixed term rates for periods up to 6 months, depending on the short-term liquidity requirements.

Liquidity risk

The Group ensures the continuity of funding through the use of a variety of sources of finance. The Board continually monitors the liquidity position of the Group and reviews options for raising additional finance. Short-term liquidity is achieved by using current and deposit bank accounts and short-term deposits.

Accounting policies

The Board reviews the Group's accounting policies in the light of current Accounting Standards. During the year, no new Standards have been issued which have a bearing on TeleCity's accounting policies and these are consistent with those in force for 2001.

Financial control

The Board has overall responsibility for ensuring the maintenance of a system of internal control which provides reasonable assurance that financial information is reliable and that the assets of the business are safeguarded.

Separate legal entities, which are self-accounting, have now been established in the countries TeleCity operate in. The Company has previously vested limited authority and responsibility in local management teams. During 2002, this authority has been extended to give the local teams greater ownership of individual site and country profit performance.

Such a structure requires well developed reporting and control disciplines to be in place.

The framework of the Company's system of internal financial control is summarised below:

- A management structure exists with clearly defined lines of responsibility and the appropriate levels of delegation;
- There are established authorisation procedures for revenue and capital expenditure and customer contracts;
- Key functions such as tax, treasury, insurance risk management and legal matters are controlled centrally;
- There is a detailed budget in place against which actual performance is measured monthly and forecasts are updated regularly;
- Well established consolidation and reporting systems exist for both the statutory and monthly management accounts;
- Finance reviews conducted by Group management have been instituted in each reporting subsidiary on a twice yearly basis. The primary focus of these reviews is the testing of the validity of balance sheet values to ensure the base for reported results is secure.

There are inherent limitations in any system of internal financial control and accordingly even the most effective system can provide only reasonable, and not absolute, assurance against material misstatement and loss.

Board of Directors



Michael Hepher

Chairman

Born in 1944. Michael Hepher was appointed non-executive Chairman in February 2000 and was also the Company's Chief Executive from May 2001 to June 2002. He is also a non-executive director of Kingfisher plc and Canada Life, Toronto. Mr Hepher was Chairman and Chief Executive of Charterhouse plc from 1996 to 1998, Group Managing Director of BT from 1991 to 1995 and Chairman and Chief Executive of Lloyds Abbey Life plc from 1980 to 1991.

Rick Hudson

Chief Executive Officer

Born in 1957. Rick Hudson became Chief Executive Officer of the Company on 19 June 2002. Mr Hudson has held senior positions in the telecoms and IT industries including Chief Operating Officer of Netscalibur, and Vice President of Global Business Development at Cable & Wireless.

Martyn Ellis

Finance Director

Born in 1956. Martyn Ellis became a Director of the Company on 1 March 2000. Mr Ellis has held senior positions at a number of companies, including Finance Director of Whitecroft plc from 1993 to 2000, Finance Director of Mann Egerton (the largest division of Inchcape plc) from 1990 to 1993, and Finance Director of the UK division of the Campbell Foods Group from 1988 to 1990.

Trevor Wadcock

Operations Director

Born in 1954. Trevor Wadcock was appointed a Director on 22 October 2001 having joined the Company in October 2000. Mr Wadcock has over 27 years' experience in the field of telecommunications management. He was previously Vice President of Operations at MCI Worldcom with responsibilities for managing network operations across Europe and Asia.

Eric Barton

Non-executive Director

Born in 1945. Eric Barton joined the Board in September 1999. From 1986 to 1999 he was a director of 3i plc having worked for 3i in various capacities since 1968. Mr Barton is also a non-executive director of Morse Holdings plc, Informa Group plc, Acal plc and Azzurri Networks Limited.

Josef Ellmauer

Non-executive Director

Born in 1950. Josef Ellmauer was appointed a Director of the Company on 15 June 2001, bringing to the Company considerable experience of the telecommunications industry, both in Germany and across Europe. Mr. Ellmauer, who is based in Frankfurt, is currently Chief Executive Officer of Encorus Technologies. Previously he was Managing Director of Sony International Europe GmbH and a senior executive at Nortel.

Alain Legendre

Non-executive Director

Born in 1943. Alain Legendre was appointed a Director of the Company on 18 May 2001. He has spent most of his career with Andersen Consulting, including appointments as Managing Partner, France, Head of Software and Technology Practice, Europe and Managing Partner R&D Worldwide. He took early retirement from Andersen Consulting in January 2000, and was founder and CEO of a venture capital firm, Startup-performance.

Directors' report

The Directors present their report and the audited accounts of TeleCity plc (the 'Company') and its subsidiary companies (the 'Group') for the year ended 31 December 2002.

Principal activity

The Group's principal activity is the provision of Internet infrastructure facilities and associated services.

Review of the business and future developments

A review of the business and future developments can be found in the Chairman's statement on pages 6 to 8, the Operating review on pages 9 to 13 and the Financial review on pages 14 to 16.

Results and dividends

The results of the Group are set out on page 28. The Directors do not propose the payment of a dividend (2001: £Nil).

Directors and their interests

During the year to 31 December 2002 the following changes took place in the composition of the Board:

	Appointed	Resigned
Anish Kapoor		31 March 2002
Les Johns	2 January 2002	9 August 2002
Rick Hudson	19 June 2002	

On 19 June 2002, Michael Hephher, who was at that date Chief Executive and Chairman, resigned as Chief Executive. He remained on the Board in the post of non-executive Chairman.

The Board has established three Committees, full details of which can be found on pages 20 and 21.

Eric Barton is the senior independent non-executive Director to whom issues of concern may be conveyed.

The interests of the Directors serving at the end of the year and their families in the Company's shares were:

	31 December 2002 beneficial ordinary shares of 0.1p	31 December 2001 beneficial ordinary shares of 0.1p
Eric Barton	175,150	175,150
Michael Hephher ¹	782,487	782,487
Alain Legendre	20,000	—
Trevor Wadcock ²	50,000	—

1. includes 750,154 shares held by The Bank of Nova Scotia Trust Company Channel Islands Limited (a Jersey company) as trustee of a Jersey trust, the Maple Leaf Family Settlement, on trust for Michael Hephher and his family.

2. includes 25,000 shares held by spouse.

There have been no changes in the interests of the Directors (or their families) between 31 December 2002 and the date of this report.

The Company's Articles of Association (the 'Articles') state that Directors who were appointed by the Board during the year are required to retire at the next Annual General Meeting of the Company. Having so retired the Articles allow each Director to offer himself for election by shareholders. In accordance with this, Rick Hudson will retire at the Annual General Meeting and will offer himself for election by shareholders. The Articles also require that a third of the other Directors (i.e. those who were not appointed by the Board during the year) submit themselves to retirement by rotation. Directors retiring by rotation are then allowed to offer themselves for re-election by shareholders. The Directors retiring by rotation at the Annual General Meeting will be Michael Hephher, who, being eligible, will be seeking re-election by shareholders, and Josef Ellmauer, who will not be seeking re-election.

On 31 August 2001, the Company entered into a service contract with Maple Leaf Global Limited, a company which is controlled by Michael Hephher, for the provision of administrative and secretarial support at a cost of £24,000 plus VAT per annum. This contract was terminated on 19 June 2002, with payments under the contract ceasing on 30 September 2002. On 20 June 2002 the Company entered into a further contract with Maple Leaf Global Limited which relates to the provision of Mr Hephher's services as a non-executive Director. On 8 May 2000, the Company entered into a service contract with Lancedale Limited, a company which is controlled by Eric Barton, which relates to the provision of Mr Barton's services as a non-executive Director.

Full details of the Directors' holdings of options to subscribe for the Company's shares and the Directors' service contracts can be found in the Remuneration report on pages 22 to 25.

Political and charitable donations

During the financial year the Group made no donations for charitable or political purposes.

Disabled employees

The Company gives full and fair consideration to applications for employment from disabled persons, taking into account the requirements of the job. If an existing employee becomes disabled, it is the Company's policy to take such steps as are practical to provide continuing employment and to assist with suitable training and career development opportunities.

