

**LIONHEAD LIMITED**  
**FINANCIAL STATEMENTS**  
**FOR THE 15 MONTHS ENDED**  
**30 JUNE 2007**

THURSDAY



\*AKUOV0W3\*

A42

26/06/2008

367

COMPANIES HOUSE

*Presenter -*

**REED SMITH  
RICHARDS BUTLER LLP  
BEAUFORT HOUSE  
15 ST. BOTOLPH STREET  
LONDON EC3A 7EE  
SOLICITORS**

*Ref: smg / 747922.104*

**DIRECTORS AND OFFICERS**

---

**DIRECTORS**

P D Molyneux  
K R Dolliver  
B O Orndorff

**SECRETARY**

RB Secretariat Ltd

**COMPANY NUMBER**

04266262 (England)

**REGISTERED OFFICE**

Beaufort House  
Tenth Floor  
15 St Botolph Street  
London  
EC3A 7EE

**AUDITORS**

Baker Tilly UK Audit LLP  
Chartered Accountants  
The Clock House  
140 London Road  
Guildford  
Surrey GU1 1UW

**DIRECTORS' REPORT**

---

The directors submit their report and the financial statements of Lionhead Limited for the 15 months ended 30 June 2007

**PRINCIPAL ACTIVITIES**

The principal activities of the companies within the group are the creation and development of games for the interactive entertainment software market

Details of the group's operating companies are given in note 8 of the accounts

**REVIEW OF THE BUSINESS**

On 5 April 2006 the group was acquired by Microsoft Corporation. The group will continue to develop games for Microsoft's Xbox 360 and PC

During the period the group's development activities were consolidated into Lionhead Studios Limited

The group's revenue to date has been driven by the releases of Black and White on PC in March 2001, Creature Isle on PC in March 2002, Fable on Xbox and PC in September 2004 and September 2005 respectively, Black and White 2 on PC in October 2005, The Movies on PC in November 2005, Black and White 2 Battle of the Gods on PC in April 2006 and The Movies Stunts & Effects on PC in June 2006. Additionally since the acquisition by Microsoft Corporation the group has received R&D commission which has been recorded as turnover

As noted above, the group will continue to develop games for Microsoft's Xbox 360 and PC and is constantly looking at additional development opportunities

Management believe the success of the group to date has been, and will continue to be, based on the quality of its employees, the originality of its ideas and its proven title and brand development process

**RESULTS AND DIVIDENDS**

The trading profit for the 15 months ended 30 June 2007 after taxation was £196,592 (31 March 2006 loss £4,210,948)

The directors do not recommend payment of an ordinary dividend and the deficit has been transferred to reserves

**DIRECTORS**

The following directors have held office since 1 April 2006 -

J P F Bradley	(appointed 27 January 2006, resigned 5 April 2006)
A Chowdhury	(resigned 5 April 2006) (Non Executive)
K R Dolliver	(appointed 5 April 2006)
A K Illsley	(resigned 5 April 2006) (Non Executive Chairman)
J Martin	(appointed 1 August 2005, resigned 5 April 2006)
P Molyneux	
P C Murphy	(resigned 5 April 2006)
B O Orndorff	(appointed 5 April 2006)
M Webley	(resigned 5 April 2006)

**DIRECTORS' REPORT**

---

**EMPLOYMENT POLICIES**

The group supports employment of disabled people wherever possible through recruitment, by retention of those who become disabled and generally through training, career development and promotion

The group is committed to keeping employees as fully-informed as possible with regard to the group's performance and prospects and seeks their views, wherever possible, on matters which affect them as employees

**POLICY ON PAYMENT OF CREDITORS**

It is group policy to agree and clearly communicate the terms of payment as part of the commercial arrangements negotiated with suppliers and then to pay according to those terms based on the timely receipt of an accurate invoice

Trade creditor days, based on creditors, at 30 June 2007 were 16 days (31 March 2006 17 days)

**STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS**


The directors who were in office on the date of approval of these financial statements have confirmed, as far as they are aware, that there is no relevant audit information of which the auditors are unaware. Each of the directors have confirmed that they have taken all the steps that they have ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that it has been communicated to the auditor

**AUDITORS**

The directors, having been notified of the cessation of the partnership known as Baker Tilly, resolved that Baker Tilly UK Audit LLP be appointed as successor auditor with effect from 1 April 2007, in accordance with the provisions of the Companies Act 1989, s26(5). The company has by elective resolution dispensed with the obligation to appoint auditors annually in accordance with Section 386 (1) of the Companies Act 1985. Therefore, the auditors, Baker Tilly UK Audit LLP, will be deemed to be reappointed for each succeeding year

