

MADWAVES (UK) LIMITED
Report of the Directors and
Financial Statements
for the year ended 31st December 2004



MADWAVES (UK) LIMITED

**Contents of the Financial Statements
for the year ended 31st December 2004**

	Page
Company Information	1
Report of the Directors	2
Report of the Independent Auditors	4
Profit and Loss Account	5
Statement of Total Recognised Gains and Losses	6
Balance Sheet	7
Notes to the Financial Statements	8
Profit and Loss Account	12

MADWAVES (UK) LIMITED

Company Information
for the year ended 31st December 2004

DIRECTORS:

Christopher Needler (Chairman)
Alain Georges
Bruno Hanoman
David Steeds
Colin Wyatt

SECRETARY:

Springfield Secretaries Ltd
99-101 Crossbrook Street
Waltham Cross
Hertfordshire
EN8 8JR

REGISTERED OFFICE:

Springfield House
99-101 Crossbrook Street
Waltham Cross
Hertfordshire
EN8 8JR

REGISTERED NUMBER:

04404583 (England and Wales)

AUDITORS:

Horwath Clark Whitehill LLP
Chartered Accountants
and Registered Auditors
St Bride's House
10 Salisbury Square
London EC4Y 8EH

FINANCIAL ADVISORS:

John East & Partners Limited
28-30 Worship Street
London EC2A 2AH

MADWAVES (UK) LIMITED

Report of the Directors for the year ended 31st December 2004

The directors present their report with the financial statements of the company for the year ended 31st December 2004.

PRINCIPAL ACTIVITY

The principal activity of the company in the year under review was that of the development and marketing of MadWaves core technology, which centres on software to enable the remixing of music in different styles.

REVIEW OF BUSINESS

The results for the year and financial position of the company are as shown in the annexed financial statements.

The company raised £2.6 million via a private placing in June 2004 in addition to an earlier subscription by existing shareholders of £142,000.

The company's products continue to be well received in the market place and a significant contract with Philips was signed during the year. However, other revenue has been slow to develop and has fallen well below expectations. As a result the company's cash resources were strained by the year-end and have worsened since.

The company is in negotiations with Philips for further contracts and with other potential customers and it is hoped that a number of these contracts can be concluded in 2005. The Board has taken steps to cut costs until further revenues are obtained, but until then the company's cash flow remains tight.

DIRECTORS

The directors during the year under review were:

Voit Damevski	
Christopher Needler	
Martin Stanley	- resigned 22.7.04
Bruno Hanoman	
David Steeds	- appointed 22.7.04
Colin Wyatt	- appointed 22.7.04

Voit Damevski ceased to be chief executive and a director on 27 January 2005. Alain Georges was appointed a director on 16 June 2005.

The beneficial interests of the directors holding office on 31st December 2004 in the issued share capital of the company were as follows:

	31.12.04	1.1.04 or date of appointment if later
Ordinary £1 shares		
Voit Damevski	-	-
Christopher Needler	1,318,341	1,251,991
Bruno Hanoman	41,300	41,300
David Steeds	-	-
Colin Wyatt	-	-

The following directors were granted performance-related share options:

Voit Damevski	212,204	267,726
Christopher Needler	-	107,090
Martin Stanley	-	47,720
David Steeds	5,000	-
Colin Wyatt	5,000	-

MADWAVES (UK) LIMITED

Report of the Directors for the year ended 31st December 2004

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

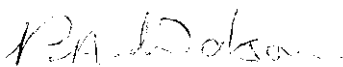
AUDITORS

During the year Trevor Jones resigned as auditors of the company and Horwath Clark Whitehill LLP were appointed.

The auditors, Horwath Clark Whitehill LLP, will be proposed for re-appointment in accordance with Section 385 of the Companies Act 1985.

This report has been prepared in accordance with the special provisions of Part VII of the Companies Act 1985 relating to small companies.

