

Alcatel Telecom Limited

Report and Financial Statements

31 December 2003



Registered No: 2650571

Directors

D Lewis
R Strubbe

Secretary

A Sadiq

Auditors

Ernst & Young LLP
1 Bridewell Street
Bristol
BS1 2AA

Bankers

Barclays Bank Plc
Windsor Court
3 Windsor Place
Cardiff
CF10 3ZL

Solicitors

Blake Lapthorn Linnell
New Court
Segensworth
Hampshire
PO15 5UA

Registered Office

Christchurch Way
Greenwich
London
SE10 0AG

Directors' report

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report, for the year ended 31 December 2003.

Principal activities

The principal activities of the company are the sale, distribution and maintenance of communications equipment primarily manufactured by members of the Alcatel S.A. group of companies, as well as related products.

Business Review

The directors expect the general level of business to continue over the next 12 months.

Results and dividends

The audited financial statements for the year ended 31 December 2003 are set out on pages 5 to 19. The loss for the year before taxation was £31,314,000 (2002 - loss before taxation £138,486,000).

The directors do not propose to pay a dividend (2002 - £nil).

Directors and their interests

The directors who served during the year were as follows:

M A Couzens	(resigned 30 April 2004)
D Lewis	
C Matthews	(resigned 14 November 2003)
R Strubbe	(appointed 14 November 2003)

The directors held no interests requiring disclosure under schedule 7 to the Companies Act 1985.

Charitable and political donations

The company contributed £3,050 (2002 - £2,500), to charities during the year.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identified with that of other employees.

Employee consultation

The company places considerable value on the involvement of the employees and has continued its previous practice of keeping them informed on matters affecting them as employees and on the various factors affecting the performance of the company. This is achieved through formal and informal meetings. Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests.

Auditors

Deloitte & Touche LLP resigned as auditors on 23 October 2003. The directors appointed Ernst & Young LLP to fill the casual vacancy. A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

By the order of the board



Director

Statement of directors' responsibilities in respect of the financial statements

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;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume 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.

Independent auditors' report

to the members of Alcatel Telecom Limited

We have audited the company's financial statements for the year ended 31 December 2003 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet, Reconciliation of Shareholders' Funds and the related notes 1 to 21. These financial statements have been prepared on the basis of 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 in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and 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 Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

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

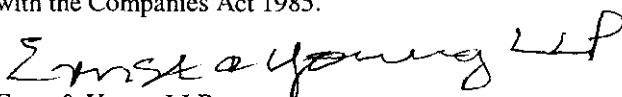
Basis of audit opinion

We conducted our audit in accordance with 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.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 December 2003 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Ernst & Young LLP
Registered Auditor
Bristol

13 Oct 2004

Profit and loss account

for the year ended 31 December 2003

	<i>Notes</i>	<i>2003</i> <i>£000</i>	<i>2002</i> <i>£000</i>
Turnover	3		
Ongoing operations		176,517	180,661
Acquisitions		-	33,110
		<hr/>	<hr/>
Continuing operations		176,517	213,771
Cost of sales		(153,384)	(198,840)
		<hr/>	<hr/>
Gross profit		23,133	14,931
Operating expenses		(42,702)	(117,220)
		<hr/>	<hr/>
Operating loss			
Ongoing operations		(19,569)	(103,632)
Acquisitions		-	1,343
		<hr/>	<hr/>
Continuing operations		(19,569)	(102,289)
Cost of fundamental restructuring of continuing operations			
- redundancy costs	4	(6,274)	(5,170)
- vacant property costs	4	(2,076)	(10,285)
Loss on sale of investments in Alcatel & Business Distribution Limited		-	(12,728)
		<hr/>	<hr/>
Loss on ordinary activities before finance charges		(27,919)	(130,472)
Income from current asset investments		199	89
Interest payable and similar charges	5	(3,594)	(8,103)
		<hr/>	<hr/>
Loss on ordinary activities before taxation	6	(31,314)	(138,486)
Tax (charge)/credit on loss on ordinary activities	9	(4,979)	868
		<hr/>	<hr/>
Loss on ordinary activities after taxation, being retained loss for the year	18	(36,293)	(137,618)
		<hr/>	<hr/>

The accompanying notes are an integral part of this profit and loss account.