By order of the board

**RB SECRETARIAT LIMITED**

by   
**Director/Secretary**

RB Secretariat Ltd

Secretary

June 9, 2008

**DIRECTORS' RESPONSIBILITIES IN THE PREPARATION OF  
FINANCIAL STATEMENTS**

---

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the group and of the profit or loss of the group for that period. In preparing those financial statements, the directors are required to

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

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

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LIONHEAD LIMITED

We have audited the financial statements on pages 6 to 21

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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition, we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

### BASIS OF OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and 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, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and parent company's affairs as at 30 June 2007 and of the group's result for the 15 months then ended and have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

  
BAKER TILLY UK AUDIT LLP

Registered Auditor  
Chartered Accountants  
The Clock House  
140 London Road  
Guildford  
Surrey GU1 1UW

18 JUNE 2008

**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
**for the 15 months ended 30 June 2007**

	Notes	15 months ended 30 June 2007 £	Year ended 31 March 2006 £
<b>TURNOVER</b>	1	16,467,199	10,733,794
Staff costs	4	(9,042,007)	(9,690,705)
Depreciation and amortisation	3	(740,045)	(2,006,416)
Other operating charges		(2,712,538)	(2,276,410)
Exceptional item - fundamental reorganisation	3	-	(1,050,869)
<b>NET OPERATING EXPENSES</b>		<b>(12,494,590)</b>	<b>(15,024,400)</b>
<b>OPERATING PROFIT/(LOSS)</b>		<b>3,972,609</b>	<b>(4,290,606)</b>
Share of operating loss in associate	8	-	(390)
<b>TOTAL OPERATING PROFIT/(LOSS)</b>		<b>3,972,609</b>	<b>(4,290,996)</b>
Net interest (payable)	2	(648,985)	(764,530)
<b>PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	3	<b>3,323,624</b>	<b>(5,055,526)</b>
Taxation (charge)/credit	5	(3,127,032)	844,578
<b>RETAINED GROUP LOSS FOR THE PERIOD AND ITS SHARE OF ASSOCIATES</b>	14	<b>196,592</b>	<b>(4,210,948)</b>

The operating profit/(loss) for the period arises from the group's continuing operations

No separate Statement of Total Recognised Gains and Losses has been presented as all such gains and losses have been dealt with in the Profit and Loss Account

**CONSOLIDATED BALANCE SHEET**  
30 June 2007

	Notes	30 June 2007 £	31 March 2006 £
<b>FIXED ASSETS</b>			
Goodwill	6	-	-
Tangible assets	7	1,874,212	331,607
Investments in associated undertaking	8	-	30,581
		<u>1,874,212</u>	<u>362,188</u>
<b>CURRENT ASSETS</b>			
Debtors due within one year	9	2,678,578	4,155,236
Debtors due after more than one year	9	-	1,179,189
Cash at bank and in hand		2,195	18,634
		<u>2,687,073</u>	<u>5,353,059</u>
<b>CREDITORS</b>			
Amounts falling due within one year	10	(13,228,747)	(9,632,254)
<b>NET CURRENT LIABILITIES</b>		<u>(10,547,974)</u>	<u>(4,279,195)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>(8,673,762)</u>	<u>(3,917,007)</u>
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>	12	-	(75,168)
		<u>(8,673,762)</u>	<u>(3,992,175)</u>
<b>CREDITORS</b>			
Amounts falling due after one year	11	-	5,000,000
<b>CAPITAL AND RESERVES</b>			
Called up share capital	13	96,379	88,257
Share premium account	15	2,451,378	2,337,679
Profit and loss account	14	(11,221,519)	(11,418,111)
<b>EQUITY SHAREHOLDERS' FUNDS</b>	16	<u>(8,673,762)</u>	<u>(8,992,175)</u>
		<u>(8,673,762)</u>	<u>(3,992,175)</u>

The financial statements on pages 6 to 21 were approved by the board of directors and authorised for issue on June 9, 2008 and are signed on its behalf by