ON BEHALF OF THE BOARD:



Springfield Secretaries Ltd
Secretary

Date: 10 October 2005

MADWAVES (UK) LIMITED

Report of the Independent Auditors to the Shareholders

We have audited the financial statements of MadWaves (UK) Limited for the year ended 31st December 2004 on pages five to eleven. These financial statements have been prepared in accordance with the Financial Reporting Standard for Smaller Entities (effective June 2002), under the historical cost convention and the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

As described on page two the company's directors are responsible for the preparation of financial statements in accordance with applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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

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

Basis of audit opinion

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

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

Going concern

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the uncertainty as to the working capital forecasts of the business and revenue potential of the company's technology. In view of the significance of this uncertainty, we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31st December 2004 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Horwath Clark Whitehill LLP

Horwath Clark Whitehill LLP

Chartered Accountants and Registered Auditors
London

Date: 10 October 2005

MADWAVES (UK) LIMITED

**Profit and Loss Account
for the year ended 31st December 2004**

		<u>2004</u>		<u>2003</u>	
	Notes	£	£	£	£
TURNOVER			(1,384)		77,440
Administrative expenses			<u>2,048,876</u>		<u>3,752,023</u>
OPERATING LOSS	2		(2,050,260)		(3,674,583)
Surplus on group companies	3		778,286		(663,302)
Costs - subsidiary liquidation	3		<u>-</u>		<u>(20,000)</u>
			(1,271,974)		(4,357,885)
Income from investments			<u>12,673</u>		<u>-</u>
			(1,259,301)		(4,357,885)
Interest payable and similar charges			<u>4,389</u>		<u>1,463</u>
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION			(1,263,690)		(4,359,348)
Tax on loss on ordinary activities	4		<u>-</u>		<u>-</u>
LOSS FOR THE FINANCIAL YEAR AFTER TAXATION			(1,263,690)		(4,359,348)
Deficit brought forward:					
As previously reported		(5,685,104)		(939,153)	
Prior year adjustments		<u>-</u>		<u>(386,603)</u>	
As restated			<u>(5,685,104)</u>		<u>(1,325,756)</u>
LOSS CARRIED FORWARD			<u>£(6,948,794)</u>		<u>£(5,685,104)</u>

The company's turnover and expenses relate to continuing operations
Notes numbered 1 to 12 form part of these financial statements.

MADWAVES (UK) LIMITED**Statement of Total Recognised Gains and Losses
for the year ended 31st December 2004**

	<u>2004</u>	<u>2003</u>
	£	£
LOSS FOR THE FINANCIAL YEAR	(1,263,690)	(4,359,348)
	<hr/>	<hr/>
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR	<u>£(1,263,690)</u>	(4,359,348)
Prior year adjustment (note 5)		<u>(386,603)</u>
TOTAL GAINS AND LOSSES RECOGNISED SINCE LAST ANNUAL REPORT		<u>£(4,745,951)</u>

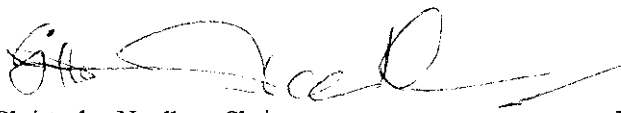
The notes form part of these financial statements

MADWAVES (UK) LIMITED**Balance Sheet
31st December 2004**

		2004		Restated 2003	
	Notes	£	£	£	£
FIXED ASSETS:					
Intangible assets	5		29,817		15,048
Investments	6		<u>15,644</u>		<u>2,053,879</u>
			45,461		2,068,927
CURRENT ASSETS:					
Debtors	7	124,262		122,342	
Cash at bank		<u>366,935</u>		<u>7,992</u>	
		491,197		130,334	
CREDITORS: Amounts falling due within one year	8	<u>216,415</u>		<u>3,187,387</u>	
NET CURRENT ASSETS/(LIABILITIES):			<u>274,782</u>		<u>(3,057,053)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES:			<u>£320,243</u>		<u>£(988,126)</u>
CAPITAL AND RESERVES:					
Called up share capital	9		3,247,197		2,758,094
Share premium	10		4,021,840		1,938,884
Profit and loss account			<u>(6,948,794)</u>		<u>(5,685,104)</u>
SHAREHOLDERS' FUNDS:			<u>£320,243</u>		<u>£(988,126)</u>

These financial statements have been prepared in accordance with the special provisions of Part VII of the Companies Act 1985 relating to small companies and with the Financial Reporting Standard for Smaller Entities (effective June 2002).

