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The Quarto Group, Inc
Annual Report
Financial Section 2004

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Sales
£79.8m 2004
[illegible]

Operating Profit
£ 7.2m 2004
[illegible]

Underlying Operating Profit
£7.6m 2004
[illegible]

Profit before tax
£ 6.0m 2004
[illegible]

Underlying Profit before Tax
£ 6.4m 2004
[illegible]

Earnings per share
21.5p 2004
[illegible]

Underlying Earnings per Share
23.3p 2004
[illegible]

Dividend per Share
6.25p 2004
[illegible]

Chief Financial Officer's Report

2004 RESULTS

In 2004, profit before tax, exceptional item and goodwill amortisation increased by 13.4% from £5.7m to £6.4m. Turnover was up 7.0% at £79.8m (2003: £74.6m). In constant currency terms, turnover was up 15.0%, with 6.0% coming from continuing operations and 9.0% from acquisitions. Operating profit, before exceptional item and goodwill amortisation, increased by 15.8% from £6.6m to £7.6m, representing 9.5% of sales, up from 8.8% in 2003.

Profit on ordinary activities before taxation was £6.0m (2003: £4.9m) and Operating Profit was £7.2m (2003: £5.8m). The figures for 2003 were both adversely affected by exceptional costs of £595,000, comprising legal and professional fees associated with the JOHCM Tender Offer and the Group's response.

INTEREST

The net interest charge increased from £0.9m to £1.2m due to higher borrowings, as a result of the acquisitions, and higher interest rates. Interest cover based on operating profit, before exceptional item and goodwill amortisation, was a healthy 6.5 times (2003: 7.4 times). Based on Operating Profit, interest cover was 6.2 times (2003: 6.5 times).

TAXATION

The taxation charge on profit before amortisation of goodwill and exceptional item, was 20.8% (2003: 16.4%). The Group's tax charge benefited, in particular, from taxable losses brought forward together with low tax rates in certain territories. The taxation charge on profit on ordinary activities before taxation was 22.2% (2003: 15.4%).

SHAREHOLDER RETURN

Underlying earnings per share (see note 6 on page 47) rose 6.7% to 23.8p (2003: 22.3p). Basic earnings per share increased by 13.8% to 21.5p (2003: 18.9p).

The proposed final dividend of 3.5p represents an increase of 7.7% on last year's final dividend. The total dividend for the year is 6.25p, an increase of 8.7% on last year. The total dividend is 3.8 times covered (2003: 3.9 times) by underlying earnings per share; it is 3.4 times covered (2003: 3.3 times) by basic earnings per share.

The market price of the shares of common stock on December 31, 2004 was 181.5p, up 15.2% compared to last year (157.5p).

Quarto's common stock has generated a very strong total shareholder return over the five years, three years and one year ended December 31, 2004 of 117%, 206% and 19% respectively. Over the same period, Quarto's common stock has significantly outperformed the FTSE 100, the FTSE small cap index and the media sector.

FIXED ASSETS

The large increase in fixed assets, during 2004, is due to goodwill of £10.1m arising on the acquisitions made during the second half of the year.

WORKING CAPITAL

Working capital at the balance sheet dates is summarised below:

	2004 £m	2003 £m
Stock and work in progress	20.7	17.5
Trade debtors	21.5	18.5
Trade creditors	(20.8)	(19.0)
Other net liabilities	(1.4)	(1.3)
	20.0	15.7

Working capital is up, due to the acquisitions

Trade debtors represent 2 8 months sales, compared to 2 8 months at the end of 2003

CASH FLOW AND NET DEBT

Net cash inflow from operating activities was £6 5m [2003 £8 0m]

At the year end, our net debt was £28 2m, up £10 8m compared to 2003 (£17 4m) During the year, we spent £8 0m on acquisitions and assumed net debt of £5 7m Excluding this, our net debt was down £2 9m Our total banking facilities at the year end were £44 1m, and of this, £38 7m was committed for more than one year

TREASURY

The Group's borrowings, liquidity, interest rate and foreign exchange exposures and banking relationships are managed at Group level The following policies have been applied during the year to manage the financial risks faced by the Group with regard to funding and liquidity, interest rate exposure and currency rate exposures

- Liquidity risk, the Group prepares an annual cash flow forecast which is reviewed by the Board covering the next twelve months This forecast is reviewed in the light of the facilities available to the Group to ensure that we have adequate liquidity The Directors, having made enquiries, consider that the Group will have adequate resources for the foreseeable future

- Interest rate risk, most of the Group's borrowings are at floating rates The Group entered into an interest rate swap during the year to fix the interest cost on US$30,000,000 of our borrowings until July 17, 2007

- Currency rate exposure, the Group's principal operating currency is the US dollar Approximately 70% of our sales are denominated in US dollars and a greater percentage of our expenditure At Group level we try to match our annual US dollar receipts and payments in order to mitigate the impact that exchange rate fluctuations, with regard to the US dollar, have on our results In 2004, there was net US dollar income because of strong performances from our US and Hong Kong subsidiaries and the acquisitions of CPi

The following table sets out the principal average exchange rates used in translating the results of our overseas subsidiaries

	2004	2003
US Dollar	1 83	1 63
Hong Kong Dollar	14 25	12 72
Australian Dollar	2 49	2 52

FINANCIAL REPORTING

We have very tight reporting deadlines so that we can focus on running the business This requires considerable commitment and hard work from my staff and I would like to thank them all for their hard work, unstinting support and loyalty We have had an extremely busy year and, at times, I have asked a lot from my staff, but they continue to produce the goods

MICHAEL J MOUSLEY
Chief Financial Officer

February 14, 2005

Directors and Advisers

DIRECTORS
Laurence Francis Orbach
(Chairman and Chief Executive) (USA)
Robert John Morley
Michael John Mousley, ACA
Peter Campbell (Non-executive)
Peter Waine (Non-executive)
Leigh Collins (Non-executive)

SECRETARY
Michael John Mousley, ACA

REGISTERED OFFICE
The Old Brewery,
6 Blundell Street,
London, N7 9BH
Tel +44 (0) 20 7700 6700

WEBSITE
www quarto com

STOCKBROKERS
Collins Stewart Limited
88 Wood Street,
London, EC2V 7QR

AUDITORS
KPMG Audit Plc
8 Salisbury Square London, EC4Y 8BB

SOLICITORS
Travers Smith Braithwaite, 6 Snow Hill, London, EC1A 2AL

REGISTRARS AND TRANSFER OFFICE
Capita Registrars
The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU

PRINCIPAL BANKERS
Bank of America
100 Federal Street, Boston, MA 02110, USA

Barclays Bank plc
27 Soho Square, London, W1D 3QR

Lloyds TSB Bank plc
25 Gresham Street, London, EC2V 7HN

The Royal Bank of Scotland plc
280 Bishopsgate, London, EC2M 4RB

REGISTERED NUMBER
FC0 13814

Directors' Report

The Directors present their report and the audited financial statements of The Quarto Group, Inc , for the year ended December 31, 2004