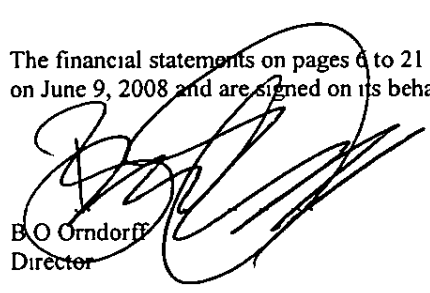
  
B O Orndorff  
Director



**BALANCE SHEET**  
**As at 30 June 2007**

	Notes	30 June 2007 £	31 March 2006 £
<b>FIXED ASSETS</b>			
Investments	8	60,684	60,684
<b>CURRENT ASSETS</b>			
Debtors due within one year	9	7,658,698	361,427
Debtors due after more than one year	9	-	7,217,028
Cash at bank and in hand		-	475
		<u>7,658,698</u>	<u>7,578,930</u>
<b>CREDITORS</b>			
Amounts falling due within one year	10	(6,292,046)	(789,722)
<b>NET CURRENT ASSETS</b>			
		<u>1,366,652</u>	<u>6,789,208</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		<u>1,427,336</u>	<u>6,849,892</u>
<b>CREDITORS</b>			
Amounts falling due after one year	11	-	5,000,000
<b>CAPITAL AND RESERVES</b>			
Called up share capital	13	96,379	88,257
Share premium account	15	2,451,378	2,337,679
Profit and loss account	14	(1,120,421)	(576,044)
<b>EQUITY SHAREHOLDERS' FUNDS</b>			
	16	<u>1,427,336</u>	<u>1,849,892</u>
		<u>1,427,336</u>	<u>6,849,892</u>

The financial statements on pages 6 to 21 were approved by the board of directors and authorised for issue on June 9, 2008 and are signed on its behalf by

  
 B O Orndorff  
 Director

**CONSOLIDATED CASH FLOW STATEMENT**  
**for the 15 months ended 30 June 2007**

	<b>Note</b>	<b>15 months ended 30 June 2007 £</b>	<b>Year ended 31 March 2006 £</b>
<b>NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES</b>	20a	12,301,973	(3,516,010)
<b>RETURNS ON INVESTMENTS AND SERVICING OF FINANCE</b>			
Interest and similar income received		331,646	2,380
Interest paid		(519,069)	(311,978)
Interest paid on finance leases			-
		<u>(187,423)</u>	<u>(309,598)</u>
<b>TAXATION</b>			
Corporation tax refund/(paid)		(1,661,228)	478,788
<b>CAPITAL EXPENDITURE &amp; FINANCIAL INVESTMENT</b>			
Payments to acquire tangible fixed assets		(2,328,202)	(187,787)
<b>ACQUISITIONS AND DISPOSALS</b>			
Purchase of shares in subsidiary undertakings		-	-
<b>NET CASH INFLOW/(OUTFLOW) BEFORE FINANCING</b>		<u>8,125,120</u>	<u>(3,534,607)</u>
<b>FINANCING</b>			
Proceeds from issue of preferred share capital		121,821	-
Repayment of long term loan		(5,000,000)	-
<b>NET CASH (OUTFLOW)/INFLOW FROM FINANCING</b>		<u>(4,878,179)</u>	<u>-</u>
<b>INCREASE/(DECREASE) IN CASH</b>	20c	<u><u>3,246,941</u></u>	<u><u>(3,534,607)</u></u>

## Financial statements for the 15 months ended 30 June 2007

ACCOUNTING POLICIES

---

**BASIS OF ACCOUNTING**

The financial statements have been prepared under the historical cost convention in accordance with applicable accounting standards and on a going concern basis which assumes the continued support of Microsoft Corporation

**GOING CONCERN**

The directors consider it appropriate to prepare the financial statements on the going concern basis due to the continued support of Microsoft Corporation

**CONSOLIDATION**

The consolidated financial statements incorporate those of Lionhead Limited and all of its subsidiary undertakings for the year

Subsidiaries are consolidated using the acquisition method. Their results are incorporated from the date control passes. The difference between the cost of acquisition of shares in subsidiaries and the fair value of the separable net assets acquired is capitalised as goodwill and written off on a straight line basis over its estimated economic life. Provision is also made for any additional impairment. All financial statements are made up to 30 June 2007.

As provided by section 230 of the Companies Act 1985, no profit and loss account is presented for Lionhead Limited.

**ASSOCIATED UNDERTAKINGS**

Undertakings in which the group has a participating interest of not less than 20% in the voting capital and over which it exerts significant influence are defined as associated undertakings. The financial statements include the appropriate share of the results and reserves of these undertakings based on audited financial statements to 30 June 2007.