Employee involvement

The Directors keep employees informed of matters affecting themselves and the performance of the Company through regular briefing meetings, as well as through informal briefings. Employees may be invited to participate directly in the success of the business through the Group's share option schemes.

Supplier payment policy and practice

The Group agrees terms of payment with its suppliers and makes payment in accordance with those terms, subject to suppliers' own adherence to the terms and conditions. At 31 December 2002 the Group had 61 (2001: 21) days' purchases outstanding in trade creditors. The Company has no trade creditors.

Substantial shareholdings

The Company has been notified that the following shareholders held in excess of 3% of the Company's ordinary shares as at 7 April 2003.

Shareholder	Number of shares held	% of the issued share capital
3i Group plc	97,718,549	48.68
Schroder Investment Management Ltd	29,991,647	14.94
Prudential plc	18,577,824	9.25
Mike Kelly	18,544,382	9.24

Annual General Meeting

The Annual General Meeting of the Company will be held on 12 June 2003 and the Notice of meeting can be found on pages 44 and 45. The Special Business to be concluded at the Annual General Meeting will include Resolutions relating to the Directors' authority to allot shares and to the Directors' authority, in permitted circumstances, to disapply shareholders' pre-emption rights.

Under the provisions of section 80 of the Companies Act 1985, the Directors are not able to allot shares except with the general or specific approval of shareholders. In Resolution 6 the Directors are seeking authority to allot securities up to a maximum nominal value of £66,911. This sum, being the lesser of the unissued ordinary share capital and one third of the issued ordinary share capital of the Company, is the maximum nominal amount to which the section 80 authority may apply in accordance with the recommendations of the Association of British Insurers ('ABI').

Sections 89 and 95 of the Companies Act 1985 provide that any ordinary shares issued for cash must first be offered to existing shareholders unless shareholders' approval is obtained that this stipulation should not be applied. In Resolution 7 the Directors are seeking authority to make allotments of shares outside of such pre-emption provisions up to a maximum nominal amount of £10,036. This sum represents 5% of the issued ordinary share capital of the Company which is the maximum percentage of the Company's share capital to which pre-emption rights may be disappplied in line with ABI guidelines.


Auditors

Following the conversion of PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned as auditors, and the Directors appointed PricewaterhouseCoopers LLP to fill the casual vacancy created by the resignation. A resolution to re-appoint PricewaterhouseCoopers LLP as the Company's auditors will be proposed at the Annual General Meeting.

On behalf of the Board

Liz Hayman, Secretary

7 April 2003



Corporate governance statement

The Company is committed to achieving high standards of corporate governance throughout the Group and to integrity and high ethical standards in all its business dealings. The Board considers that it has complied throughout the financial period with the provisions set out in Section 1 of the Combined Code (the 'Code'), except in five instances. First, as shown in the Remuneration report, the Company has granted share options in single large amounts to a small number of senior executives. The Board believes that it is necessary, in order to recruit and retain high quality candidates in a highly competitive environment, to grant a substantial number of options on initial appointment. Second, from 10 May 2001 until 19 June 2002, the Company combined the posts of Chairman and Chief Executive in one person. The Board believes that this position was fully justified in terms of the size of the Board and of the Company. The decision to combine these posts was discussed fully with the Company's major shareholders who gave their support to the Board's intentions. The Board has a strong and independent non-executive element with a recognised senior member. Third, Michael Hefher, a non-independent non-executive Director is a member of the Remuneration Committee. The Board believes that it is sufficient that the majority of the members of the Remuneration Committee are independent non-executive Directors. Fourth, from 10 May 2001 until 19 June 2002, the Company's Audit Committee comprised two non-executive Directors rather than three as required by the Code. The Board feels that, given the size of the Board, the independent functioning of the Audit Committee was not jeopardised by having two rather than three members. Fifth, the system of internal control is not currently as robust as required by the Code. Further details can be found under 'Internal control' below.

The Board of Directors

The Board has established guidelines requiring specified matters to be subject to discussion by the full Board, including overall strategy, financial strategy and planning, material acquisitions, disposals, property related commitments, investments and capital projects.

At the end of the year the Board comprised three executive Directors and four non-executive Directors, three of whom are considered to be independent for the purposes of the Combined Code. In the view of the whole Board, the non-executive Directors represent a significant factor in the Board's decision making. The Board has nominated Eric Barton as the senior independent non-executive Director, to whom issues can be conveyed.

The Board has twelve scheduled meetings per year and meets otherwise as required. Directors receive timely and adequate information regarding the Group as necessary and in preparation for Board meetings. All Directors have access to the Company Secretary who is responsible for ensuring that Board procedures are adhered to. A procedure exists under which all Directors may take independent professional advice, if necessary, at the Company's expense.

All Directors are aware of and have access to appropriate training in respect of their duties as Directors.

All Directors are required by the Articles of Association to submit themselves for re-election at least every three years.

Committees of the Board

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

Audit Committee

In monitoring the effectiveness of the Board, this Committee is responsible for ensuring that systems which are designed to identify the nature and extent of risks facing the business from both internal and external sources and the appropriate evaluation of such risks are in place and are reviewed periodically to ensure their continuing effectiveness. The Committee is also responsible for ensuring that appropriate steps are taken by the Board to reduce and/or eliminate such risks.

In addition, the Committee has other responsibilities including agreeing with the Company's auditors the nature and scope of the audit and reviewing the effectiveness of the system of internal control and reporting on this to the Board of Directors.

The Committee comprises Eric Barton (Chairman) and Alain Legendre who are both independent non-executive Directors of the Company and Michael Hefher, the non-executive Chairman. For the purposes of the Audit Committee held on 14 February 2002 only, the Board appointed Anish Kapoor as a member of the Committee.

Remuneration Committee

This Committee reviews and determines the Group's policy on remuneration of senior executives and controls the operation of the Company's share option schemes including the grant of new options. The Committee considers and approves specific remuneration packages for each of the executive Directors.

The Committee comprises Michael Hefher (Chairman), Eric Barton and Josef Elimaier who are, with the exception of Michael Hefher, independent non-executive Directors of the Company. The Committee has given full consideration to the principles and policies of the Code relating to remuneration matters and to Schedule A of the Code.

Fees payable to the non-executive Directors are set by the executive Directors.

Details of Directors' remuneration can be found in the Remuneration report on pages 22 to 25.

Nominations Committee

This Committee initiates the selection process, identifying suitable candidates for appointment as Directors and making recommendations to the Board regarding such appointments.

The Committee comprises Michael Hepher (Chairman), Eric Barton, Alain Legendre and Josef Ellmauer who are, with the exception of Michael Hepher, all independent non-executive Directors of the Company.

Relations with shareholders

The Company actively promotes and maintains relationships with its shareholders, holding regular meetings with major shareholders including presentations following the Company's interim and preliminary announcements.

The Company intends to use the Annual General Meeting to present and explain the Group's business and strategy and the Chairmen of the various Board Committees will be present and available to answer questions from shareholders.

It is intended that the Resolutions to be proposed at the Annual General Meeting, which are set out in full in the Notice of Meeting on pages 44 and 45, will be presented as separate Resolutions and will include Resolutions relating to the Report and Accounts and the Remuneration report. It is also intended that details of proxy votes on all Resolutions will be announced at the Annual General Meeting.

Internal control

The Code requires that the Board maintain a sound system of internal control to safeguard shareholders' investment and the Company's assets and should report on its review of the effectiveness of the Group's system of internal controls, which should be conducted at least annually. The review should cover all controls, including financial, operational and compliance controls and risk management. Formal guidance has been issued by the Turnbull Committee in order to assist Directors in complying with these internal control requirements (the 'Turnbull Guidance').

Certain of the Directors have carried out a review of the Turnbull Guidance and, for the first six months of the year to 31 December 2002, a risk control framework, which covered both UK and non-UK operations, was in place to ensure compliance with the internal control requirements of the Code.