Statement of total recognised gains and losses

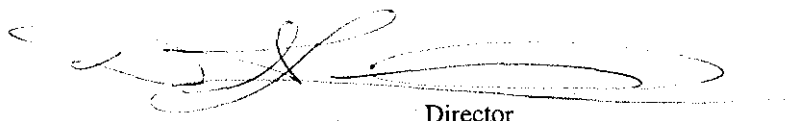
for the year ended 31 December 2003

There are no recognised gains and losses in either year other than the loss for that year.

Balance sheet

at 31 December 2003

	Notes	2003 £000	2002 £000
Fixed assets			
Intangible assets	10	32,793	33,546
Tangible assets	11	9,468	15,425
Investments	12	80,409	79,855
		<u>122,670</u>	<u>128,826</u>
Current assets			
Stocks	13	13,506	13,860
Debtors			
- amounts falling due within one year	14	40,666	66,418
- amounts falling due after more than one year	14	4,222	13,729
Cash at bank and in hand		70	53
		<u>58,464</u>	<u>94,060</u>
Creditors: amounts falling due within one year	15	(191,185)	(260,396)
Net current liabilities		<u>(132,721)</u>	<u>(166,336)</u>
Total assets less current liabilities		<u>(10,051)</u>	<u>(37,510)</u>
Provisions for liabilities and charges	16	(21,340)	(22,588)
Net liabilities		<u>(31,391)</u>	<u>(60,098)</u>
Capital and reserves			
Called up equity share capital	17	213,711	148,711
Share premium account	18	47,289	47,289
Profit and loss account	18	(292,391)	(256,098)
Equity shareholders' deficit	19	<u>(31,391)</u>	<u>(60,098)</u>



Director

Date 8th October 2004

Notes to the financial statements

at 31 December 2003

1. Fundamental accounting concept

The company is dependent on continuing finance being made available by its parent company to enable it to continue operating and to meet its liabilities as they fall due.

The directors are of the opinion the parent entity will continue to provide financial support for the foreseeable future in the same way as it has done since 1998. On this basis, the directors consider it appropriate to prepare the financial statements on the going concern basis. The financial statements do not include any adjustments that would result should continuing finance cease to be made available.

2. Accounting policies

Basis of accounting

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

The consolidated financial statements of Alcatel S.A., the company's ultimate parent company, are publicly available and therefore the company is exempt under the provisions of Financial Reporting Standard No.1 (revised) from presenting its own cash flow statement.

Group financial statements have not been prepared as the company has taken advantage of the relief available under Section 228 of the Companies Act 1985, as the results of the company and its subsidiary undertaking are included within the consolidated financial statements of Alcatel S.A. These financial statements therefore present information about the company as an individual undertaking and not about its group.

Intangible assets

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consolidation given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which has been estimated as twenty years. Provision is made for any impairment.

Goodwill arising on acquisitions in the year ended 31 December 1997 and earlier periods was written off to reserves in accordance with the accounting standard then in force. As permitted by the current accounting standard the goodwill previously written off to reserves has not been reinstated in the balance sheet. On disposal or closure of a previously acquired business, the attributable amount of goodwill previously written off to reserves is included in determining the profit or loss on disposal.

Intangible assets acquired separately from a business are capitalised at cost. Intangible assets acquired as part of an acquisition of a business are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the year in which it is incurred.

Intangible assets are amortised on a straight line basis over their estimated useful lives up to a maximum of 20 years. The carrying value of intangible assets is reviewed for impairment at the end of the first full year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Notes to the financial statements

at 31 December 2003

2. Accounting policies (continued)

Tangible fixed assets

Fixed assets are shown at original historical cost net of accumulated depreciation and provision for impairment.

Depreciation is provided on all fixed assets, other than freehold land, to write off the cost of the asset, less estimated residual value, on a straight-line basis over its estimated useful life, as follows:

Freehold buildings	35 years
Leasehold improvements	10 years or lease term
Plant and equipment	3 to 5 years
Motor vehicles	4 to 5 years

Stocks

Finished goods stock is valued at the lower of cost, calculated on a first-in first-out basis, and net realisable value, based on estimated normal selling price less further costs expected to be incurred to completion and disposal. Provision is made for obsolete, slow-moving or defective items where appropriate.

Spares stock is used by the company to meet obligations under service maintenance contracts and warranty agreements and is stated at cost, calculated on a first-in first-out basis, less provisions. Provisions are made to reflect the ageing of the spares stock and for obsolete, slow-moving or defective items, where appropriate.