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The Group conducts an international business whose principal activity is as a publisher of illustrated non-fiction books in co-edition and under its own imprint, for both adults and children A detailed review of the development of the business of the Group is given in the Chairman's Letter on pages 3 to 13 and the Review of Operations on pages 16 to 22

RESULTS AND DIVIDENDS

The profit for the year after taxation and minority interests amounted to £4 285,000 [2003 £3,809,000] The Directors propose a final ordinary dividend of 3 5p [2003 3 25p] per share subject to approval at the Annual General Meeting The retained profit for the year was £2,736,000 [2003 £2,351,000] which has been transferred to reserves

DIRECTORS

The Directors of the Company, who served as Directors during the year, were as follows

L F Orbach
R J Morley
M J Mousley
P Campbell (Non-executive)
P Waine (Non executive)
L Collins (Non-executive)

Previously an academic in New York, Laurence Orbach, Chairman and Chief Executive had some publishing experience before founding Quarto in 1976 Together with his role as Chairman and Chief Executive, he is also responsible for Group Strategy

Robert Morley, Creative Director, trained as a designer, and was magazine art director for the Sunday Telegraph between 1967 and 1970 Before co-founding Quarto, he spent some time with Reader's Digest and IPC Part Works amongst others

Mick Mousley Group Finance Director, worked for 12 years at Deloitte Haskins & Sells (now part of Price Waterhouse Coopers) the last two years of which were as a senior manager in the Mergers and Acquisitions Department He joined Quarto in 1987, and was appointed Finance Director in 1989

Educated at Eton College, Peter Campbell started his business career with the Booker Group, holding a number of marketing positions in their United Rum Merchants subsidiary From 1972 to 1989 he was with the Ocean Group initially on the sales and marketing side, and from 1987 to 1989 he was the General Manager, UK Operations for the MSAS subsidiary, with responsibility for 27 locations and 800 staff Since 1989 he has been involved in management training and development, and is currently a Director of Catalyst Development, a member of the Blueprint Group

Peter Waine has a wide corporate experience gained as a result of holding executive and non-executive Directorships in a variety of different sectors and with companies both public and private, up to £1 billion turnover The organisations he has worked for include GEC, Coopers & Lybrand, W R Royle, and the CBI He is the co-founder of Hanson Green, the principal source for non-executive appointments in the UK

Leigh Collins has been a stockbroker since 1970 and was a director of Collins Stewart Limited of which he was a founding director in 1991, until 2000

None of the Directors has a service agreement of more than one year's duration

Save as disclosed in Note 22, no Director has had a material interest in any contract of significance with the Company or its subsidiaries during the year

DIRECTORS INTERESTS IN SHARES

The Directors who held office at December 31 2004 had the following interests in the share capital of the Company

	Number of US$0 10 shares of common stock	
SHAREHOLDING	31 December, 2004	1 January, 2004
L F Orbach*	2,858,985	2,957,413
R J Morley	1,402 852	1,583,424
M J Mousley	42 700	42,700
L Collins	337 650	337,650
P Campbell	1,000	1 000
P Waine	-	-

Details of the Director's options are given in the Director's Remuneration Report on page 34

*2,678,413 shares in which L F Orbach is interested are owned through his family trusts

At 1 January, 2004, 279,000 of the shares in which L F Orbach and R J Morley were interested were owned through the Quarto Publishing plc pension scheme, which was for the benefit of both L F Orbach and R J Morley During 2004, this shareholding has been split between L F Orbach and R J Morley

L F Orbach held 5,000 and M J Mousley held 15,000 convertible cumulative redeemable shares of preferred stock of par value US$0 10 each at 31 December, 2004 (At January 1, 2004 L F Orbach 5,000, M J Mousley 15,000)

During the year the market price of the shares of common stock ranged between 156 5p and 183 5p The market price at December 31 2004 was 181 5p

Between December 31, 2004 and February 14 2005 there have been no changes in the interests of the Directors

SUBSTANTIAL SHAREHOLDERS

As at February 14, 2005 the latest practicable date prior to the publication of this report, the Directors have been advised of the following shareholders who have an interest of 3% or more in the shares of common stock of the Company

	Number of US$0 10 Shares of common stock	Percentage
Lattice Group Pension Scheme	681,026	3 6%
Chelverton Fund Limited	625,000	3 3%
Ennismore Fund Management	625,000	3 3%
Herald Investment Trust	1,437,500	7 7%
Invesco English & International Trust	770,000	4 1%
J O Hambro Capital Management	4,968 843	26 6%
Liontrust	1,287 520	6 9%
L F Orbach	2,858 985	15 3%
R J Morley	1,402 852	7 5%
The Quarto Group, Inc	714,000	3 8%

CORPORATE GOVERNANCE

The Directors have reviewed the governance arrangements of The Quarto Group, Inc in the context of the Combined Code, revised in July 2003 The principles of the Code have been applied as follows

a) The Board of Directors represents the shareholders' interests in maintaining and growing a successful business including optimising consistent long-term financial returns

b) The Board comprises three executive Directors and three non-executive Directors The non-executive Directors, P Campbell, P Waine and L Collins are considered by the Board to be independent, not withstanding the fact that P Campbell receives £15,000 per annum for consulting fees and that L Collins has 337,650 shares

c) The Board meets eight times a year The executive Directors attended all the meetings, P Campbell attended 6 meetings and P Waine and L Collins attended 7 meetings A formal agenda is prepared for each meeting and all board papers and information are circulated to the Board forty-eight hours before the meetings

d) All of the Directors are subject to re-election by the shareholders at the Annual General Meeting

e) The remuneration of the executive Directors is recommended by the Remuneration Committee The Remuneration of non-executive directors is determined by the board as a whole A separate report with respect to Directors' remuneration is included on page 33
f) The Chairman and the Finance Director are responsible for investor relations They meet with major shareholders during the course of the year to ensure that they develop an understanding of their views, which are communicated to the rest oof the Board at Board Meetings Shareholders are invited to attend the AGM at least twenty working days in advance of that meeting
g) The Audit Committee, comprising P Campbell, P Waine and L Collins meet with the independent auditors at least twice a year L Collins provides the Committee with financial experience The Committee regularly review at Board level the financial back-up and facilities available at Head Office, as the Group continues to expand Additional resources were added during 2004 The Committee does not have formal written terms of reference, this will be rectified in 2005 The Committee monitors the level of non-audit fees paid to the auditors to ensure that their objectivity is safeguarded

The Group has complied throughout the year with the provisions set out in Section 1 of the Combined Code appended to the Listing Rules of the London Stock Exchange, apart from those listed below Where non-compliance is reported, this is because, in the opinion of the Board, it is not appropriate to change current practice due to the size and constitution of the Board The provisions of the Combined Code not complied with are as follows

a) The Chairman of the Company is also the Chief Executive
b) A formal schedule of matters specifically reserved for the Board is not required, since the Board forms the executive management of the Group
c) The Company does not have any formal arrangements for Directors, in the furtherance of their duties, to take independent professional advice
d) The Remuneration Committee consists of the three independent non-executive Directors, but, it does not have responsibility for the remuneration of senior management below main Board Level
e) Performance related bonuses are not normally given
f) There is no nominated senior non-executive Director
g) The Company does not have a Nominations Committee The Board as a whole is responsible for the appointment of its own members
h) The Group does not have formal 'whistleblowing' procedures However, the structure is flat and the line of communication is short In addition, the Executive Board and the finance department carry out several visits per year to individual operating units
i) The Audit Committee does not have formal written terms of reference this will be rectified in 2005