During the year the structure of the Company changed to one of country-based management rather than being centrally-driven. The effect of this was not a change in the risks themselves, but a fundamental change in responsibility for managing them. In the view of the Directors an attempt to install the required risk control framework document in a transitional period would have been unsuccessful as well as a significant distraction to the country management teams. As these teams are now well-established, work can begin to re-establish the risk control framework document and to re-allocate responsibilities for ensuring that the risk control processes and reporting are satisfactory.

The Board believes that, given the changes to which the Company has been subject during the year, it has followed appropriate internal control procedures to manage risk. The Board acknowledges that it is responsible for the Group's system of internal financial control and for reviewing its effectiveness. 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.

Further details on financial control are set out in the Financial review on pages 14 to 16.

The Group does not at present have an internal audit function as the Directors do not consider that the scale of the Company's operations warrants the establishment of a separate department. The Audit Committee and the Board will continue to monitor the need for an internal audit function.

Going concern

After making enquiries, the Directors, at the time of approving the accounts, have determined that there is reasonable expectation that the Company and the Group have adequate resources to continue operating for the foreseeable future. For this reason, the Directors have adopted the going concern basis in preparing the accounts.

Remuneration report

The Board presents its report on remuneration which includes all disclosures required by Section 1 of the Combined Code (the 'Code'). Except as specifically referred to in the Corporate governance statement on pages 20 and 21, the Company has in all respects complied with the recommendations on remuneration within the Code.

Remuneration policy

The Company's policy for the current year and subsequent years is to ensure that packages paid to Directors are competitive when compared to similar companies and to recognise the long-term growth plans of the Company whilst ensuring due consideration of short-term objectives, in order to closely align the interests of the Directors with those of the Company and the shareholders. Within these overall objectives the Company provides basic salary, benefits, an Executive Incentive Plan, share options and pension contributions. Details of performance conditions relating to the Executive Incentive Plan and the Executive Share Option Scheme can be found under the relevant headings below.

Remuneration review

During the year Directors' remuneration was reviewed by the Remuneration Committee (the 'Committee') in accordance with the terms above and giving consideration to external professional advice from Watson Wyatt, who have been appointed by the Committee to give advice in this regard. Watson Wyatt also provide the Company with advice on the annual salary review for all employees, on the Company's provision of pension and other benefits and on the Company's share option scheme.

The members of the Committee present when the Directors' salaries were reviewed were Eric Barton, Josef Ellmauer and Alain Legendre. Also present at the meeting by invitation, although not a member of the Committee at that time, was Michael Hephner, who attended in a non-participatory capacity.

Full details of the Committee can be found in the Corporate governance statement on pages 20 and 21.

Benefits

The only benefits provided by the Company are private health insurance and the provision of a company car (or a non-pensionable cash allowance in lieu of a company car). Details of the value of benefits received by the Directors during the year can be found in the Directors' emoluments table on page 23.

Executive Incentive Plan

The Executive Incentive Plan is structured to pay executive Directors performance bonuses based on the achievement of market visible financial targets and functional objectives as shown in the table below.

Business measure		Weighting (proportion of annual bonus)
Revenue	achievement of budgeted revenue (not including exceptional revenue)	50%
EBITDA	achievement of budgeted earnings	30%
Functional	achievement of operational improvements and set service levels within the Director's area of responsibility	20%

If all the targets and objectives are met in full, the annual on-target bonus that can be achieved by a Director will be equivalent to 30% of base salary (50% for the Chief Executive). If achievement of any business measure falls below target, the corresponding bonus element is reduced. The corresponding bonus is a) zero when revenue achieved is less than 90% of target; and b) zero when EBITDA achieved is less than 80% of target. If achievement of any business measure exceeds the target, the corresponding bonus element is increased. The corresponding on-target bonus is adjusted by a) the same percentage as actual revenue is as a percentage of target revenue; and b) the same percentage as actual EBITDA is as a percentage of target EBITDA, but this ratio is capped at 130% in any event.

The business measures shown above were chosen because, although they are based on short-term objectives, they are compatible with the long-term aims of the Company. Details of bonuses paid to the Directors during the year can be found in the Directors' emoluments table on page 23.

Pensions

In the United Kingdom, the Company operates a defined contribution (money purchase) scheme of which all of its UK resident employees, including the executive Directors, are entitled to be members. The Company's standard contribution rate for all employees, including the executive Directors, is 6.5% of basic salary including earnings above the Inland Revenue earnings cap. Employees are required to contribute not less than 5% of their basic salary. There is also another contribution rate which has been set up for employees who do not wish to make a contribution of 5% of basic salary whereby both the Company and the employee make a contribution of 3% of basic salary.

The Company has introduced pension schemes for the benefit of non-UK employees, where appropriate. The terms of these schemes are comparable with the UK scheme.

Pension contributions for executive Directors are shown below:

	2002 £	2001 £
Anish Kapoor	—	7,800
Mike Kelly	—	7,800
Glenn Tookey	—	13,772
Trevor Wadcock	8,450	1,517

Directors' emoluments:

The disclosures below include remuneration for the current and prior years whilst acting as Directors of the Company and of TeleCity UK Limited.

	2002				2001
	Salary/fees £	Annual bonus £	Benefits £	Total excluding pension contributions £	Total excluding pension contributions £
Non-executive Directors					
Eric Barton	36,250	–	–	36,250	34,596
Christopher Duckworth	–	–	–	–	15,625
Josef Ellmauer	25,000	–	–	25,000	13,542
Michael Hepher ^{4,6}	35,000	–	–	35,000	24,979
Anish Kapoor ^{1,2}	6,250	–	–	6,250	200,951 ⁵
Alain Legendre	25,000	–	–	25,000	15,524
Executive Directors					
Martyn Ellis	145,000	8,700	16,546	170,246	167,724
Michael Hepher ^{4,6}	100,000	50,000	–	150,000	128,271
Rick Hudson ¹	97,538	25,000	9,821	132,359	–
Les Johns ¹	140,436 ³	–	10,691	151,127	–
Mike Kelly	–	–	–	–	285,349 ⁵
Glenn Tookey	–	–	–	–	322,787 ⁵
Trevor Wadcock	130,000	7,800	16,534	154,334	37,795
Total	740,474	91,500	53,592	885,566	1,247,143

1. appointed and/or resigned during the period. Full details can be found in the Directors' report on page 18.

2. salary in 2001 relates to employment as an executive Director.

3. including compensation for loss of office of £55,000.

4. total remuneration for the year: 2002 – £185,000 (2001 – £153,250).

5. includes compensation for loss of office.

6. non-executive Director from 1 January to 9 May 2001, executive Director from 10 May 2001 to 19 June 2002, non-executive Director from 20 June 2002.

Share Option Schemes

On 12 November 1999, the Group established the TeleCity Limited Approved and Unapproved Share Option Schemes (the 'Old Option Schemes'). On 13 April 2000, prior and subject to the Company's flotation on the London Stock Exchange, the Old Option Schemes were replaced by the TeleCity plc Approved and Unapproved Executive Share Option Schemes (the 'Current Option Schemes'). On flotation the Old Option Schemes were closed to new grants and participants' share options became options to subscribe for ordinary shares in TeleCity plc rather than in TeleCity Limited.

Remuneration report

Company's policy on grant of share options

Share options are granted to executive Directors on appointment and thereafter on an ad hoc basis when the Board considers that it is warranted by the performance of the individual Director. There is no policy for share options to be awarded at regular intervals or at particular times in the financial calendar.

Exercise of share options

Subject to the satisfaction of performance criteria where applicable, options are normally first capable of exercise three years after the date of grant and expire ten years after the date of grant.

Options granted under the Old Option Schemes are not subject to the satisfaction of performance criteria because they were granted before flotation.