Long-term contracts

Profit on long-term contracts is taken as the work is carried out if the final outcome can be assessed with reasonable certainty. The profit included is calculated on a prudent basis to reflect the proportion of the work carried out at the year end, by recording turnover and related costs (as defined in Stocks above) as contract activity progresses. Turnover is calculated as that proportion of total contract value which costs incurred to date bear to total expected costs for that contract. Revenues derived from variations on contracts are recognised only when they have been accepted by the customer. Full provision is made for losses on all contracts in the year in which they are first foreseen.

Research and development

Research and development costs are written off as incurred.

Investments

Fixed asset investments are shown at cost less provision for impairment.

Foreign currency

Transactions denominated in foreign currencies are recorded in sterling at either the rate ruling at the dates of the transactions or, where appropriate, at the related forward exchange contract rates. Gains or losses are reported in the profit and loss account to reflect changes in exchange rates subsequent to the date of the transaction.

Monetary assets and liabilities which are denominated in foreign currencies are translated at the rates of exchange ruling at the year end or, where appropriate, at the related forward exchange contract rates. Resulting gains or losses are reported in the profit and loss account.

Turnover

Turnover comprises the value of sales and services provided during the year (net of value added tax).

Revenues from services maintenance contracts which are invoiced in advance are deferred to the future period to which they relate.

Notes to the financial statements

at 31 December 2003

2. Accounting policies (continued)

Leases

Rentals under operating leases are charged to the profit and loss account on a straight line basis over the lease term.

Deferred taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or right to pay less or to receive more, tax, with the following exceptions:

- Provision is made for tax on gains arising from the revaluation (and similar fair value adjustments) of fixed assets, or gains on disposal of fixed assets that have been rolled over into replacement assets, only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However, no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only where the replacement assets are sold.
- Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Pension costs

The company provides pension benefits based on final pensionable pay under a defined benefit scheme. The assets of the scheme are held independently of the company by trustees.

The amount charged to the profit and loss account is the estimated regular cost of providing the benefits accrued in the year, adjusted to reflect variations from the cost. The regular cost is calculated so that it represents a substantially level percentage of current and future pensionable payroll. Variations from regular costs are charged or credited to the profit and loss account over the estimated average remaining working lives of scheme members.

Any difference between amounts charged to the profit and loss account and contributions paid to the scheme is shown as a separately identified liability or asset in the balance sheet.

3. Turnover and segmental information

The analysis of turnover by geographical location is as follows:

	2003 £000	2002 £000
United Kingdom	139,573	162,229
Continental Europe	31,443	37,253
North America	2,189	7,914
Other	3,312	6,375
	<u>176,517</u>	<u>213,771</u>

All of Alcatel Telecom Limited's turnover is derived from the sale, distribution and maintenance of communication services and equipment.

Notes to the financial statements

at 31 December 2003

4. Cost of fundamental restructuring of continuing operations

	2003 £000	2002 £000
Redundancy costs	6,274	5,170
Vacant property costs	2,076	10,285
	<u>8,350</u>	<u>15,455</u>

During the year and the previous year the company undertook a fundamental restructuring of its continuing operations. This led to a rationalisation of both the workforce and of certain properties and has a material impact on the nature and focus of the company's operations.

The effect of the exceptional items reported after operating losses on the amounts charged to profit and loss account for taxation was to increase available tax losses in the year by £6,274,000.

5. Interest payable and similar charges

	2003 £000	2002 £000
Bank overdrafts	3	-
Finance leases and hire purchase contracts	-	3
Interest payable to other group companies	3,591	8,100
	<u>3,594</u>	<u>8,103</u>

6. Loss on ordinary activities before taxation

The loss on ordinary activities before taxation is stated after charging (crediting):

	2003 £000	2002 £000
Goodwill amortisation	1,998	6,096
Amortisation of intangible assets	1,744	-
Depreciation		
- owned assets	5,736	4,705
- assets held under finance leases	-	3
Operating lease rentals		
- plant and machinery	1,526	2,326
- other	4,638	7,443
Auditors' remuneration		
- audit fees	80	100
- fees for non-audit services	5	47
Management charges		
- group allocation for research and development	6,170	7,303
- other	3,536	485
Foreign exchange	(403)	(1,704)
	<u></u>	<u></u>

Notes to the financial statements

at 31 December 2003

7. Staff costs

The average monthly number of persons employed by the company (including executive directors) during the year are as follows:

	2003 No.	2002 No.
Service and technical personnel	294	319
Sales and marketing	216	237
Administration	98	127
	<u>608</u>	<u>683</u>

	2003 £000	2002 £000
Aggregate remuneration comprised:		
Wages and salaries	41,598	46,547
Social security costs	3,395	3,260
Other pension costs	2,730	2,895
	<u>47,723</u>	<u>52,702</u>

8. Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	2003 £000	2002 £000
Salaries and other emoluments	<u>663</u>	<u>781</u>
Pension contributions	<u>56</u>	<u>49</u>

Pensions

The number of directors who were members of the pension schemes is as follows:

	2003 No.	2002 No.
Defined benefit schemes	<u>3</u>	<u>3</u>

Notes to the financial statements

at 31 December 2003

8. Directors' remuneration and transactions (continued)

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	2003 £000	2002 £000
Emoluments	248	222
Pension contributions	13	26

9. Tax on loss on ordinary activities

	2003 £000	2002 £000
Current tax		
Adjustments in respect of prior years:		
- UK Corporation tax	(4,979)	868

The differences between the total current tax shown and the amount calculated by applying the standard rate of UK Corporation tax to the profit before tax are as follows:

	2003 £000	2002 £000
Loss on ordinary activities before taxation	(31,314)	(138,486)
Tax on profit on ordinary activities at standard UK Corporation tax rate of 30% (2002 - 30%)	9,394	41,546
<i>Effects of:</i>		
Expenses not deductible for tax purposes	(1,950)	(20,011)
Losses not recognised as a deferred tax asset	(7,444)	(21,535)
Adjustments to tax charges in respect of previous periods	(4,979)	868
	(4,979)	868

A deferred tax asset has not been recognised in respect of timing differences relating to tax losses due to the uncertainty of the profitability of the company in the foreseeable future. The amount of the asset not recognised is approximately £57,000,000 (2002 - £50,000,000). The asset would be recovered if the company made sufficient profits in the future.

Notes to the financial statements

at 31 December 2003

10. Intangible fixed assets

	<i>IPR Asset</i> £000	<i>Goodwill</i> £000	<i>Total</i> £000
Cost:			
At 1 January 2003	-	111,156	111,156
Additions	2,989	-	2,989
Disposals	-	(853)	(853)
At 31 December 2003	2,989	110,303	113,292
Amortisation:			
At 1 January 2003	-	77,610	77,610
Charge for the year	1,744	1,998	3,742
Disposals	-	(853)	(853)
At 31 December 2003	1,744	78,755	80,499
Net book value:			
At 31 December 2003	1,245	31,548	32,793
At 1 January 2003	-	33,546	33,546

Intellectual Property Rights are being amortised evenly over their useful economic lives of one year.

During the prior year, the company undertook an impairment review of goodwill. This resulted in an impairment of goodwill of £65,869,000 in the prior year. The remaining net book value of goodwill is being amortised over its estimated remaining life.

On 1 January 2003, Alcatel Telecom Limited entered into an agreement to acquire the entire issued share capital of Alcanet International UK Limited. On the same date, the trade and assets of Alcanet International UK Limited were transferred to Alcatel Telecom Limited for cash consideration of £524,000.

The following table explains the major categories of assets and liabilities acquired.

	<i>Alcanet International UK Limited Book and fair value £000</i>
Tangible fixed assets	127
Current assets	1,321
Creditors and provisions	(924)
Net assets acquired	524
Consideration	524

Notes to the financial statements

at 31 December 2003

11. Tangible fixed assets

	<i>Freehold land and buildings</i>	<i>Leasehold improvements</i>	<i>Plant and machinery</i>	<i>Total</i>
	£000	£000	£000	£000
Cost:				
At 1 January 2003	5,839	555	15,732	22,126
Additions	-	-	979	979
Transfers from subsidiary	-	-	127	127
Disposals	(2,222)	(506)	(622)	(3,350)
At 31 December 2003	3,617	49	16,216	19,882
Depreciation:				
At 1 January 2003	243	59	6,399	6,701
Charge for the year	81	20	5,635	5,736
Disposals	(86)	(71)	(1,866)	(2,023)
At 31 December 2003	238	8	10,168	10,414
Net book value:				
At 31 December 2003	3,379	41	6,048	9,468
At 1 January 2003	5,596	496	9,333	15,425

Freehold land amounting to £382,000 (2002 - £882,000) has not been depreciated.