The Board will continue to review its corporate governance arrangements, in the light of the Combined Code, as the Group develops and grows, and, in particular will review those provisions of the Combined Code that are not complied with currently

GOING CONCERN

The Directors, having made enquiries, consider that the Group will have adequate resources to continue in operational existence for the forseeable future, and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements

INTERNAL CONTROLS

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss

The main elements of the internal control system are

a) The results of individual operating units are reported monthly and reviewed by the Board at its eight board meetings a year
b) The management reports of each operating unit are tailored to suit the business and management needs of local management Each operating unit has its own performance indicators and these are regularly reviewed and assessed

c) In addition to the monthly reporting, individual operating units report certain management information more frequently where it is considered appropriate
d) All operating units report their bank balances twice weekly and a report is produced summarising the Group position
e) The Board and the finance department make frequent visits to all operating units These visits include a review of the internal control system
f) All operating units prepare annual budgets and cash flow forecasts which are reviewed by the Board

The Combined Code introduced a requirement that the directors review the effectiveness of the group's system of internal controls This extends the existing requirement in respect of internal financial controls to cover all controls including financial, operational, compliance, and risk management Following publication of guidance for the directors, *Internal Control Guidance for Directors on the Combined Code* (the Turnbull guidance), the Board confirms that there is an ongoing process for, and an annual review covering, the identification, evaluation and management of the significant risks faced by the Group, that has been in place for the year under review and up to the date of approval of the annual report and accounts and that this process is regularly reviewed by the Board and accords with the guidance The process is carried out through, inter alia

a) Group Board meetings
b) Quarterly subsidiary management meetings
c) Quarterly strategy meetings
d) Presentations by subsidiary Chief Executive officers to the Board
e) Discussion and review by the Executive Board and the finance department during the several visits per year to individual operating units
f) Discussions with professional advisers where appropriate

AUDIT COMMITTEE

The duties of the Audit Committee include

a) Monitor integrity of financial statements and formal announcements
b) Review the Company's internal financial controls
c) Make recommendations in relation to the reappointment and removal of external auditor
d) Approve remuneration and terms of engagement of the external auditor
e) Review and monitor independence and objectivity of the external auditor

The Board has considered the need for an internal audit function, but has resolved that, due to the size of the Group, this cannot be justified on the grounds of cost effectiveness at present

SUPPLIER PAYMENT POLICIES

The Group agrees terms and conditions for its business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate These arrangements are adhered to when making payments, subject to the terms and conditions being met by the supplier At December 31, 2004, Group creditor days amounted to 107 days (2003 108 days)
The holding company does not have any trade creditors

AUDITOR

Our independent auditor, KPMG Audit Plc, is willing to continue in office and, accordingly, a resolution is to be proposed at the annual general meeting for the reappointment of KPMG Audit Plc as auditor to the Company

M J MOUSLEY
Secretary
February 14, 2005

Directors' Remuneration Report

The remuneration committee is responsible for making recommendations on behalf of the Board on the remuneration policy with regard to the Company's executive Directors. It consists of the Chairman and the three non-executive Directors. The remuneration committee is constituted within the relevant provisions of Section B of the Combined Code, save that it does not consist exclusively of non-executive Directors and its terms of reference are not formally documented. The remuneration committee has given full consideration to Section B of the Combined Code in framing its remuneration policy. This report sets out the committee's policy and disclosures on Director's remuneration.

REMUNERATION POLICY

Remuneration levels are set by reference to individual performance, experience and market conditions with a view to providing a package which is appropriate for the responsibilities involved.

An individual director's performance is reviewed and assessed constantly throughout the year and specifically at two formal meetings of the remuneration committee each year. This process includes consideration of the financial results of the Company.

The stated policy is expected to remain in place for the forthcoming year.

COMPONENTS OF REMUNERATION

Basic salaries are determined according to the competitive market for executive directors, taking into account their experience, contribution and performance. This determination is carried out internally.

Bonuses and share options are awarded on a discretionary basis in recognition of individual performances during the year.

Options granted under the Company's Executive Share Option Schemes are at market value at the date of grant and exercisable between a minimum period of three years and a maximum period of seven years or ten years. Options are exercisable if there has been an increase in the Company's earnings per share of at least 2% per annum above the growth in the retail prices index over a period of three years.

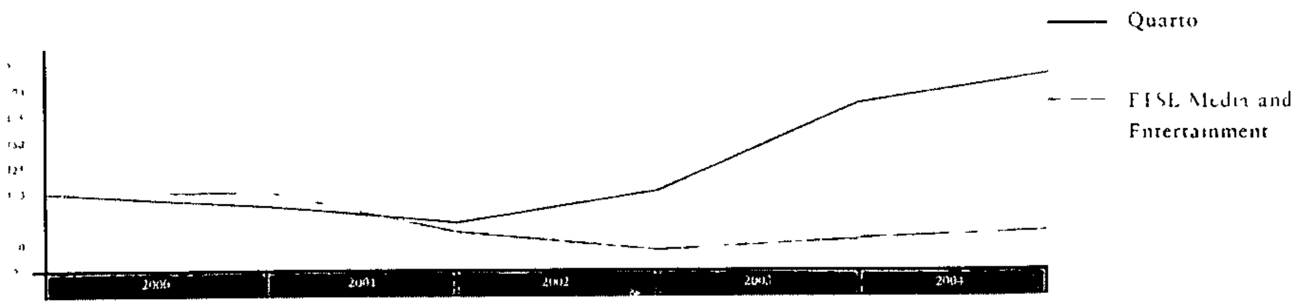
SERVICE AGREEMENTS

The executive Directors have service agreements which provide for 12 months' notice by the Director or the Company. There are no provisions for compensation other than the notice period. As from 2004, the independent non-executive Directors are engaged on annual rolling contracts. Their fees are reviewed by the Board.

All of the Directors stand for re-election annually at the Annual General Meeting of the Company.

TOTAL SHAREHOLDER RETURN

The following graph charts the total shareholder return of the Company for the last five years.



The index selected for comparison is the FTSE Media and Entertainment index as this was considered to be a broad representation of the Company's peer group in terms of its size and business.