Under the Current Option Schemes, the exercise of options granted before 28 September 2001 is subject to the satisfaction of a performance criterion which requires that total shareholder return over a three year period must not be less than the median total shareholder return achieved during the same period by the constituent companies of the Software and Computer Services and Telecommunication sectors of the FT-SE 250 index (the 'First Performance Criterion'). The exercise of options granted on or after 28 September 2001 is subject to the satisfaction of share price performance criteria which requires that the Company's average share price be at or above a predefined value over the 30 day period immediately prior to either the third or the fifth anniversary of the date of grant (the 'Second Performance Criterion'). The values to be achieved vary according to the date of the grant of the option but the value to be achieved by the fifth anniversary will always be higher than that to be achieved by the third anniversary.

The Committee has power to redefine the performance criteria from time to time and to create special performance criteria for a particular option grant. The Committee takes the view that, as has been the case with a small number of senior executives, it is necessary, in a competitive market place, to grant options in significant numbers in order to recruit and retain candidates of high quality.

No options under either the Old Option Schemes or the Current Option Schemes were exercised by Directors during the period.

Options to subscribe for the Company's shares held by Directors including those granted during the year are shown below:

	Options held at 31 December 2001	Options granted during the year	Total options held at 31 December 2002	Earliest date of exercise	Expiry date
Martyn Ellis					
– approved ^a	812,231		812,231	currently exercisable	16 March 2010
– unapproved ^a	90,232		90,232	currently exercisable	16 March 2010
– approved ^{a,3}		305,529	305,529	30 May 2005	29 May 2012
– unapproved ^{d,3}		194,471	194,471	30 May 2005	29 May 2012
Total	902,463	500,000	1,402,463		
Michael Hephner					
– approved ^{b,7}	234,375		234,375	currently exercisable	27 March 2005
– unapproved ^{b,7}	2,890,625		2,890,625	currently exercisable	27 March 2005
Total	3,125,000		3,125,000		
Rick Hudson					
– approved ^{e,4}	–	384,615	384,615	19 June 2005	18 June 2012
– unapproved ^{e,4}	–	115,385	115,385	19 June 2005	18 June 2012
– unapproved ^{e,5}	–	1,000,000	1,000,000	19 June 2005	18 June 2012
Total	– †	1,500,000	1,500,000		
Les Johns					
– approved ⁶	–	259,067	–	lapsed	
– unapproved ⁶	–	490,933	–	lapsed	
Total	– †	750,000	–		
Trevor Wadcock					
– approved ^{c,1}	7,912		7,912	23 October 2003	22 October 2010
– unapproved ^{c,1}	165,515		165,515	23 October 2003	22 October 2010
– approved ^{b,2}	43		43	28 September 2004	27 September 2011
– unapproved ^{b,2}	599,957		599,957	28 September 2004	27 September 2011
Total	773,427		773,427		

† held at date of appointment.

Exercise prices

- a. exercisable at 0.12 pence each
- b. exercisable at 12.8 pence each
- c. exercisable at 379.1 pence each
- d. exercisable at 9.5 pence each
- e. exercisable at 7.8 pence each

Performance criteria

- 1. subject to First Performance Criterion.
 - 2. subject to Second Performance Criterion – third year value 29.0 pence, fifth year value 42.0 pence.
 - 3. subject to Second Performance Criterion – third year value 33.3 pence, fifth year value 46.3 pence.
 - 4. subject to Second Performance Criterion – third year value 33.7 pence, fifth year value 46.7 pence.
 - 5. subject to Second Performance Criterion – third year value 40.4 pence, fifth year value 56.0 pence.
 - 6. subject to Second Performance Criterion – third year value 31.6 pence, fifth year value 44.6 pence.
 - 7. options granted whilst employed as Chief Executive and became exercisable upon the cessation of employment in an executive capacity.
- The options were subject to a special performance criterion, the successful re-financing of the Company, which was achieved in 2001.

During the year the Committee has also approved the grant of 1,300,000 options to persons other than the Directors in numbers determined by the Committee by reference to the level of earnings of the employees concerned and taking account of practice amongst other listed companies and competitors.

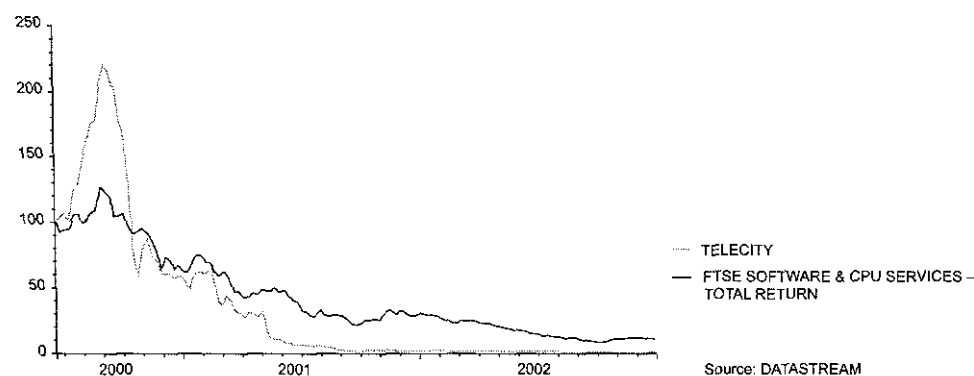
The market price of the Company's shares at the end of the year was 3.0 pence. During the year, the closing mid-market price ranged between 14.0 pence and 2.25 pence.

Service contracts

Service contracts for the executive Directors are open-ended and follow the recommendations of the Code. They may, with the exception of the contract of Martyn Ellis, be terminated by six months' notice from either party. Martyn Ellis' contract differs from the norm in that it requires the Company to give 12 months' notice. The contracts contain no specific terms allowing for compensation for loss of office. The contracts of Rick Hudson, Trevor Wadcock and Martyn Ellis are dated 29 May 2002, 22 October 2001 and 6 May 2000 respectively.

Service contracts for the non-executive Directors are for fixed periods of 12 months. On expiry of the fixed period, if both parties agree, the contracts may be renewed for further periods of 12 months. In the event of non-renewal, no compensation will be payable. The contracts of Michael Hepher, Alain Legendre, Eric Barton and Josef Ellmauer expire on 30 June, 17 May, 31 May and 14 June 2003 respectively.

Total return to shareholders



Statement of Directors' responsibilities

Company law requires the Directors to prepare accounts for each financial year that give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. The Directors are also required by Company law to prepare a report giving specific details regarding Directors' remuneration.

In preparing the accounts the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The Directors confirm that they have complied with the above requirements in preparing the accounts.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the TeleCity plc website is the responsibility of the Directors.

The legislation in the UK governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

Independent auditors' report to the members of TeleCity plc

We have audited the accounts, which have been prepared under the historical cost convention and the accounting policies set out in the statement of accounting policies, which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses, the reconciliation of movements in equity shareholders' funds and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Remuneration report ('the auditable part').

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Remuneration report and the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the accounts and the auditable part of the Remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the auditable part of the Remuneration report 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 accounts, 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 is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. The other information comprises only the Chairman's statement, the Operating review, the Financial review, the Directors' report, the Corporate governance statement and the unaudited part of the Remuneration report.

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

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts and the auditable part of the Remuneration report 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 accounts.