**REVENUE RECOGNITION**

Revenue from royalty agreements is recognised upon shipment or transfer of title to the end customer in accordance with the agreements. Revenue also includes non-refundable advances received from distributors in return for the right to distribute games in certain territories. Such advances are recognised based upon the proportion of costs incurred to date in relation to total expected game development costs.

All deferred advances have now been recognised as revenue following completion of the relevant games. No further deferred revenue is expected as no further advances will be received following the acquisition by Microsoft Corporation.

Provisions for returns are made against sales during the period based upon market experience.

**TANGIBLE FIXED ASSETS**

Fixed assets are stated at historical cost.

Depreciation is provided on all tangible fixed assets at rates calculated to write each asset down to its estimated residual value evenly over its expected useful life, as follows -

Leasehold improvements	over 5 years
Office equipment	over 3 years
Computer equipment	over 1 month
Software	over 3 years

**Financial statements for the 15 months ended 30 June 2007****ACCOUNTING POLICIES**

---

**INVESTMENTS**

Fixed asset investments are stated at cost less provision for any diminution in value

**SOFTWARE DEVELOPMENT COSTS**

All costs associated with the development of software are written off against profits as incurred

**DEFERRED TAXATION**

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

**LEASED ASSETS AND OBLIGATIONS**

All leases are "operating leases" and the annual rentals are charged to the profit and loss on a straight-line basis over the lease term.

**PENSION CONTRIBUTIONS**

The pension costs charged in the financial statements represent the contributions payable by the group to defined contribution schemes during the period.

**PURCHASED GOODWILL**

Goodwill representing the excess of the purchase price compared with the fair value of net assets acquired is capitalized and written off evenly over 4 years as in the opinion of the directors this represents the period over which the goodwill is effective.

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the 15 months ended 30 June 2007**

**1 TURNOVER**

The group's turnover and profit/(loss) before taxation were all derived from its principal activity wholly undertaken in the United Kingdom

An accurate worldwide analysis of royalty income by destination is not available to the group

**2 NET INTEREST PAYABLE**

	<b>15 months ended 30 June 2007 £</b>	<b>Year ended 31 March 2006 £</b>
Interest receivable		
Bank interest receivable	86,196	2,380
Other interest	245,450	-
	<u>331,646</u>	<u>2,380</u>
Interest payable		
On bank overdraft	(10,592)	(104,388)
On loans	(969,959)	(454,932)
Other interest	(80)	(207,590)
	<u>(980,631)</u>	<u>(766,910)</u>
Net interest payable	<u>(648,985)</u>	<u>(764,530)</u>

**3 PROFIT/(LOSS) ON ORDINARY ACTIVITIES  
BEFORE TAXATION**

	<b>15 months ended 30 June 2007 £</b>	<b>Year ended 31 March 2006 £</b>
Profit/(loss) on ordinary activities before taxation is stated after charging		
Depreciation of tangible assets		
Charge for the period		
owned assets	740,045	279,375
Amortisation of goodwill	-	1,727,041
	<u>740,045</u>	<u>2,006,416</u>
Loss on disposal of fixed assets	83,321	-
Operating lease rentals		
Land and buildings	683,650	398,316
Auditors remuneration		
audit fees payable to Baker Tilly UK Audit LLP	29,500	-
audit fees payable to Baker Tilly	-	31,750
non-audit fees payable to Baker Tilly	-	8,900
	<u></u>	<u></u>

**EXCEPTIONAL ITEM**

The exceptional item in 2006 relates to a fundamental reorganisation of the group following completion of Fable The Lost Chapters for Xbox and PC, Black & White 2 for PC and The Movies for PC in preparation for the next generation of game development

**NOTES TO THE FINANCIAL STATEMENTS**  
for the 15 months ended 30 June 2007

	15 months ended 30 June 2007	Year ended 31 March 2006
<b>4 EMPLOYEES</b>		
The average monthly number of persons (including directors) employed by the group during the period was	No	No
Development, office and management	139	228
	<u>£</u>	<u>£</u>
Staff costs for the above persons		
Wages and Salaries	7,744,700	8,350,403
Social Security costs	896,791	929,923
Other Pension costs	400,516	410,379
	<u>9,042,007</u>	<u>9,690,705</u>
<b>DIRECTORS REMUNERATION</b>		
Emoluments for qualifying services	-	687,287
Company pension contributions to money purchase schemes	-	72,505
	<u>-</u>	<u>72,505</u>
The number of directors for whom retirement benefits are accruing under defined contribution pension schemes amounted to nil (31 March 2006 4)		
Emoluments disclosed above include the following amounts paid to the highest paid director		
Emoluments for qualifying services	-	181,289
	<u>-</u>	<u>181,289</u>
Company pension contributions to money purchase schemes	-	24,300
	<u>-</u>	<u>24,300</u>