12. Fixed asset investments

	£000
Cost and net book value:	
At 1 January 2003	79,855
Additions	554
At 31 December 2003	80,409

The additions figure represents the fair value of the consideration paid upon acquisition of the trade and assets of Alcanet International UK Limited (note 10), and the consideration paid for 80 Media Cruise Solutions KK shares purchased in the year.

The company had ordinary share investments in the following directly held subsidiary undertakings:

	<i>Country of Incorporation</i>	<i>Principal activity</i>	<i>Holding</i>
Alcatel Internetworking UK Limited	United Kingdom	Dormant	100%
Alcatel Networks Limited	United Kingdom	Dormant	100%
Alcatel Networks Services Limited	United Kingdom	Dormant	100%
Alcanet International UK Limited	United Kingdom	Dormant	100%

Notes to the financial statements

at 31 December 2003

13. Stocks

The following are included in the net book value of stocks:

	2003 £000	2002 £000
Spares	1,760	2,124
Finished goods	11,746	11,736
	<u>13,506</u>	<u>13,860</u>

There is no material difference between the balance sheet value of stocks and their replacement cost.

14. Debtors

	2003 £000	2002 £000
<i>Amounts falling due within one year:</i>		
Trade Debtors	12,939	23,281
Amounts owed by group undertakings	17,892	38,943
Prepayments and accrued income	9,835	4,194
	<u>40,666</u>	<u>66,418</u>
<i>Amounts falling due after more than one year:</i>		
Corporation tax	3,411	8,552
Amounts owed by group undertakings	811	5,177
	<u>4,222</u>	<u>13,729</u>
	<u>44,888</u>	<u>80,147</u>

15. Creditors: amounts falling due within one year

	2003 £000	2002 £000
Bank overdrafts	1,678	-
Trade creditors	11,968	15,059
Amounts owed to other group undertakings	144,880	209,679
Other creditors		
- social security and PAYE	1,159	1,075
- other creditors	4,704	5,117
Pension accrual	4,980	331
Accruals and deferred income	21,816	29,135
	<u>191,185</u>	<u>260,396</u>

Notes to the financial statements

at 31 December 2003

16. Provisions for liabilities and charges

	2003 £000	2002 £000
Provision for restructuring	2,268	121
Provision for warranties	-	475
Vacant property provision	19,072	21,992
	<u>21,340</u>	<u>22,588</u>

The movements in provisions are as follows:

	Restructuring £000	Warranties £000	Vacant Property provision £000	2003 Total £000	2002 Total £000
At beginning of year	121	475	21,992	22,588	20,500
Charged to profit and loss account	6,274	-	2,076	8,350	15,455
Utilised during the year	(4,127)	(475)	(4,996)	(9,598)	(13,367)
At end of year	<u>2,268</u>	<u>-</u>	<u>19,072</u>	<u>21,340</u>	<u>22,588</u>

Restructuring

The company has provided for the cost of redundancies resulting from a restructuring of the business. This is to be utilised within the next financial year.

Warranties

Warranty provisions were fully utilised during the year. Any contracts requiring warranty provisions expired during the year and therefore no new provisions were booked.

Vacant property provisions

This represents provision of vacated properties. The leases expire within the next 15 years.

17. Called up share capital

	2003 £	2002 £
Authorised:		
Ordinary shares of £1 each	225,000,000	160,000,000
	<u>£</u>	<u>£</u>
Allotted, called up and fully paid:		
Ordinary shares of £1 each	213,711,268	148,711,268
	<u>£</u>	<u>£</u>

During the year, the authorised share capital was increased by £65,000,000, by the creation of 65,000,000 ordinary shares of £1 each. On 15 September 2003, 65,000,000 ordinary shares with aggregate nominal value of £65,000,000 were issued at par and fully paid for cash consideration.

Notes to the financial statements

at 31 December 2003

17. Called up share capital (continued)

On 13 October 2004, the authorised share capital was increased by £60,000,000 by the creation of 60,000,000 ordinary shares of £1 each. On this date, 60,000,000 ordinary shares with aggregate nominal value of £60,000,000 were issued at par and fully paid for cash consideration.