Opinion

In our opinion:

- the accounts give a true and fair view of the state of affairs of the Company and the Group at 31 December 2002 and of the loss and cash flows of the Group for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the Remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
Manchester

7 April 2003

Consolidated profit and loss account

For the year ended 31 December 2002

	Notes	2002 £'000	2001 £'000
Continuing operations			
Turnover before exceptional items		23,750	25,128
Exceptional items		1,204	7,500
Turnover	3	24,954	32,628
Operating loss before exceptional items		(14,481)	(21,228)
Exceptional items	2	(26,207)	(15,272)
Operating loss	2	(40,688)	(36,500)
Net interest receivable	5	84	1,108
Loss on ordinary activities before taxation	3	(40,604)	(35,392)
Taxation	6	–	–
Retained loss for the year attributable to ordinary shareholders	18	(40,604)	(35,392)
Loss per ordinary share			
Basic and diluted	8	(20.2p)	(25.2p)

Consolidated balance sheet

As at 31 December 2002

	Notes	2002 £'000	2001 £'000
Fixed assets			
Tangible assets	9	47,130	74,105
Current assets			
Stocks	11	21	38
Debtors	12	6,635	7,013
Cash at bank and in hand	13	6,476	17,794
		13,132	24,845
Creditors – amounts falling due within one year	14	(14,389)	(17,950)
Net current (liabilities)/assets		(1,257)	6,895
Total assets less current liabilities		45,873	81,000
Creditors – amounts falling due after more than one year	15	(1,334)	(102)
Provisions for liabilities and charges	16	(5,991)	(4,443)
Net assets		38,548	76,455
Capital and reserves			
Called up share capital	17	201	201
Share premium account	18	111,735	111,735
Merger reserve	18	17,862	17,862
Profit and loss account	18	(91,250)	(53,343)
Equity shareholders' funds		38,548	76,455

Approved by the Board on 7 April 2003 and signed on its behalf by

M L Hepher, Chairman

M A Ellis, Finance Director

M L Hepher
M A Ellis

Parent company balance sheet

As at 31 December 2002

	Notes	2002 £'000	2001 £'000
Fixed assets			
Investments	10	24,949	98,065
Current assets			
Debtors	12	13,599	14,356
Creditors – amounts falling due within one year	14	–	(657)
Net current assets		13,599	13,699
Net assets		38,548	111,764
Capital and reserves			
Called up share capital	17	201	201
Share premium account	18	111,735	111,735
Profit and loss account	18	(73,388)	(172)
Equity shareholders' funds		38,548	111,764

Approved by the Board on 7 April 2003 and signed on its behalf by

M L Hepher, Chairman

M A Ellis, Finance Director

M L Hepher
M A Ellis

Consolidated cash flow statement

For the year ended 31 December 2002

	Notes	2002 £'000	2001 £'000
Net cash outflow from operations	19	(8,066)	(12,579)
Returns on investments and servicing of finance:			
Interest received		396	1,184
Interest paid		(44)	(14)
Interest paid on finance leases		(121)	(18)
		231	1,152
Taxation		-	-
Capital expenditure and financial investment:			
Purchase of tangible fixed assets		(3,106)	(32,181)
Sale of tangible fixed assets		221	5
		(2,885)	(32,176)
Net cash outflow before management of liquid resources and financing		(10,720)	(43,603)
Management of liquid resources		11,794	24,387
Financing:			
Proceeds of issue of share capital		-	15,565
New loan raised		-	112
Repayment of loan		(10)	-
Capital element of finance lease payments		(87)	(144)
Expenses paid in connection with finance raised		(706)	(1,032)
Net cash (outflow)/inflow from financing		(803)	14,501
Increase/(decrease) in cash in the period	20	271	(4,715)
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash in the period		271	(4,715)
Management of liquid resources		(11,794)	(24,387)
		(11,523)	(29,102)
New loan raised		-	(112)
Repayment of loan		10	-
Capital element of finance lease payments		87	144
Change in net funds arising from cash flows		(11,426)	(29,070)
New finance leases		(1,295)	-
Translation differences		152	(146)
Movement in net funds in year		(12,569)	(29,216)
Net funds at 31 December 2001		17,627	46,843
Net funds at 31 December 2002	20	5,058	17,627

Statement of total recognised gains and losses

For the year ended 31 December 2002

	2002 £'000	2001 £'000
Loss for the financial year	(40,604)	(35,392)
Currency translation gains/(losses) on foreign currency net investments	2,697	(1,629)
Total recognised losses for the financial year	(37,907)	(37,021)

Reconciliation of movements in equity shareholders' funds

For the year ended 31 December 2002

	2002 £'000	2001 £'000
Loss for the financial year	(40,604)	(35,392)
Currency translation gains/(losses) on foreign currency net investments	2,697	(1,629)
Shares issued (net of issue costs)	—	14,116
Net decrease in equity shareholders' funds	(37,907)	(22,905)
Opening equity shareholders' funds	76,455	99,360
Closing equity shareholders' funds	38,548	76,455

Notes to the accounts

1 Accounting policies

The accounts have been prepared in accordance with Accounting Standards currently applicable in the United Kingdom. The principal accounting policies, which have been applied consistently, are set out below.

Accounting convention

The accounts have been prepared under the historical cost convention.

Basis of consolidation

The accounts of the parent company and all subsidiaries included in the consolidated accounts are made up to 31 December 2002.

Turnover

Turnover represents the value of goods and services supplied to customers during the period, excluding value added tax. Where invoices are raised in advance for contracted services, the revenue is spread over the period of the service. Revenue earned from the fitting-out of customers' suites is spread over the course of the related contract on a straight line basis. The spreading of revenue gives rise to deferred income in the balance sheet.

Tangible fixed assets

The cost of tangible fixed assets comprises their purchase cost, together with the incidental costs of installation and commissioning. These costs include external consultancy fees and internal employment and travel costs which are directly and exclusively related to the underlying assets.

Leasehold improvements include the discounted cost of restoring leasehold premises to their original condition at the end of the lease, which is depreciated over the duration of the relevant lease. The discount is calculated as the difference between the long-term inflation rate and the 10 year bond rate in each country, with the discount unwinding in future years through interest.

Depreciation is calculated from the date an asset becomes available for use, so as to write off the cost of the asset over its expected useful economic life. The principal annual rates used for this purpose are:

Leasehold improvements	10% straight line
Plant and machinery	10% straight line
Office equipment	25% straight line

Provision is made for tangible fixed assets within operating businesses where the present value of expected future cash flows, discounted at the Group's weighted average cost of capital of 15%, is less than the carrying value.

Stocks

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

Finance and operating leases

Leasing agreements which transfer to the Group substantially all the benefits and risks of ownership of an asset are treated as if the asset had been purchased outright. The assets are included in fixed assets and the capital element of the leasing commitments is shown within obligations under finance leases. The lease rentals are treated as consisting of capital and interest elements. The capital element is applied to reduce the outstanding obligations and the interest element is charged against profit in proportion to the reducing capital element outstanding.

Costs in respect of operating leases are charged on a straight line basis over the term of the lease. Benefits received by the Group as an incentive to sign the lease are spread on a straight line basis over the lease term or, if provided in the lease, the period to the first review date on which the rent is expected to be adjusted to the prevailing market rate.

Pensions

The Group operates a defined contribution group personal pension arrangement for all employees, including the executive Directors. Contributions are made in accordance with the scheme rules and are expensed to the profit and loss account as incurred.

Deferred taxation

Deferred taxation is provided in full on all material timing differences. Deferred tax assets are only recognised to the extent that their recoverability is regarded as more likely than not.

Foreign currencies

Assets and liabilities denominated in overseas currencies are translated into sterling at rates of exchange prevailing on the balance sheet date. The results of overseas subsidiaries are translated at average rates for the year. Differences on exchange arising from the retranslation of the net investment in overseas subsidiaries, including long-term inter-company loans, are taken to reserves and reported in the statement of total recognised gains and losses. Exchange differences relating to transactions are taken to the profit and loss account in the period in which they arise.

Notes to the accounts

2 Operating loss

	2002			2001		
	Before exceptional items £'000	Exceptional items £'000	Total £'000	Before exceptional items £'000	Exceptional items £'000	Total £'000
Turnover	23,750	1,204	24,954	25,128	7,500	32,628
Cost of sales	(23,705)	(24,486)	(48,191)	(26,191)	(8,486)	(34,677)
Gross profit/(loss)	45	(23,282)	(23,237)	(1,063)	(986)	(2,049)
Selling and distribution costs	(3,979)	—	(3,979)	(4,232)	—	(4,232)
Administrative expenses	(10,547)	(2,925)	(13,472)	(15,933)	(14,286)	(30,219)
Net operating expenses	(14,526)	(2,925)	(17,451)	(20,165)	(14,286)	(34,451)
Operating loss	(14,481)	(26,207)	(40,688)	(21,228)	(15,272)	(36,500)

Exceptional items

The exceptional items are all attributable to continuing operations. The exceptional items are analysed as follows:

	2002 £'000	2001 £'000
Exceptional revenue	1,204	—
Provisions against fixed assets	(24,939)	(5,493)
Costs and provisions in respect of exiting property lease contracts	(870)	(6,326)
Loss on contract relating to storage equipment	—	(986)
Costs in respect of aborted raising of debt facilities	—	(883)
Redundancy costs incurred	(1,880)	(1,584)
Other	278	—
Exceptional operating loss	(26,207)	(15,272)

The exceptional revenue arises from the early termination of a significant contract.