DETAILS OF DIRECTORS' REMUNERATION

The auditors are required to report on the information contained in this page of the remuneration report

The remuneration in respect of each Director who served as a Director during the year was as follows

	SALARY / FEES £000	BENEFITS £000	2004 TOTAL £000	2003 TOTAL £000
L F Orbach	325	13	338	313
R J Morley	171	5	176	179
M J Mousley	175	3	178	162
P Campbell	40	-	40	46
P Waine	25	-	25	33
I Collins	25	-	25	33
	761	21	782	766

Benefits consist of benefits in kind in respect of health and life insurance The remuneration of the three non-executive Directors comprises £25,000 fees for their ongoing role as a non-executive Director In addition, P Campbell received £15,000 of consulting fees on an arm's length basis

Each of the executive Directors has a defined contribution pension plan During the year contributions were made as follows

	2004 £000	2003 £000
L F Orbach	72	71
R J Morley	26	26
M J Mousley	26	24
	124	121

SHARE OPTIONS

Details of share options of those directors who served during the year are as follows

	At January 1, 2004	Awarded	At December 31, 2004	Exercise* price	Earliest date of exercise	Expiry date
L F Orbach	10,000	-	10,000	£1 115	22 2 2003	21 2 2007
R J Morley	5,000	-	5,000	£1 115	22 2 2003	21 2 2010
M J Mousley	10,000	-	10 000	£1 115	22 2 2003	21 2 2010
	5,000	-	5,000	£0 685	31 3 2001	30 3 2008
	15,000	-	15 000	£0 825	29 3 2004	28 3 2011
	3,900	-	3 900	£0 775	26 2 2005	25 2 2012
	11,100	-	11 100	£0 775	26 2 2005	25 2 2009
	7,500	-	7 500	£0 83	14 2 2006	13 2 2010
		7,500	7,500	£1 63	30 9 2007	29 9 2011

* Market price at date of award

No gains were made by Directors on the exercise of the share options in the current or prior year

Details of the performance criteria of these options are given above under components of remuneration

The highest and lowest prices of the Company's shares during the year were 183 5p and 156 5p respectively The price at the year end was 181 5p

This report was approved by the Board of Directors on February 14, 2005

P WAINE
Chairman of Remuneration Committee

Statement of Directors' Responsibilities

The Company is incorporated in the State of Delaware, United States and is subject to the law of that state which places no requirement for annual reporting to shareholders upon the directors However, since the Company has a listing on the London Stock Exchange and a place of business in the UK, the Directors are required to prepare financial statements which comply with certain provisions which are contained within the Listing Rules of the UK Financial Services Authority (the Listing Rules) and UK company law for oversea companies

The Company is an "oversea company" within the meaning of the Companies Act 1985 The Directors have elected to adopt UK Generally Accepted Accounting Principles and to prepare the financial statements in accordance with applicable United Kingdom accounting standards The Directors have also elected to prepare the accounts in accordance with the requirements of the Companies Act 1985, as if the full requirements of that Act were to apply

The Directors have accepted responsibility for preparing financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss for that period In preparing these financial statements, the Directors have assumed responsibility 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 Group will continue in business

The Directors have accepted responsibility for maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the relevant requirements of UK company law and Delaware company law They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities

Independent Auditor's Report to The Quarto Group, Inc

We have audited the financial statements on pages 37 to 59 In addition to our audit of the financial statements, the directors have engaged us to audit the information in the directors' remuneration report that is described as having been audited, which the directors have decided to prepare as if the Company were required to comply with the requirements of Schedule 7A to the Companies Act 1985

This report is made solely to the Company in accordance with the terms of our engagement Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state in this audit 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 for our audit work, for this report, or for the opinions we have formed

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS
The directors have accepted responsibility for preparing the Annual Report and the directors' remuneration report As described on page 35, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom accounting standards and the requirements of the Companies Act 1985, as if the requirements of that Act were to apply Our responsibilities, as independent auditors, are established by the terms of our engagement letter, the Auditing Practices Board and by our profession's ethical guidance

Under the terms of our engagement, we report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the stated basis of preparation We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Group is not disclosed, as if that law were to apply

In addition to our audit of the financial statements, the directors have engaged us to review their corporate governance statement as if the Company were required to comply with the Listing Rules of the Financial Services Authority in relation to these matters We review whether the Corporate Governance statement on pages 30 to 32 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for audit review by those rules, and we report if it does not We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures

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

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

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

OPINION
In our opinion

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at December 31, 2004 and of the profit of the Group for the year then ended, and
- the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985, as if the full requirements of that Act had applied to the financial statements

KPMG Audit PLC

KPMG Audit Plc, Chartered Accountants
London, February 14, 2005

Consolidated profit and loss account for the year ended December 31, 2004

	Notes	GROUP 2004 £000	GROUP 2003 £000
TURNOVER	1		
Continuing operations		73,141	74 623
Acquisitions		6,694	-
		79,835	74 623
Cost of Sales		(50,931)	(49 240)
GROSS PROFIT		28 904	25 383
Distribution costs		(3 014)	(2 535)
Administration expenses			
-Before exceptional item and goodwill amortisation		(18,412)	(16,395)
-Exceptional item	2	-	(595)
-Goodwill amortisation		(410)	(206)
Total administrative expenses		(18,822)	(17 196)
Other operating income		126	113
GROUP OPERATING PROFIT		7,194	5 765
Continuing operations		6,489	5,765
Acquisitions		705	-
		7,194	5 765
Net interest payable and similar charges	3	(1 169)	(892)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	2	6,025	4 873
Tax on profit on ordinary activities	4	(1 337)	(750)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		4,688	4,123
Minority interests – equity		(403)	(314)
PROFIT FOR THE YEAR		4 285	3 809
Dividends (including non-equity)	5	(1 549)	(1,458)
RETAINED PROFIT FOR THE YEAR	18	2,736	2 351
EARNINGS PER SHARE	6	21 5p	18 9p
UNDERLYING EARNINGS PER SHARE	6	23 8p	22 3p
DILUTED EARNINGS PER SHARE	6	20 1p	18 2p
DILUTED UNDERLYING EARNINGS PER SHARE	6	22 0p	21 2p

There is no material difference between the results as disclosed in the profit and loss and those results on a historical cost basis

Balance Sheets at December 31, 2004

	Notes	GROUP 2004 £000	GROUP 2003 £000	COMPANY 2004 £000	COMPANY 2003 £000
FIXED ASSETS					
Intangible assets	7	13,005	3,337	-	-
Tangible assets	7	8,982	8,909	-	-
Investments	8	-	-	10,817	12,294
		21,987	12,246	10,817	12,294
CURRENT ASSETS					
Stocks and work in progress	9	20,727	17,451	-	-
Debtors	10	24,066	20,667	-	-
Cash and deposits	11	12,578	12,490	-	-
		57,371	50,608	-	-
CREDITORS Amounts falling due within one year	12	(28,927)	(24,303)	(629)	(583)
NET CURRENT ASSETS / (LIABILITIES)		28,444	26,305	(629)	(583)
TOTAL ASSETS LESS CURRENT LIABILITIES		50,431	38,551	10,188	11,711
CREDITORS Amounts falling due after more than one year	13	(38,618)	(29,588)	-	-
PROVISION FOR LIABILITIES AND CHARGES					
Deferred taxation	15	(646)	(875)	-	-
NET ASSETS		11,167	8,088	10,188	11,711
CAPITAL AND RESERVES					
Called up share capital	16	1,341	1,341	1,341	1,341
Treasury stock	17	(786)	(802)	(786)	(802)
Reserves – Paid in surplus	18	23,903	23,893	23,903	23,893
– Revaluation	18	968	978	-	-
– Profit and loss	18	(16,979)	(19,758)	(14,270)	(12,721)
SHAREHOLDERS' FUNDS		8,447	5,652	10,188	11,711
Equity		3,575	780	5,316	6,839
Non-equity		4,872	4,872	4,872	4,872
		8,447	5,652	10,188	11,711
MINORITY INTERESTS – EQUITY		2,720	2,436	-	-
		11,167	8,088	10,188	11,711