**NOTES TO THE FINANCIAL STATEMENTS**  
for the 15 months ended 30 June 2007

	15 months ended 30 June 2007 £	Year ended 31 March 2006 £
<b>5 TAXATION</b>		
Current tax		
UK corporation tax on profits of year	936,262	-
Adjustment in respect of previous periods	(809,175)	(485,697)
Group relief receivables	(268,652)	-
Current tax credit	(141,565)	(485,697)
Deferred tax		
Origination and reversal of timing differences	(6,621)	(358,881)
Elimination of deferred tax asset on tax losses	3,275,218	-
Tax on profit/(loss) on ordinary activities	<u>3,127,032</u>	<u>(844,578)</u>

**Factors affecting tax charge for the period**

The tax assessed for the period varies from the standard rate of corporation tax as explained below

Profit/(loss) on ordinary activities before tax	3,323,624	(5,055,526)
Profit/(loss) on ordinary activities multiplied by the standard rate of corporation tax (30%)	997,087	(1,516,658)
Effects of		
(Income)/expenses not deductible for tax purposes	(366,748)	833,567
Capital allowances less than depreciation	37,271	10,402
Unutilised tax losses	-	717,472
Adjustment to tax charge in respect of previous periods	(809,175)	(485,697)
R & D Tax credits	-	(44,783)
Current tax (credit)/charge for the period	<u>(141,565)</u>	<u>(485,697)</u>

The group has estimated losses of £Nil (31 March 2006 £11,205,438) available for carry forward against future trading profit, which are reflected in the deferred tax asset balances discussed in note 9

**6 INTANGIBLE FIXED ASSETS - GROUP**

	2007 £	2006 £
Purchased goodwill		
Cost		
1 April 2006	2,932,336	1,471,806
Adjustment to purchase cost (note 21)	-	1,460,530
30 June 2007	<u>2,932,336</u>	<u>2,932,336</u>
Amortisation		
1 April 2006	2,932,336	1,205,295
Charged in the year	-	1,727,041
30 June 2007	<u>2,932,336</u>	<u>2,932,336</u>
Net book value		
30 June 2007	<u>-</u>	<u>-</u>

**NOTES TO THE FINANCIAL STATEMENTS**  
for the 15 months ended 30 June 2007

**7 TANGIBLE FIXED ASSETS - GROUP**

	Leasehold improvements £	Office equipment £	Computer equipment £	Computer software £	TOTAL £
Cost					
1 April 2006	355,704	335,230	1,138,717	95,692	1,925,343
Additions	1,865,881	247,618	197,228	55,254	2,365,981
Disposals	(362,105)	(283,821)	(874,691)	(95,692)	(1,616,309)
30 June 2007	1,859,480	299,027	461,254	55,254	2,675,015
Depreciation					
1 April 2006	263,415	228,763	1,005,876	95,692	1,593,746
Charge in the year	276,150	118,747	330,069	15,079	740,045
Disposals	(322,626)	(239,979)	(874,691)	(95,692)	(1,532,988)
30 June 2007	216,939	107,531	461,254	15,079	800,803
Net book value					
30 June 2007	1,642,541	191,496	-	40,175	1,874,212
31 March 2006	92,289	106,477	132,841	-	331,607

On 5 April 2006, the group was acquired by Microsoft Corporation. Therefore the group has adopted the depreciation estimates of fixed assets to harmonise accounting policies with Microsoft Corporation.