Notes numbered 1 to 12 form part of these financial statements.

ON BEHALF OF THE BOARD:


Christopher Needler – Chairman



David Steeds - Director

Approved by the Board on 10 October 2005

The notes form part of these financial statements

MADWAVES (UK) LIMITED

Notes to the Financial Statements for the year ended 31st December 2004

1. ACCOUNTING POLICIES

Basis of Preparation

The financial statements have been prepared under the historical cost convention and in accordance with the Financial Reporting Standard for Smaller Entities (effective June 2002).

The financial statements have been prepared on a going concern basis. In forming this opinion, the directors have considered the working capital forecast of the business and the revenue potential of the Company's technology.

Turnover

Turnover represents net invoiced sales of Madplayers, excluding value added tax, and royalty income.

Intangible fixed assets

Research and development expenditure represents amounts paid to SARL Madwaves, a French subsidiary company and to Madwaves ApS, a Danish subsidiary company. In previous years these amounts were capitalised and written off to the profit and loss account over a period of three years. In 2004 this policy was reviewed in the light of SSAP 13 and the innovative nature of the company's research. The company will now write off all research and development expenditure as it is incurred. Patents & licences are written off over 7 years from the date the expenses are incurred.

Investments

Investments are stated at cost less amounts written off.

Exemption from Group Accounts

The company has taken advantage of the exemption under Section 248 of the Companies Act 1985 not to prepare group accounts on the basis of the size of the group.

Taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not been reversed by the balance sheet date. Deferred taxation assets are recognised to the extent that they are regarded as recoverable.

Foreign exchange

Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated into sterling at the rate ruling on the date of the transaction. Exchange differences are taken into account in arriving at the operating loss.

2. OPERATING LOSS

The operating loss is stated after charging:

	2004	2003
	£	£
Patents and licences written off	5,768	2,846
Auditors' remuneration	7,500	7,500
Directors' emoluments and other benefits etc	<u>21,250</u>	<u>-</u>

In addition to the above, during the year £18,807 was paid to Steeds & Co., of which D W H Steeds is principal, for accounting and financial advice.

3. EXCEPTIONAL ITEMS

During the year, the liquidation of Madwaves ApS, a subsidiary company in Denmark, was completed and the company received a surplus on distribution of the assets.

4. TAXATION

Analysis of the tax charge

No liability to UK corporation tax arose on ordinary activities for the year ended 31st December 2004 nor for the year ended 31st December 2003.

MADWAVES (UK) LIMITED

Notes to the Financial Statements for the year ended 31st December 2004

5. INTANGIBLE FIXED ASSETS

	Restated Patents and licences
	£
COST:	
At 1st January 2004 (as restated)	19,840
Additions	<u>20,537</u>
At 31st December 2004	<u>40,377</u>
AMORTISATION:	
At 1st January 2004 (as restated)	4,792
Charge for year	<u>5,768</u>
At 31st December 2004	<u>10,560</u>
NET BOOK VALUE:	
At 31st December 2004	<u>29,817</u>
At 31st December 2003 (as restated)	<u>15,048</u>

Prior period adjustment

As explained in note 1, the policy for accounting for Research and Development costs was changed following a review in 2004. Such costs are now written off as incurred. The balance sheet at 31 December 2003 has been restated accordingly

6. FIXED ASSET INVESTMENTS

The company's investments at the balance sheet date in the share capital of unlisted companies include the following:

MadWaves ApS

Country of incorporation: Denmark

Nature of business: Research and development

	% holding
Class of shares:	
Ordinary shares of DKK 0.35	Nil

	2004 £	2003 £
Aggregate capital and reserves	-	2,866,228
Profit for the year	<u>-</u>	<u>352,655</u>

Madwaves ApS was placed into liquidation on 2 January 2004. All the assets of that company, being the benefit of patents and licence rights were transferred at cost to Madwaves (UK) Limited under an agreement dated 31 December 2003. No independent valuation of those assets has been obtained. The surplus on this transaction is explained in note 3 above and shown as surplus on group companies.

The above figures are extracted from the final liquidation statements.

MADWAVES (UK) LIMITED

Notes to the Financial Statements for the year ended 31st December 2004

6. FIXED ASSET INVESTMENTS (continued)

MadWaves USA Inc

Country of incorporation: USA

Nature of business: Wholesale of electronic goods

Class of shares:	% holding
Common Stock, of US\$.01	100.00

	2004	2003
Aggregate capital and reserves	(945,109)	(989,903)
Loss for the year	<u>(23,871)</u>	<u>(622,665)</u>

The above figures are extracted from unaudited accounts.

SARL Madwaves

Country of incorporation: France

Nature of business: Research and development

Class of shares:	% holding
Ordinary shares of 15.25 euros	100.00

	2004 £	2003 £
Aggregate capital and reserves	11,465	(639)
Profit for the year	<u>12,113</u>	<u>13,305</u>

The above figures are extracted from unaudited accounts.

Investments were as follows:

	2004 £	2003 £
Investment - MadWaves ApS	-	2,038,235
Investment - MadWaves USA Inc	644	644
Investment - SARL Madwaves	<u>15,000</u>	<u>15,000</u>
	<u>15,644</u>	<u>2,053,879</u>

7. DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2004 £	2003 £
V.A.T.	6,437	-
Trade debtors	-	68,470
Other debtors	107,565	6
Amounts owed - group companies	<u>10,260</u>	<u>53,866</u>
	<u>124,262</u>	<u>122,342</u>

MADWAVES (UK) LIMITED

Notes to the Financial Statements for the year ended 31st December 2004

8. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2004	2003
	£	£
Trade creditors	43,365	69,216
Directors current accounts	69,977	90,304
Due to Group companies	82,465	2,996,059
V.A.T.	-	4,308
Social security & other taxes	2,489	-
Accrued expenses	18,119	27,500
	<u>216,415</u>	<u>3,187,387</u>

9. CALLED UP SHARE CAPITAL

Authorised:				
Number:	Class:	Nominal value:	2004	2003
			£	£
6,000,000	Ordinary	£1	6,000,000	3,000,000
(2003 - 3,000,000)			<u></u>	<u></u>
Allotted, issued and fully paid:				
Number:	Class:	Nominal value:	2004	2003
			£	£
3,247,197	Ordinary	£1	3,247,197	2,758,094
(2003 - 2,758,094)			<u></u>	<u></u>

During the year, 34,466 shares were issued at a premium of £3.12 and June 2004 the company successfully placed a total of 454,637 £1 ordinary shares at a premium of £4.71 per share, raising a total of £2,737,977.

10. SHARE PREMIUM

	2004	2003
	£	£
Share premium account	<u>4,021,840</u>	<u>1,938,884</u>

11. RELATED PARTY DISCLOSURES

Under a research & development agreement the company paid Euros 2,045,000 to SARL MadWaves, a subsidiary of MadWaves UK Ltd, based in Sophia Antipolis, France.

At the year end Madwaves UK Limited owed £82,465 (2003 £161,540) to SARL Madwaves, and was owed £10,260 (2003 £10,260) by the same company.

12. POST BALANCE SHEET EVENTS

As explained in the Directors' Report, the company's financial position remains difficult until further contracts with customers can be agreed.