The financial statements on pages 37 to 59 were approved by the Board of Directors on February 14, 2005 and were signed on its behalf by

M J MOUSLEY
Director

Consolidated Statement of Total Recognised Gains and Losses for the Year Ended December 31, 2004

	GROUP	
	2004	2003
	£000	£000
PROFIT FOR THE FINANCIAL YEAR	4,285	3,809
Currency translation differences on foreign currency net investments	33	16
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR	4,318	3,825

There are no other recognised gains and losses for the company (2003 nil), apart from the loss (2003 loss) for the financial year as disclosed below

Reconciliation of movement in shareholders' funds for the Year Ended December 31, 2004

	GROUP		COMPANY	
	2004	2003	2004	2003
	£000	£000	£000	£000
PROFIT FOR THE FINANCIAL YEAR	4 285	3,809	-	-
Dividends	(1,549)	(1,458)	(1,549)	(1,458)
Retained profit (loss) for the financial year	2 736	2,351	(1,549)	(1,458)
Other recognised gains and losses relating to the year	33	16	-	-
Issues of shares (notes 16-18)	26	8	26	8
Purchase of shares (note 17)	-	(110)	-	(110)
Net movement in shareholders' funds	2,795	2,265	(1,523)	(1,560)
Shareholders' funds at December 31 2003	5,652	3,387	11,711	13,271
SHAREHOLDERS FUNDS AT DECEMBER 31, 2004	8,447	5,652	10 188	11,711

Consolidated Cash Flow Statement for the Year Ended December 31, 2004

	GROUP	
	2004 £000	2003 £000
NET CASH INFLOW FROM OPERATING ACTIVITIES	6,503	7,965
RETURN ON INVESTMENT AND SERVICING OF FINANCE		
Interest received	51	107
Interest paid	(1,280)	(961)
Interest element of hire purchase payments	(47)	(39)
Preference dividend paid	(426)	(426)
Dividend paid to minority shareholder	(103)	(103)
NET CASH OUTFLOW FROM RETURN ON INVESTMENT AND SERVICING OF FINANCE	(1,805)	(1,422)
TAXATION		
UK and overseas corporation tax paid	(1,062)	(371)
CAPITAL EXPENDITURE		
Purchase of tangible fixed assets	(1,020)	(2,532)
Sale of tangible fixed assets	38	30
Net cash outflow from capital expenditure	(982)	(2 502)
ACQUISITIONS		
Purchase of businesses / subsidiaries (including cash and cash equivalents acquired)	(13,700)	(179)
EQUITY DIVIDENDS PAID		
Dividends paid	(1,077)	(969)
NET CASH OUTFLOW BEFORE USE OF LIQUID RESOURCES AND FINANCING	(12,123)	2,522
MANAGEMENT OF LIQUID RESOURCES		
Movement in short term deposits	1,927	(1,593)
FINANCING		
Issue of shares	26	8
Purchase of shares	-	(110)
Capital element of finance leases	(322)	(632)
Increase in debt	11,289	2,365
NET CASH OUTFLOW FROM FINANCING	10,993	1,631
INCREASE IN CASH	797	2,560
RECONCILIATION OF NET CASHFLOW TO MOVEMENT IN NET DEBT		
Increase increase in cash	797	2,560
(Increase) in debt and lease financing	(10 967)	(1 733)
Management of liquid resources	(1,927)	1 593
	(12,097)	2 420
New finance leases	-	(1 631)
Translation differences	1,254	1 607
MOVEMENT IN DEBT FOR YEAR	(10,843)	2 396
Net debt at beginning of year	(17,387)	(19 783)
Net debt at end of year	(28,230)	(17 387)

See note 21 for an analysis of certain of the items included above

Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements

BASIS OF PREPARATION

The significant accounting policies that have been adopted in the financial statements, which are presented under the historical cost basis of accounting and the going concern assumption, as modified by the revaluation of freehold property, are as set out below and comply with applicable accounting standards The Company is an "oversea company" within the meaning of the Companies Act 1985 The Directors have elected to adopt UK Generally Accepted Accounting Principles and to prepare the financial statements in accordance with applicable United Kingdom accounting standards The Directors have also elected to prepare the accounts in accordance with the requirements of the Companies Act 1985, as if the full requirements of that Act were to apply

BASIS OF CONSOLIDATION

The consolidated financial statements represent a consolidation of the audited accounts of The Quarto Group, Inc and each of its subsidiaries, all of which have a December 31 year end

The results of subsidiaries acquired during the year are included from the date on which control passes On the acquisition of a business, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets Where the fair value of the purchase consideration exceeds the fair value attributable to the Group's share of such net assets, the difference is treated as purchased goodwill and for accounting periods up to December 31, 1997 this was written off directly to reserves in the year of acquisition Goodwill on acquisitions subsequent to December 31, 1997 is capitalised as an intangible fixed asset and written off over its useful economic life, being 20 years for acquisitions of businesses and 10 years for acquisitions of backlists Reorganisation and integration costs resulting from the acquisition are charged to the profit and loss account, as they are incurred The profit or loss on the disposal of a previously acquired business is calculated taking account of the attributable amount of purchased goodwill relating to that business

In accordance with the exemptions allowed by Section 230 of the Companies Act 1985, the Company has not presented its own profit and loss account

TANGIBLE FIXED ASSETS

As permitted by the transitional arrangements of FRS15, the Group has chosen to hold the cost of freehold properties at previous valuations, with effect from January 2000 Other fixed assets are held at cost less accumulated depreciation Provision for any impairment in the value of tangible fixed assets is made in the profit and loss account

DEPRECIATION

Depreciation is calculated to write off the cost less estimated residual value of fixed assets by annual instalments over their estimated economic lives at the following annual rates

Freehold buildings / Long leasehold	2% straight line
Short leaseholds	over the period of the lease
Plant, equipment and motor vehicles	10–25% straight line
Fixtures and fittings	15–20% straight line

No depreciation is provided on freehold land

Accounting Policies

FOREIGN CURRENCY

Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the respective balance sheet dates Profit and loss accounts in foreign currencies are translated at average rates for the respective accounting periods Exchange differences arising on the translation of the net assets and profit and loss accounts of non-UK companies together with exchange differences on related borrowings are accounted for through reserves All other exchange differences are recorded in the profit and loss account