The effect on the period was to increase depreciation charged in the year by

Leasehold improvement	£ 28,360
Office equipment	£ 28,360
Computer equipment	£ 155,054
Computer software	£ 4,079

**8 FIXED ASSET INVESTMENTS**

**GROUP**

	Associate undertaking £
Share of net assets/cost	
1 April 2006	30,581
Provision for impairment	(30,581)
30 June 2007	-

**COMPANY**

	Subsidiary undertakings £
Cost	
31 March 2006 and 30 June 2007	60,684



**NOTES TO THE FINANCIAL STATEMENTS**  
**for the 15 months ended 30 June 2007**

**8 FIXED ASSET INVESTMENTS (Continued)**

**Holdings of more than 20%**

The company through its holding in Lionhead Studios Limited holds more than 20% of the share capital of the following companies

Company	Country of incorporation	Shares held Class	%
<b>Subsidiary undertakings</b>			
Lionhead Studios Limited	England	Ordinary	100
Black and White Studios Limited	England	Ordinary	100
Big Blue Box Studios Limited	England	'A' and 'B'	100
Intrepid Computer Entertainment Limited	England	'A' and 'B'	100
Lionhead Group Limited	England	Ordinary	100
<b>Participating interests</b>			
LIH Limited	England	Ordinary	50

**9 DEBTORS**

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
Due within one year				
Trade debtors	831,587	1,097,739	-	-
Amounts owed by subsidiary undertakings	-	-	7,425,393	307,197
Amounts owed by fellow group undertakings	268,523	-	233,305	-
Corporation tax	1,087,063	-	-	-
Other debtors	68,014	289,912	-	-
Prepayments and accrued income	330,228	463,870	-	54,230
Deferred tax asset	93,034	2,303,715	-	-
	<u>2,678,449</u>	<u>4,155,236</u>	<u>7,658,698</u>	<u>361,427</u>
Due in more than one year				
Deferred tax asset	-	1,057,916	-	-
Amounts owed by subsidiary undertakings	-	-	-	7,095,755
Other debtors	-	121,273	-	121,273
	<u>2,678,449</u>	<u>5,334,425</u>	<u>7,658,698</u>	<u>7,578,455</u>

The recoverability of the deferred tax asset is dependent on future taxable profits in 2007/8

The balance on the deferred tax asset is as follows

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
Excess of depreciation and capital allowances	80,854	86,413	-	-
Tax losses carried forward	-	3,275,218	-	-
Provisions	12,180	-	-	-
	<u>93,034</u>	<u>3,361,631</u>	<u>-</u>	<u>-</u>

**NOTES TO THE FINANCIAL STATEMENTS**  
for the 15 months ended 30 June 2007

9	DEBTORS (Continued)	GROUP		COMPANY	
		2007	2006	2007	2006
		£	£	£	£
	Deferred tax asset at start of period	3,361,631	3,002,750	-	-
	Deferred tax (charge)/credit in profit and loss account	(3,268,597)	358,881	-	-
		<u>93,034</u>	<u>3,361,631</u>	<u>-</u>	<u>-</u>
10	CREDITORS	GROUP		COMPANY	
		2007	2006	2007	2006
		£	£	£	£
	Amounts falling due within one year				
	Bank overdraft	26,350	3,289,730	-	-
	Loan notes	-	29,500	-	-
	Trade creditors	162,919	218,871	-	-
	Corporation tax	31,634	478,712	-	-
	Other creditors	15,000	15,000	-	-
	Other taxes and social security	205,081	605,263	-	2,612
	Deferred income	-	470,723	-	-
	Accruals	2,816,534	4,524,455	-	787,110
	Amounts owed to parent undertaking	9,971,229	-	6,292,046	-
		<u>13,228,747</u>	<u>9,632,254</u>	<u>6,292,046</u>	<u>789,722</u>

At 31 March 2006, £29,500 'A' unsecured redeemable convertible fixed rate loan notes of Lionhead Studios Limited were outstanding as part of the settlement of the deferred consideration accrued payable within one year on the acquisition of Big Blue Box Studios Limited

Interest accrued on the loan notes at the rate of 2% per annum up until the initial redemption date and at a rate of 1% per annum thereafter

The loan notes were redeemed in April 2006

The balance due to parent consists of £5,000,000 bearing interest at 9% and the remainder bearing interest at between 4% and 6% This balance is due to fund working capital and there are no fixed repayment terms

11	CREDITORS	GROUP AND COMPANY	
		2007	2006
		£	£
	Amounts falling due after one year		
	Loan	-	5,000,000

On 8 July 2004 a consortium of investors advanced the Company an amount of £5,000,000 by way of an unsecured loan Interest is payable at the rate of 9% per annum On acquisition of the company by Microsoft this loan was repaid by Microsoft on behalf of the company