The provisions against fixed assets in 2002 arise from the exit of the Edinburgh and Munich sites and impairment reviews at certain of the Group's continuing sites.

The Group has sublet the London 3 and Manchester 2 sites and has reached agreement to surrender the lease on the Munich site. The future costs relating to these sites have been included in the provision for property leases under provisions for liabilities and charges (Note 16).

The loss on contract relating to storage equipment in 2001 derived from a one-off sale amounting to £7,500,000 at a cost of £8,486,000.

The operating loss is after charging:	2002 £'000	2001 £'000
Depreciation:		
Tangible owned fixed assets	9,072	8,106
Tangible fixed assets held under finance leases	151	35
Operating lease costs:		
Plant and machinery	93	117
Other	7,132	8,505
Auditors' remuneration for:		
Audit services	134	61
Non-audit services – taxation advice	46	142
– consultancy services	—	168

The contract for consultancy services in 2001 was awarded to PricewaterhouseCoopers after conducting a formal tender process.

In addition, payments to the auditors in 2001, in relation to the issue of shares, amounting to £342,000 were included in share issue costs deducted from the share premium account.

3 Analysis of turnover, loss and net assets

The Directors consider that the Group's activities consist of one class of business, namely the provision of Internet infrastructure facilities and associated services.

The analysis by geographic origin of the Group's activities is as follows:

	2002			2001		
	Turnover £'000	Operating loss £'000	Net assets £'000	Turnover £'000	Operating loss £'000	Net assets £'000
United Kingdom	14,242	(9,363)	14,485	24,416	(18,144)	17,043
Rest of Europe	10,712	(31,325)	19,005	8,212	(18,356)	41,785
	24,954	(40,688)	33,490	32,628	(36,500)	58,828
Net interest receivable	—	84	—	—	1,108	—
Interest bearing assets less liabilities	—	—	5,058	—	—	17,627
Group turnover, loss before tax and net assets	24,954	(40,604)	38,548	32,628	(35,392)	76,455

The analysis of turnover by geographic destination is equivalent to the analysis by geographic origin.

4 Employee information

	2002 Number	2001 Number
The average number employed by the Group within each category of persons including executive Directors was:		
Operations	143	203
Sales and administration	83	103
	226	306
	£'000	£'000
The costs incurred in respect of these employees were:		
Wages and salaries	9,613	11,478
Social security costs	1,289	1,657
Other pension costs	322	299
	11,224	13,434

Details of Directors' remuneration, pension contributions and share options are included in the Remuneration report on pages 22 to 25.

5 Interest

	2002 £'000	2001 £'000
Receivable:		
Bank and other short-term deposits	396	1,140
Payable:		
Finance leases	(121)	(18)
Other	(44)	(14)
Effect of unwinding discount on provision for reinstatement costs	(147)	—
	(312)	(32)
Net interest receivable	84	1,108

Notes to the accounts

6 Taxation

There is no taxation payable and no provision is required for deferred taxation for the current or previous periods as the Group has tax losses in several jurisdictions available to carry forward and offset against future trading profits. The unrecognised deferred tax asset, which arises in a number of jurisdictions, is analysed as follows:

	2002 £'000	2001 £'000
Tax losses and short-term timing differences	19,920	14,876
Capital allowances in excess of depreciation	(2,582)	(3,230)
	17,338	11,646

7 Retained loss for the year

As permitted by section 230 of the Companies Act 1985 a profit and loss account for the parent company is not presented. The parent company's loss for the year amounted to £73,216,000 (2001: £1,277,000).

8 Loss per ordinary share

The loss per ordinary share is based on the loss for the year £40,604,000 (2001: £35,392,000) and a weighted average of 200,590,533 (2001: 140,238,777) ordinary shares in issue during the year (as adjusted for the effects of Rights and Bonus Issues). As the impact of issuing potential ordinary shares is anti-dilutive, the diluted loss per ordinary share is equivalent to the basic loss per share.

9 Tangible fixed assets

Group	Leasehold improvements £'000	Plant and machinery £'000	Office equipment £'000	Total £'000
Cost:				
At 1 January 2002	57,641	25,116	4,549	87,306
Exchange differences	2,466	1,100	101	3,667
Additions	3,021	1,246	249	4,516
Disposals	(4,018)	(1,151)	(135)	(5,304)
At 31 December 2002	59,110	26,311	4,764	90,185
Accumulated depreciation:				
At 1 January 2002	8,853	2,975	1,373	13,201
Exchange differences	518	218	41	777
Charge for the year	5,614	2,447	1,162	9,223
Provisions for impairment	22,137	2,440	362	24,939
Disposals	(3,815)	(1,151)	(119)	(5,085)
At 31 December 2002	33,307	6,929	2,819	43,055
Net book value:				
At 31 December 2002	25,803	19,382	1,945	47,130
At 31 December 2001	48,788	22,141	3,176	74,105

Additions to leasehold improvements include £1,295,000 in respect of assets acquired under finance leases.

The net book value of tangible fixed assets includes an amount of £1,185,000 in respect of assets held under finance leases (2001: £265,000).

Notes to the accounts

10 Fixed asset investments

Parent	Subsidiary companies		
	Shares £'000	Loans £'000	Total £'000
Cost:			
At 1 January 2002 and 31 December 2002	65	102,869	102,934
Provisions:			
At 1 January 2002	—	4,869	4,869
Provided in year	65	73,051	73,116
At 31 December 2002	65	77,920	77,985
Net book value:			
At 31 December 2002	—	24,949	24,949
At 31 December 2001	65	98,000	98,065

On 31 December 2002 TeleCity plc was the beneficial owner of all the issued share capital of the following companies:

Name of undertaking	Country of incorporation	Principal activity
TeleCity UK Limited	United Kingdom	Internet infrastructure
TeleCity BV	Netherlands	Internet infrastructure
TeleCity GmbH	Germany	Internet infrastructure
TeleCity Sverige AB	Sweden	Internet infrastructure
TeleCity SAS	France	Internet infrastructure
TeleCity Ireland Limited	Ireland	Internet infrastructure
TeleCity Internet Exchange SL	Spain	Non-trading
TeleCity Internet Exchange AG	Switzerland	Non-trading
TeleCity NV	Belgium	Non-trading
TeleCity Investments Limited	United Kingdom	Holding company
TeleCity Finance Limited	United Kingdom	Group finance company
TeleCity Holdings Limited	United Kingdom	Non-trading

Other than TeleCity UK Limited, TeleCity Investments Limited and TeleCity Holdings Limited, which are owned directly by TeleCity plc, these companies are owned by TeleCity UK Limited.

Other than TeleCity UK Limited, the share capital of the subsidiary companies comprises ordinary shares. The shares in TeleCity UK Limited comprise the following: ordinary; 'A' ordinary; 'B' ordinary; 9% redeemable preference; 6% 'B' redeemable preference; 10% 'C' redeemable preference; and variable rate 'D' redeemable preference.