TURNOVER

Turnover represents the invoiced value of goods and services supplied to third parties, excluding Value Added Tax

STOCKS AND WORK IN PROGRESS

Stocks and work in progress are valued at the lower of cost, including an appropriate portion of overheads, and net realisable value Production costs (excluding unit print costs), including an appropriate proportion of overheads in respect of a book are charged to the profit and loss account on the first printing of a book

DEFERRED TAXATION

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19

Deferred tax assets are only recognised to the extent that is considered more likely than not they will be recovered against future taxable profits

COPYRIGHTS

Predominately the Group owns the copyright in its titles No value is attributed to these rights

LEASE AND HIRE PURCHASE CONTRACTS

Where assets are acquired under finance leases (including hire purchase contracts), which confer rights and obligations similar to those attached to owned assets, the amount representing the outright purchase price of such assets is included in tangible fixed assets Depreciation is provided in accordance with the accounting policy above The capital element of future finance lease payments is included in creditors and the interest element is charged to the profit and loss account over the period of the lease in proportion to the capital element outstanding Expenditure on operating leases is charged to the profit and loss account on a straight line basis

PENSIONS

Substantially all of the Group's pension costs relate to individual pension plans and are charged to the profit and loss account as they fall due The Quarto Publishing plc pension scheme is a personal defined contribution pension scheme

FINANCIAL INSTRUMENTS

Page 54 of the financial statements provides an explanation of the role that financial instruments have had during the period in creating or changing the risks the Group faces in its activities The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts and the strategies for achieving those objectives that have been followed during the period

As permitted by FRS 13, short-term debtors and creditors have been excluded from the disclosures, other than currency disclosures

Notes to the Financial Statements

	GROUP 2004 £000	GROUP 2003 £000
1 SEGMENTAL ANALYSIS		
GEOGRAPHICAL ANALYSIS OF TURNOVER BY DESTINATION		
United Kingdom	15,889	14,983
United States of America	43,072	41 624
Canada	2,141	1,955
Europe	9,211	8,270
Australasia and the Far East	8,375	6,721
Rest of the World	1,147	1,070
	79,835	74,623

CLASS OF BUSINESS

The directors regard the Group's business as a single segment

ANALYSIS BY GEOGRAPHICAL AREA OF ORIGIN

	TURNOVER		PROFIT BEFORE TAX		NET OPERATING ASSETS	
	2004 £000	2003 £000	2004 £000	2003 £000	2004 £000	2003 £000
United Kingdom	29 551	28,939	783	1,749	13,979	10,165
United States of America	32,246	29,681	4,355	3,284	21,612	11,284
Rest of the World	18 038	16,003	2,056	1,327	6,231	6,238
	79 835	74 623	7 194	6,360	41,822	27,687
Exceptional item			-	(595)		
Net interest payable			(1,169)	(892)		
			6 025	4,873		

The Group interest expense is arranged centrally and is not attributed to geographical areas

Notes to the Financial Statements

	GROUP 2004 £000	GROUP 2003 £000
1 SEGMENTAL ANALYSIS (CONTINUED)		
The net operating assets can be reconciled to the consolidated balance sheet as follows		
Net operating assets	41,822	27,687
Total bank loans and other borrowings	(40,808)	(29,877)
Cash at bank and in hand	12,578	12,490
Corporation tax and deferred tax	(1 796)	(1,629)
Dividends payable	(629)	(583)
Net assets	11 167	8,088
2 PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION IS STATED AFTER CHARGING		
Depreciation	1 073	956
Goodwill amortisation	410	206
Auditors' remuneration audit	197	191
other fees paid to auditors and their associates	14	11
Operating lease rentals in respect of		
plant and machinery	115	142
other assets	1,059	1,144
Exceptional item Comprises US and UK legal and professional charges in 2003 associated with the JOHCM tender offer and the Group's response	-	595

Operating profit is stated after charging the following amounts with respect to acquisitions cost of sales £3,912,000, distribution expenses £403,000 and administration expenses £1,674 000

Included under auditors' remuneration are audit fees in respect of the Company, amounting to £40,000 [2003 £40,000] The fees have been dealt with through the financial statements of Quarto Publishing plc

A loss of £1,549,000 [2003 Loss £1,458,000] has been dealt with in the accounts of the Company

Notes to the Financial Statements

	GROUP	
	2004 £000	2003 £000
2 PROFIT ON ORDINARY ACTIVITIES (CONTINUED)		
EMPLOYEES		
STAFF COSTS INCLUDING DIRECTORS EMOLUMENTS COMPRISE		
Wages and salaries	12,417	11,528
Social security costs	1,069	974
Pension costs	423	351
	13,909	12,853
Substantially all of the Group's pension costs consist of contributions to personal pension plans		
	2004 Number	2003 Number
THE AVERAGE MONTHLY NUMBER OF PERSONS EMPLOYED BY THE GROUP DURING THE YEAR WAS	480	427

DIRECTORS' REMUNERATION

Details of Directors' remuneration are given in the directors' remuneration report on page 34

Notes to the Financial Statements

	GROUP 2004 £000	GROUP 2003 £000
3 NET INTEREST PAYABLE AND SIMILAR CHARGES		
Interest payable		
On bank loans and overdrafts repayable within 5 years by instalments	1,126	952
On bank loans repayable after more than 5 years by instalments	61	10
Hire purchase	47	39
	1,234	1,001
Interest receivable	(65)	(109)
	1,169	892
4 TAXATION		
United Kingdom corporation tax at 30% Current	-	62
Adjustment to prior periods	(5)	29
Overseas tax	1,532	950
Total current tax	1,527	1,041
Deferred taxation – UK	93	26
– Overseas For the period	(153)	(232)
Adjustment to prior periods	(130)	(85)
	1,337	750

The current tax charge for the year is lower than the standard rate of corporation tax in the UK [30%, 2003 30%] The differences are explained below

	2004 £000	2003 £000
Profit on ordinary activities before tax	6,025	4,873
Current tax at 30%	1,808	1,462
Effects of		
Utilization of tax losses	(397)	(507)
Differing tax rates in certain territories	(63)	(250)
Tax losses not utilized	82	58
Other (including temporary and permanent timing differences)	97	278
Total current tax charge	1,527	1,041

Future tax charges may be affected by the utilization of tax losses and differing tax rates in certain territories

	2004 £000	2003 £000
5 DIVIDENDS		
Equity Ordinary Interim paid of 2 75p per share [2003 2 5p per share]	494	449
Ordinary Final proposed of 3 5p per share [2003 3 25p per share]	629	583
	1,123	1,032
Non-equity Preference	426	426
	1,549	1,458

Notes to the Financial Statements

6 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the earnings attributable to common stock holders (ie earnings less preference dividends) by the weighted average number of shares in issue during the period, excluding those held as treasury stock

For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all dilutive potential shares of common stock These represent share options granted to employees where the exercise price is less than the weighted average market price of the Company's shares during the period and preference shares which are convertible into shares of common stock and a loan note which is convertible into shares of common stock