The balance is now owed to Microsoft and has no fixed repayment date, due to this it is included in amounts falling due in less than a year The loan bears interest at 9%

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the 15 months ended 30 June 2007**

**12 PROVISIONS FOR LIABILITIES AND CHARGES**

PROVISIONS FOR RETURNS	GROUP		COMPANY	
	2007 £	2006 £	2007 £	2006 £
At 1 April 2006	75,168	599,166	-	-
Provided during the period	-	-	-	-
Release to profit and loss account	(75,168)	(523,998)	-	-
At 30 June 2007	-	75,168	-	-
<b>ONEROUS PROPERTY CONTRACTS</b>				
At 1 April 2006	-	68,068	-	-
Provided during the year	-	-	-	-
Release to profit and loss account	-	(68,068)	-	-
At 30 June 2007	-	-	-	-
<b>TOTAL PROVISIONS</b>	<b>-</b>	<b>75,168</b>	<b>-</b>	<b>-</b>

13 SHARE CAPITAL	2007 £	2006 £
Authorised		
(2006 34,993,380) 'A' Ordinary shares of 1p	-	349,934
(2006 1,306,620) 'B' Ordinary shares of 1p	-	13,066
(2006 3,700,000) 'A' Preferred shares of 1p	-	37,000
40,000,000 ordinary shares of 1p	400,000	-
	<u>400,000</u>	<u>400,000</u>
Allotted, issued and fully paid -		
(2006 6,068,380) 'A' Ordinary shares of 1p	-	60,684
(2006 2,757,253) 'A' Preferred shares of 1p	-	27,573
9,637,775 ordinary shares of 1p	96,379	-
	<u>96,379</u>	<u>88,257</u>

'B' Ordinary shares have the same rights as 'A' Ordinary shares in accordance with the company's Articles of Association. The 'A' Preferred shares of 1p have the same voting rights as the 'A' Ordinary shares and have conversion rights under the Articles of Association to ensure that they participate fully in the equity of the company.

The total number of share options as at 31 March 2006 over 'A' and 'B' Ordinary shares was 1,225,022, all at an exercise price of 15p. 812,142 options were exercised in the year, the remainder have now lapsed.

On 5 April 2006 the 402,500 A Ordinary shares of £0.01 each, held at this date by the Lionhead EBT, were converted into B Ordinary shares of £0.01 each.

On 22 December 2006 the existing 28,512,178 authorised but unissued "A" Ordinary shares of £0.01 each and the 6,481,202 issued "A" Ordinary shares of £0.01 each were converted into Ordinary shares of £0.01 each, the existing 904,120 authorised but unissued "B" Ordinary shares of £0.01 each and the 402,500 issued "B" Ordinary shares of £0.01 each were converted into ordinary shares of £0.01 each and the existing 942,747 authorised but unissued "A" Preferred shares of £0.01 each and the 2,757,253 issued "A" Preferred shares of £0.01 each were converted into ordinary shares of £0.01 each.

**NOTES TO THE FINANCIAL STATEMENTS**  
for the 15 months ended 30 June 2007

**14 PROFIT AND LOSS ACCOUNT**

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>15 months ended 30 June 2007 £</b>	<b>Year ended 31 March 2006 £</b>	<b>15 months ended 30 June 2007 £</b>	<b>Year ended 31 March 2006 £</b>
At 1 April 2006	(11,418,111)	(7,207,163)	(576,044)	(242,847)
Retained profit/(loss) for the year	196,592	(4,210,948)	(544,377)	(333,197)
At 30 June 2007	<u>(11,221,519)</u>	<u>(11,418,111)</u>	<u>(1,120,421)</u>	<u>(576,044)</u>

**15 SHARE PREMIUM ACCOUNT**

	<b>2007 £</b>	<b>2006 £</b>
Premium on issue of shares (net of expenses)		
At 1 April 2006	2,337,679	2,337,679
Premium on shares issued in the period	113,699	-
At 30 June 2007	<u>2,451,378</u>	<u>2,337,679</u>

**16 RECONCILIATION OF MOVEMENTS  
IN SHAREHOLDERS' FUNDS**

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>2007 £</b>	<b>2006 £</b>	<b>2007 £</b>	<b>2006 £</b>
Profit/(loss) for the financial year	196,592	(4,210,948)	(544,377)	(333,197)
Issue of shares (net of expenses)	121,821	-	121,821	-
Net addition/(reduction) to shareholders' funds	318,413	(4,210,948)	(422,556)	(333,197)
Opening shareholders' funds	(8,992,175)	(4,781,227)	1,849,892	2,183,089
Closing shareholders' funds	<u>(8,673,762)</u>	<u>(8,992,175)</u>	<u>1,427,336</u>	<u>1,849,892</u>