11 Stocks

	Group	
	2002 £'000	2001 £'000
Goods held for resale	21	38

12 Debtors

	Group		Parent	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Trade debtors	2,374	3,277	—	—
Amounts owed by group undertakings	—	—	13,599	14,356
Other debtors	2,238	2,171	—	—
Prepayments and accrued income	2,023	1,565	—	—
	6,635	7,013	13,599	14,356

13 Cash at bank and in hand

	Group	
	2002 £'000	2001 £'000
Cash at bank available on demand	4,587	4,181
Deposit accounts pledged to Bank of Scotland (see note 23)	1,889	1,821
Funds held in liquidity unit trust	—	11,792
	6,476	17,794

14 Creditors: amounts falling due within one year

	Group		Parent	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Other loan (see note 15)	11	10	—	—
Obligations under finance leases	73	55	—	—
Trade creditors	4,235	4,113	—	—
Other taxation and social security costs	808	1,242	—	—
Other creditors	176	223	—	—
Accruals	3,924	5,597	—	657
Deferred income	5,162	6,710	—	—
	14,389	17,950	—	657

15 Creditors: amounts falling due after more than one year

	Group	
	2002 £'000	2001 £'000
Other loan	98	102
Obligations under finance leases	1,236	—
	1,334	102

The other loan bears interest at 7.5% p.a. and is repayable in equal monthly instalments including interest. The loan will be fully repaid on 1 August 2010.

The future minimum payments to which the Group is committed under finance leases is as follows:

	2002 £'000	2001 £'000
In one year or less	140	58
Between one and five years	561	—
After five years	1,122	—
	1,823	58
Interest element	(514)	(3)
	1,309	55

16 Provisions for liabilities and charges

Group	Property leases £'000	Reinstatement costs £'000	Total £'000
At 1 January 2002	1,500	2,943	4,443
Exchange differences	75	—	75
Provided/(released) in year	870	(62)	808
Utilised	(422)	—	(422)
Effect of unwinding of discount	—	147	147
Transfer from creditors falling due within one year	940	—	940
At 31 December 2002	2,963	3,028	5,991

The provision for property leases relates to the future costs of leases on sites which the Group has exited (see note 2).

The provision for reinstatement costs represents management's estimate of the discounted cost of reinstating leasehold properties at the end of leases in accordance with the lease contracts. The leases expire over a range of 8 to 22 years. The discounted cost has been added to the cost of leasehold improvements and is being depreciated over the period of the leases. The discount is unwinding through interest in the profit and loss account.

Notes to the accounts

17 Share capital

Authorised	Number	£'000
Ordinary shares of 0.1p each		
At 1 January 2002 and 31 December 2002	400,000,000	400
Allotted, called up and fully paid		
Ordinary shares of 0.1p each		
At 1 January 2002	200,509,716	201
Allotted during the year	100,897	—
At 31 December 2002	200,610,613	201

The consideration received for shares allotted during the year was £121.

Options over ordinary shares granted to Directors and employees and which were outstanding at 31 December 2002 are detailed in the table below.

The exercise price and number of ordinary shares subject to option have been re-stated following the Rights Issue in September 2001.

Date of grant	Period during which options are capable of exercise from to		Exercise price per each ordinary share of 0.1p £	No. of ordinary shares subject to option 2002	No. of ordinary shares subject to option 2001
31/12/99	currently	30/12/09	0.001	1,463,338	1,586,421
17/03/00	17/03/03	16/03/10	0.001	1,334,639	1,348,860
17/03/00	currently	16/03/10	0.001	90,232	90,232
11/08/00	11/08/03	10/08/10	8.811	45,791	45,791
23/10/00	23/10/03	22/10/10	3.791	173,427	173,427
30/11/00	30/11/03	29/11/10	3.791	261,111	279,760
11/12/00	11/12/03	10/12/10	3.344	52,028	52,028
01/06/01	01/06/04	31/05/11	0.588	8,671	8,671
28/09/01	28/09/04	27/09/11	0.128	4,605,000	4,605,000
22/02/02	22/02/05	21/02/12	0.116	200,000	—
30/05/02	30/05/05	29/05/12	0.095	1,350,000	—
19/06/02	19/06/05	18/06/12	0.078	1,500,000	—
02/09/02	02/09/05	01/09/12	0.045	100,000	—
				11,184,237	8,190,190

The movement in share options is analysed as follows:

	Number
At 1 January 2002	8,190,190
Granted during the year	4,050,000
Exercised during the year	(100,897)
Lapsed during the year	(955,056)
At 31 December 2002	11,184,237

18 Reserves

Group	Share premium account £'000	Merger reserve £'000	Profit and loss account £'000	Total £'000
At 1 January 2002	111,735	17,862	(53,343)	76,254
Translation differences	–	–	2,697	2,697
Retained loss for the year	–	–	(40,604)	(40,604)
At 31 December 2002	111,735	17,862	(91,250)	38,347
Parent				
At 1 January 2002	111,735	–	(172)	111,563
Retained loss for the year	–	–	(73,216)	(73,216)
At 31 December 2002	111,735	–	(73,388)	38,347

19 Reconciliation of operating loss to net cash outflow from operations

	2002 £'000	2001 £'000
Operating loss	(40,688)	(36,500)
Depreciation including profit and loss on disposal	9,223	8,141
Provision against fixed assets	24,939	5,493
Movement in provision for liabilities and charges	1,326	1,500
Decrease in stocks	17	3,653
Decrease in debtors	510	2,815
(Decrease)/increase in creditors	(3,393)	2,319
Net cash outflow from operations	(8,066)	(12,579)

20 Analysis of movement in net funds

	1 January 2002 £'000	Cash flow £'000	Exchange movements £'000	New finance leases £'000	Other non-cash movements £'000	31 December 2002 £'000
Cash at bank available on demand	4,181	271	135	–	–	4,587
Liquid resources	13,613	(11,794)	70	–	–	1,889
Finance leases due within one year	(55)	87	(1)	(31)	(73)	(73)
Loan due within one year	(10)	10	(1)	–	(10)	(11)
Finance leases due after more than one year	–	–	(45)	(1,264)	73	(1,236)
Loan due after more than one year	(102)	–	(6)	–	10	(98)
	(167)	97	(53)	(1,295)	–	(1,418)
Total net funds	17,827	(11,426)	152	(1,295)	–	5,058

Liquid resources at 31 December 2002 comprise pledged deposit accounts, available on release of guarantees given by Bank of Scotland, and funds held in a liquidity unit trust which are available at not less than 24 hours notice (see note 13).

Notes to the accounts

21 Financial commitments

The Group has annual commitments under non-cancellable operating leases as follows:

	Land and buildings		Other	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Expiring within one year	787	22	13	15
Expiring within two to five years	—	—	37	160
Expiring after five years	6,346	7,020	—	—
	7,133	7,042	50	175

22 Capital commitments

Capital expenditure that has been contracted for but has not been provided in the accounts amounts to £90,000 (2001: £1,445,000).

23 Contingent liabilities

Financial guarantees granted by Bank of Scotland in respect of operating leases amount to £1,889,000 (2001: £1,821,000). TeleCity UK Limited has given counter indemnities in respect of these guarantees and the value of these guarantees is held in deposit accounts which are pledged to the bank.

24 Financial instruments

An explanation of the Group's objectives and policies with regard to derivatives and other financial instruments is set out in the Financial review on pages 14 to 16.

The disclosures below exclude short-term debtors and creditors, with the exception of the analysis of currency exposure.

Interest rate and currency profile of financial liabilities

				2002
	Fixed rate £'000	Floating rate £'000	Non-interest bearing £'000	Total £'000
Sterling	—	2,475	765	3,240
Euro	1,418	418	2,198	4,034
Swedish krona	—	135	—	135
Total	1,418	3,028	2,963	7,409

				2001
	Fixed rate £'000	Floating rate £'000	Non-interest bearing £'000	Total £'000
Sterling	55	2,415	1,500	3,970
Euro	112	399	—	511
Swedish krona	—	129	—	129
Total	167	2,943	1,500	4,610

			2002	2001
	Average interest rate of fixed rate liabilities %	Average period to maturity of fixed rate liabilities Years	Average period to maturity of non-interest bearing liabilities Years	Average period to maturity of fixed rate liabilities Years
Sterling	—	—	1.3	15.5
Euro	5.2	12.6	1.0	7.5
Average	5.2	12.6	1.1	10.1
				6.2

In 2001, the non-interest bearing liability, which comprises the provision for property leases, had no fixed maturity date.