18. Reserves

	Share premium £000	Profit and loss account £000	Total £000
At Beginning of year	47,289	(256,098)	(208,809)
Retained loss for the financial year	-	(36,293)	(36,293)
At end of year	47,289	(292,391)	(245,102)

19. Reconciliation of movement in shareholders' funds

	2003 £000	2002 £000
Loss for the financial year	(36,293)	(137,618)
Issue of share capital	65,000	60,000
Net increase/(decrease) in shareholders' funds	28,707	(77,618)
Opening shareholders' funds	(60,098)	17,520
Closing shareholders' funds	(31,391)	(60,098)

20. Guarantees and other financial commitments

a) Capital commitments

At the end of the year capital commitments were:

	2003 £000	2002 £000
Contracted for but not provided	-	18

b) Contingent liabilities

The company has provided a £1,080,000 (2002 - £1,080,000) guarantee to Royal Mail in respect of franking machines sold and serviced before the demerger of the franking machine business in 1992. It also has other guarantees of £34,755,000 (2002 - £6,063,000) in respect of duty deferment guarantees and performance bonds.

Notes to the financial statements

at 31 December 2003

20. Guarantees and other financial commitments (continued)

c) Lease commitments

At 31 December 2003 the company had annual commitments under non-cancellable operating leases as follows:

	<i>Plant and machinery</i>		<i>Land and buildings</i>	
	2003	2002	2003	2002
	£000	£000	£000	£000
Expiring within 1 year	262	412	534	807
Expiring between 2 and 5 years	514	555	103	92
Expiring after 5 years	-	-	3,749	3,864
	<u>776</u>	<u>967</u>	<u>4,386</u>	<u>4,763</u>

d) Pension arrangements

The Company participates in the Alcatel Pension Scheme, a defined benefit pension scheme, for the majority of its employees. The scheme has five sections covering Alcatel companies in the UK. The Telecom section of the scheme to which the company contributes was closed to new entrants with effect from 1 July 2001. The assets of the scheme are held in a separate fund, administered by a corporate trustee (Alcatel Pension Trustees Limited), and the scheme does not invest in the company.

The pension cost relating to the scheme as a whole is assessed in accordance with the advice of independent qualified actuaries and employer's contributions to the scheme are paid as recommended by the actuaries. Employee's normal contributions are paid to the scheme.

The scheme is valued at regular intervals, on a triennial basis. The latest actuarial valuation of the scheme was carried out as at 30 June 2003. The market value of the scheme's assets at that date was £173,400,000.

The main assumptions were that the investment return would be 6.5% per annum, salary increases would average 5.1% per annum, and future pensions would increase by 2.6% per annum. Using these assumptions, the actuarial valuation showed that the actuarial value of the scheme's assets was sufficient to cover 59% of the value of the benefits accrued to members after allowing for expected future increases in earnings. Having regard to the size of the deficit at 30 June 2003 of £118,700,000, the actuaries advised that further employer's contributions of £10m per annum in addition to 23.5% of pensionable earnings, should be made in order to eliminate the deficiency in the scheme. The deficit in the scheme is being recognised as a variation from regular cost over 15 years, the average expected remaining service lives of the employees.

The projected unit method was used both for the funding of the scheme and in assessing pension costs for accounting purposes. Members retiring are assumed to be replaced by new entrants so that the average age of the membership remains constant.

Notes to the financial statements

at 31 December 2003

20. Guarantees and other financial commitments (continued)

e) FRS 17 disclosure

Additional disclosures regarding the group defined benefit scheme are required under the transitional provisions of FRS 17 "Retirement benefits". In accordance with FRS 17, the company will account for its contributions to the scheme as if it were a defined contribution scheme because it is not able to identify the its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis. The latest actuarial valuation of the scheme, prepared for the purposes of making the transitional disclosures in accordance with FRS 17 in the consolidated financial statements of the parent company, shows a deficit of £77,600,000. Further details of this valuation can be found in the annual report of Alcatel UK Limited which can be obtained from Christchurch Way, Greenwich, London, SE10 0AG.

21. Ultimate parent company

The company is a subsidiary undertaking of Alcatel S.A. incorporated in France.

The smallest and largest group of which Alcatel Telecom Limited is a member and for which group financial statements are drawn up is that headed by Alcatel S.A.

The consolidated financial statements of this group are available to the public and may be obtained from the corporate offices at 54 rue La Boétie, 75008 Paris, France.

As a wholly owned subsidiary of Alcatel S.A., in accordance with FRS 8 "Related party disclosures" the company is not required to disclose transactions with other members of the group.