Underlying earnings per share figures are presented These exclude the effects of exceptional items and goodwill amortisation The Board of Directors consider that this figure gives a better reflection of underlying performance

	EARNINGS £000	2004 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE	EARNINGS £000	2003 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE
Basic earnings per share	3,859	17,955,495	21.5	3,383	17,926,756	18.9
Effect of dilutive options	-	111,636	-	-	66,305	-
Dilutive loan note	23	437,347	5.3	-	-	-
Dilutive preference shares	426	2,923,514	14.6	426	2,933,965	14.6
Diluted earnings per share	4,308	21,427,992	20.1	3,809	20,927,026	18.2
Underlying earnings per share figures						
Basic earnings per share	3,859	17,955,495	21.5	3,383	17,926,756	18.9
Effect of						
Exceptional item*	-	-	-	416	-	2.3
Goodwill amortisation	410	-	2.3	206	-	1.1
Basic earnings per share before goodwill amortisation and exceptional items	4,269	17,955,495	23.8	4,005	17,926,756	22.3
Underlying basic earnings per share	4,269	17,955,495	23.8	4,005	17,926,756	22.3
Effect of						
Dilutive options	-	111,636	-	-	66,305	-
Dilutive loan note	23	437,347	5.3	-		-
Dilutive preference shares	426	2,923,514	14.6	426	2,933,965	14.6
Diluted underlying earnings per share before goodwill amortisation and exceptional items	4,718	21,427,992	22.0	4,431	20,927,026	21.2

*The exceptional item in 2003 (see note 2) is stated net of a tax credit of £179,000

Notes to the Financial Statements

	GROUP				
	FREEHOLD PROPERTY £000	LEASEHOLD PROPERTY £000	PLANT EQUIPMENT AND MOTOR VEHICLES £000	FIXTURES AND FITTINGS £000	TOTAL £000
7 FIXED ASSETS					
TANGIBLE FIXED ASSETS					
Group					
Cost or valuation					
At January 1, 2004	5 200	802	6,859	883	13,744
Exchange differences	(48)	(42)	(151)	(38)	(279)
Additions	128	253	377	262	1,020
Subsidiaries acquired	-	79	130	52	261
Disposals	-	(5)	(316)	(162)	(483)
At December 31 2004	5,280	1,087	6 899	997	14,263
Depreciation					
At January 1, 2004	167	449	3,757	462	4 835
Exchange differences	(5)	(15)	(133)	(28)	(181)
Charge for the year	67	85	690	231	1 073
Disposals	-	(5)	(280)	(161)	(446)
At December 31, 2004	229	514	4 034	504	5,281
Net book value					
At December 31, 2004	5,051	573	2,865	493	8,982
At December 31, 2003	5 033	353	3,102	421	8,909

The net book value of plant, equipment and motor vehicles included £1,485,000 [2003 £1,786,000] in respect of assets held under hire purchase contracts The depreciation charged on these assets during the year was £241,000 [2003 £163,000] Included in leasehold property at cost is £294,000 [2003 £322,000] in respect of a long leasehold property, the net book value was £213,000 [2003 £241,000]

The total cost of freehold property comprises £3,064,000 in respect of buildings and £2 216,000 in respect of land A freehold property, with a net book value of £2,117,000, is secured against a mortgage

As stated in the accounting policy note on page 41, the Directors have chosen to hold the cost of freehold properties at previous valuations with effect from January 2000 The cost of freehold property held at previous valuations comprises buildings £1,593,000 and land £1,321,000 The principal freehold property in the UK with a historical cost of £382,000, was revalued on the basis of an open market value for existing use at December 31, 1989 by Conway Kersh, independent Professional Valuers The valuation was £1 7 million but the Directors ascribed a value of £1 4 million, on the grounds of prudence The valuation was in accordance with RICS Statements of Asset Valuation Practice and Guidance Notes

Notes to the Financial Statements

7 FIXED ASSETS (CONTINUED)
INTANGIBLE FIXED ASSETS
GOODWILL

	GROUP		
	COST £000	AMORTISATION £000	NET BOOK VALUE £000
At January 1, 2004	3,862	(525)	3,337
Additions	10,078	-	10,078
Amortisation for the year	-	(410)	(410)
At December 31, 2004	13,940	(935)	13,005

Additions to goodwill in the year arose from the acquisition of the major part of the business of Creative Publishing international (CPi) (on August 4, 2004), and majority shareholdings in Aurum Press Limited (on July 28, 2004) and Lifetime Distributors The Book People' Pty Limited (on November 12, 2004) It represents the difference between the cost of the acquisition and the fair value of the net tangible assets acquired, as set out in the tables below This has been determined on a provisional basis

CPi

	BOOK VALUE £000	ACCOUNTING POLICY ADJUSTMENTS £000	FAIR VALUE ADJUSTMENTS £000	FAIR VALUE £000
Fixed assets	208	-	(40)	168
Stocks and work in progress	7,456	(4,266)	(1,142)	2,048
Debtors	2,470	(589)	(256)	1,625
Creditors falling due in less than one year	(1,113)	-	(312)	(1,425)
Bank overdraft	(5,027)			(5,027)
Deferred taxation	-		4	4
	3,994	(4,855)	(1,746)	(2,607)
Cost of investment				
Cash consideration				3,821
Loan note				1,803
Acquisition costs				349
				5,973
Goodwill				8,580

It is not possible to state the profit after tax figures for this business prior to acquisition because we acquired only a part of the whole business carried on by CPi and it was not possible to separately identify the profits of the part of the business that we acquired

Notes to the Financial Statements

7 FIXED ASSETS (CONTINUED)
INTANGIBLE FIXED ASSETS
GOODWILL
AURUM AND LIFETIME

	BOOK VALUE £000	FAIR VALUE ADJUSTMENTS £000	FAIR VALUE £000
Fixed assets	101	(8)	93
Stocks and work in progress	1,941	(322)	1,619
Debtors	2,801	(154)	2,647
Cash	304		304
Creditors falling due in less than one year	(2,977)	(61)	(3,038)
Short term debt falling due in less than one year	(940)		(940)
Deferred taxation	-	5	5
Minority interests	(264)	102	(162)
	966	(438)	528

Cost of investment	
Cash consideration	1,839
Acquisition costs	187
	2,026
Goodwill	1,498

Aurum and Lifetime, combined, made a profit after tax of £219,000 for the year ended December 31, 2003 and a profit after tax of £258,000 in the period from January 1, 2004 to the dates of acquisition.