The floating rate liabilities, which comprise the provision for reinstatement of leasehold properties, are discounted at the difference between the long-term inflation rate and the 10 year bond rate in each country.

24 Financial instruments (continued)

Interest rate and currency profile of financial assets

	2002	2001
	Floating rate £'000	Floating rate £'000
Sterling	2,641	15,286
Euro	3,298	2,118
Swedish krona	532	387
Swiss franc	5	3
	6,476	17,794

Floating rate financial assets earn interest based on relevant national LIBOR equivalents.

Currency exposure

The value of net monetary assets held by operations in currencies other than their local currency is as follows:

	2002
	Total £'000
Functional currency of operations	
Sterling	–
Euro	(89)
Other	202
	113
	1,303
	(2)
	1,414

	2001
	Total £'000
Functional currency of operations	
Sterling	–
Euro	10
Other	64
	74
	1,427
	28
	25
	–
	53
	1,455
	35
	95
	1,585

Maturity of financial liabilities

	2002
	Total £'000
Finance leases	
Other loan	
Provisions	
Within one year or on demand	73
Between one and two years	77
Between two and five years	256
After five years	903
	1,309
	11
	12
	42
	44
	2,902
	120
	–
	2,969
	2,986
	209
	298
	3,916
	7,409

	2001
	Total £'000
Finance leases	
Other loan	
Provisions	
No fixed maturity date	–
Within one year or on demand	55
Between one and two years	–
Between two and five years	–
After five years	–
	55
	10
	10
	36
	56
	1,500
	–
	–
	–
	2,943
	4,610

Borrowing facilities

The Group did not have any undrawn committed borrowing facilities at 31 December 2002 or 31 December 2001.

Since 31 December 2002 a loan facility of £0.7m has been arranged with 3i Group plc, a substantial shareholder in the Company.

Fair values of financial assets and liabilities

The fair values of financial assets and liabilities, determined by discounting expected cash flows of current interest and exchange rates, are not materially different to the book values.

There are no unrecognised or deferred hedges.

Notice of meeting

Notice is hereby given that the Annual General Meeting (the 'Meeting') of TeleCity plc (the 'Company') for the year 2003 will be held at Galloway House, 57 Millharbour, London, E14 9TD at 9.30 a.m. on Thursday 12 June 2003.

The Business of the Meeting will be:

Ordinary business

1. To receive and adopt the Directors' report and the audited accounts for the year ended 31 December 2002.
2. To approve the Remuneration report for the year ended 31 December 2002.
3. To elect Rick Hudson, who retires under Article 117 of the Company's Articles of Association, as a Director of the Company.
4. To re-elect Michael Hepher, who retires under Article 112 of the Company's Articles of Association, as a Director of the Company.
5. To re-appoint PricewaterhouseCoopers LLP as auditors of the Company (having previously been appointed by the Board to fill the casual vacancy arising by reason of the resignation of PricewaterhouseCoopers) and to authorise the Directors to fix the auditors' remuneration.

Special business

To consider and, if thought fit, pass the following Resolutions, Resolution 6 being proposed as an Ordinary Resolution and Resolution 7 as a Special Resolution:

6. That for the purposes of section 80 of the Companies Act 1985 (the 'Act') (and so that expressions used in this resolution shall bear the same meaning as in the said Section) the Directors be and they are hereby generally unconditionally authorised to exercise all powers of the Company to allot relevant securities up to a maximum aggregate nominal value of £66,911, being not more than one third of the Company's issued share capital at 7 April 2003, provided that:
 - (i) this authority will expire at the conclusion of the next Annual General Meeting of the Company held after the passing of this resolution or 15 months after the passing of this resolution, whichever is the earlier, except to the extent that the same is renewed or extended on or before that date;
 - (ii) the Company may prior to the expiry of such period make any offer or agreement which would or might require relevant securities to be allotted under this authority after it expires and the Directors may allot relevant securities in pursuance of any such offer or agreement notwithstanding the expiry of the authority given by this resolution; and
 - (iii) the authority hereby given shall be in substitution for any existing authorities under section 80 of the Act.
7. That, subject to the passing of resolution 6, in accordance with section 95(1) of the Act, the Directors of the Company be and they are hereby authorised to make allotments of equity securities (as defined in section 94(2) of the Act) for cash pursuant to the general authority conferred upon them in accordance with section 80 of the Act by Resolution number 6 above as if section 89(1) of the Act did not apply to any such allotments so that:
 - (i) reference to allotment in this resolution shall be construed in accordance with section 94(3) of the Act; and
 - (ii) the power conferred by this Resolution shall enable the Company to make any offer or agreement before the expiry of the period stated in (b) below which would or might require equity securities to be allotted after the expiry of the said power and the Directors may allot equity securities in pursuance of any such offer or agreement notwithstanding the expiry of such power;

PROVIDED however that the power conferred by this resolution shall:


- (a) be limited:
 - (i) to the allotment of equity securities which are offered to all the holders of issued ordinary shares of the Company (at a date selected by the Directors of the Company) where the equity securities respectively allotted to the holders of ordinary shares are as nearly as practicable in proportion to the number of ordinary shares held by them respectively but such exclusions and other arrangements that the Directors of the Company may deem necessary or expedient in relation to fractional entitlements or any legal or practical difficulties under the laws of any territory or the requirements of any regulatory body or stock exchange;
 - (ii) to the allotment (otherwise than pursuant to sub-paragraph (a)(i) above) of equity securities up to an aggregate nominal value of £10,036 being not more than 5% of the Company's issued ordinary share capital at 7 April 2003; and

- (b) expire at the conclusion of the next Annual General Meeting of the Company held after the passing of this resolution or 15 months from the passing of this resolution whichever is the earlier except to the extent that the same is renewed or extended on or before that date.

By order of the Board

Liz Hayman, Secretary

7 April 2003



Notes

1. A member entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote instead of him or her. A proxy need not be a member of the Company. To be valid the form of proxy, duly executed, together with any power of attorney or other authority under which it is executed, must be deposited with Northern Registrars Limited, Northern House, Woodsome Park, Fenay Bridge, Huddersfield, HD8 0LA no later than 48 hours before the Meeting. Completion and return of the form of proxy will not prevent a member attending the Meeting and voting in person if he or she so wishes. A form of proxy for use at the above Meeting is enclosed herewith.
2. Pursuant to the Uncertificated Securities Regulations 1995, the Company has specified that only those shareholders registered in the Register of Members of the Company at 9.30 a.m. on Tuesday 10 June 2003 will be entitled to attend and vote at the Meeting in respect of the number of ordinary shares registered in their name at that time. Changes to the Register of Members after 9.30 a.m. on Tuesday 10 June 2003 will be disregarded in determining the rights of any person to attend and vote at the Meeting.
3. Copies of the Register of the Directors' Interests in the share capital of the Company, and the Directors Service Agreements will be available for inspection at the registered office of the Company and at Eversheds, London Scottish House, 24 Mount Street, Manchester M2 3DB during normal business hours on any business day (Saturdays, Sundays and public holidays excepted) from the date of this Notice up to and including the date of the Annual General Meeting.

Company information

Registered Number:

3819054

Registered Office:

TeleCity plc
Galloway House
57 Millharbour
London
E14 9TD

Tel: 020 7512 3500

Fax: 020 7513 2819

www.telecity.com

Company Secretary:

Liz Hayman

Registrars:

Northern Registrars Limited
Northern House
Woodsome Park
Fenay Bridge
Huddersfield
HD8 0LA

Tel: 01484 600900

Fax: 01484 600911

www.northernregistrars.co.uk

Auditors:

PricewaterhouseCoopers LLP
Manchester

Bankers:

Bank of Scotland
Manchester