**17 COMMITMENTS UNDER OPERATING LEASES**

At 30 June 2007 the group had annual commitments under non-cancellable operating leases as follows

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>2007 £</b>	<b>2006 £</b>	<b>2007 £</b>	<b>2006 £</b>
Land and buildings expiring within one year	21,729	-	-	-
expiring in the second to fifth year	-	376,166	-	-
expiring in over five years	447,500	-	-	-
	<u>469,229</u>	<u>367,166</u>	<u>-</u>	<u>-</u>

**18 PENSION COMMITMENTS**

The group operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the group in an independently administered fund. The pension cost charge represents contributions payable by the group to the fund and amounted to £400,516 (31 March 2006 £410,379).

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the 15 months ended 30 June 2007**

**19 RELATED PARTY TRANSACTIONS**

The group companies are exempt from disclosing intra-group related party transactions under Financial Reporting Standard 8 by virtue of being wholly owned subsidiary undertakings of Lionhead Limited, for which group accounts are prepared, and the group is wholly owned subsidiary of Microsoft Corporation, for which group accounts are prepared and are publicly available

**20 NOTES TO THE CASH FLOW STATEMENT**

20

NOTES TO THE CASH FLOW STATEMENT

		2007	2006		
		£	£		
a	Reconciliation of operating loss to net cash flow from operating activities				
	Operating profit/(loss)	3,972,609	(4,290,606)		
	Depreciation	740,045	279,375		
	Amortisation	-	1,727,041		
	Loss on disposal	83,321	-		
	Impairment in investment	30,581	-		
	(Decrease)/increase in deferred income	(470,723)	(904,025)		
	Decrease/(increase) in debtors	742,965	549,733		
	(Decrease)/increase in creditors	7,278,343	(285,462)		
	(Decrease)/increase in provisions	(75,168)	(592,066)		
		12,301,973	(3,516,010)		
		2007	2006		
		£	£		
b	Reconciliation of net cash flow to movement in net debt				
	(Decrease)/increase in cash in the period	3,246,941	(3,534,607)		
	Redemption of loan notes	29,500	20,900		
	Long term loan	5,000,000	-		
		8,276,441	(3,513,707)		
	Net debt at 1 April 2006	(8,300,596)	(4,786,889)		
	Net debt at 30 June 2007	24,155	(8,300,596)		
c	Analysis of changes in net debt				
	1 April 2006 £	Cash flows £	Other changes £	30 June 2007 £	
	Cash at bank and in hand	18,634	(16,439)	-	2,195
	Overdrafts	(3,289,730)	3,263,380	-	(26,350)
		(3,271,096)	3,246,941	-	(24,155)
	Loan notes	(29,500)	29,500	-	-
	Long term loan	(5,000,000)	5,000,000	-	-
		(8,300,596)	8,276,441	-	(24,155)

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the 15 months ended 30 June 2007**

---

**21 PURCHASE OF SUBSIDIARY UNDERTAKINGS**

During the year ended 31 March 2003 the company increased its shareholdings in Big Blue Box Studios Limited (BBB) and Intrepid Computer Entertainment Limited (ICE) to 100% settled by a consideration of cash, convertible fixed rate loan notes and deferred consideration inclusive of estimated earn-out amounts

The actual deferred consideration and earn-out amounts paid in respect of ICE was £327,903 less than the estimates included in the acquisition cost originally allowed for and the related cost reduction has therefore been adjusted for in the year to 31 March 2005

The actual earn-out deferred consideration to be paid in respect of BBB is £ 1,616,659 and this has been fully provided for in these accounts

**22 ULTIMATE CONTROLLING PARTY**

The immediate parent company is Microsoft Corporation, a company registered in the USA, which has agreed to provide financial support as and when required to enable the company to meet its external obligations. On this basis, the directors consider it appropriate to prepare the accounts on a going concern basis. The financial statements do not include adjustments that would result from a withdrawal of this financial support.

This parent undertaking is the holding company of the largest group for which group accounts are prepared and of which the company is a member. Copies of the financial statements are available from 1 Microsoft Way, Redmond, Washington, 98052-6399 USA.