The cash outflow in respect of the purchase of business / subsidiaries consists of the following:

			£000
CPI	Cost of investment		5,973
	Cash equivalents acquired		5,027
Aurum and Lifetime combined		Cost of investment	2,026
		Cash equivalents acquired	636
Deferred consideration in respect of prior period acquisitions			38
			13,700

Notes to the Financial Statements

COMPANY

INVESTMENTS IN GROUP UNDERTAKINGS

	SHARES AT COST £000	LOANS £000	TOTAL £000
8 FIXED ASSET INVESTMENTS			
At January 1, 2004	11,653	641	12,294
Loans repaid	(836)	(641)	(1,477)
At December 31, 2004	10,817	-	10,817

The Company has the following principal trading subsidiaries (*Directly held by The Quarto Group, Inc), all of which operate in their country of incorporation

NAME	PLACE AND DATE OF INCORPORATION	ISSUED AND FULLY PAID SHARE CAPITAL	PERCENTAGE HELD	BUSINESS
Quarto Publishing plc	England 1 April, 1976	100,000 shares of £1 each	100*	Co-edition Publishing
Quarto Inc	Delaware, USA 16 October, 1986	60 shares of no par value	100*	Co-edition Publishing
Western Screen and Sign Limited	England 24 November, 1961	1,500 shares of £1 each	100*	Publishing
Quarto Magazines Limited	England 20 May, 1986	1,000 shares of £1 each	100	Publishing
Regent Publishing Services Limited	Hong Kong 23 October, 1985	1,000 shares of HK$10 each	75	Co-edition Publishing
Apple Press Limited	England 5 June, 1984	100 shares of £1 each	100	Publishing
Quarto Australia Pty Ltd	Australia 14 September, 1981	8 redeemable preference shares of A$1 each and 103 ordinary shares of A$1 each	100*	Publishing
AP Screenprinters Limited	England 30 September, 1980	1,000 shares of £1 each	100	Publishing
RotoVision S A	Switzerland 18 July, 1977	1,500 shares of SFr500 each	100*	Co-edition Publishing
Rockport Publishers Inc	Massachusetts, USA 4 December, 1985	4,000 shares of no par value	100	Co-edition Publishing
Book Sales Inc	Delaware, USA 13 December, 1972	85 shares of no par value	85	Publishing
Scafa-Tornabene Art Publishing Co Inc	Delaware, USA 29 June, 1987	1,210 shares of no par value	100	Publishing
Walter Foster Publishing, Inc	Delaware, USA 10 February, 1988	19,625 shares of US$0 01 each	100	Publishing
Global Book Publishing Pty Limited	Australia 4 November, 1999	1,000 shares of A$1 each	100*	Co-edition Publishing
Creative Publishing international, Inc	Delaware, USA 28 June, 2004	100 shares of US$0 01 each	100	Publishing
Aurum Press Limited	England 31 May, 1977	382,502 shares of £1 each	80	Publishing
Lifetime Distributors 'The Book People' Pty Limited	Australia 3 December, 1990	100,004 shares of A$1 each	75	Publishing

Notes to the Financial Statements

	GROUP		COMPANY	
	2004 £000	2003 £000	2004 £000	2003 £000
9 STOCKS AND WORK IN PROGRESS				
Finished goods	14,222	11,949	-	-
Work in progress	6,444	5,376	-	-
Raw materials	351	429	-	-
Less Payments on account	(290)	(303)	-	
	20 727	17,451		-
10 DEBTORS				
Trade debtors	21 497	18 532	-	-
Prepayments and accrued income	1,844	1 733	-	-
Other debtors	725	402	-	-
	24,066	20 667	-	-
11 CASH AND DEPOSITS				
Cash at bank	9,730	7,463	-	
Short term deposits	2,848	5,027	-	
	12,578	12,490	-	-
12 CREDITORS AMOUNTS FALLING DUE WITHIN ONE YEAR				
Bank overdrafts	1,967	35	-	-
Current loan instalments	134	144	-	-
Hire purchase creditors	299	349	-	
Total borrowings	2,400	528	-	
Trade creditors	20,776	19 019	-	
Other creditors including taxation and social security				
Corporation tax	1,150	754	-	-
Dividend payable	629	583	629	583
Social security	529	457	-	-
Other creditors	1,923	1,626	-	-
Accruals and deferred income	1,520	1 336	-	-
	28,927	24,303	629	583

Notes to the Financial Statements

	GROUP		COMPANY	
	2004	2003	2004	2003
	£000	£000	£000	£000
13 CREDITORS AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Bank loans	36,035	28,423		-
Hire purchase liabilities	654	926	-	-
Loan note	1,719	-	-	-
Total borrowings	38,408	29,349		-
Other creditors	210	239	-	-
	38,618	29,588	-	-
Total borrowings are repayable as follows				
Bank loans and overdrafts				
In one year or less, or on demand	2,101	179	-	-
Between one and two years	134	128	-	-
Between two and five years	35,364	27,658	-	-
Over five years	537	637	-	-
	38,136	28 602	-	-
Other borrowings (hire purchase liabilities and loan note)				
In one year or less, or on demand	299	349	-	-
Between one and two years	1,152	291	-	-
Between two and five years	1,221	635	-	-
	2,672	1,275	-	-
Total loans and other borrowings				
In one year or less, or on demand	2,400	528	-	-
Between one and two years	1,286	419	-	-
Between two and five years	36 585	28 293	-	-
Over five years	537	637	-	-
	40,808	29,877	-	-

The above borrowings carry interest at commercial rates ranging from 1 3% to 6 1% Of the total borrowings £30,075,000 (2003 £22,342 000) was denominated in US dollars, the remainder being denominated in a variety of currencies Bank loans include £1 208,000 (2003 £1,275,000) which is secured on a freehold property All other bank loans are unsecured The loan note is US$3,300,000 and it is convertible into 1,074,288 shares of common stock

The Group has a US$60m (2003 US$45m) syndicated bank facility which expires on July 15 2007 and a £4m facility which expires on June 10, 2007 These facilities are subject to three principal covenants, namely

(a) Total consolidated net indebtedness shall not exceed 3 33 times the consolidated operating profit before depreciation, goodwill amortization, exceptional items and development costs (production costs excluding printing) charged to the profit and loss but not paid in cash in the year This measure amounted to £15,194 000 giving a maximum indebtedness of £50,596,000
(b) The consolidated operating profit before exceptional items and goodwill amortization shall exceed three times net interest payable For the year ended December 31, 2004, net interest payable was 6 5 times covered under this covenant
(c) The consolidated operating profit before goodwill amortization shall exceed 1 5 times net interest payable For the year ended December 31, 2004, net interest payable was 6 5 times covered under this covenant

Exchange, interest and liquidity risk are discussed in the Chief Financial Officer's Report on pages 26 to 27

Notes to the Financial Statements

14 DERIVATIVE FINANCIAL INSTRUMENTS

FINANCING AND INTEREST RATE RISK

Group interest rate management policy aims to provide certainty in a proportion of it's financing, all Group loans are at floating interest rates During the year the board renewed this position and took out an interest rate swap to convert US$30,000 000 to a fixed interest rate

The majority of the Group's loan borrowings are denominated in US Dollars

DERIVATIVE FINANCIAL INSTRUMENTS

During the year the Group took out an interest rate swap to cover US$30,000,000 floating interest rate exposures The Group s policy is not to trade in derivatives but to use these instruments to hedge anticipated exposures

FINANCIAL INSTRUMENTS

The objectives, policies and strategies applied by the Group with respect to financial instruments are determined at a group level The principal financial instruments used by the Group to finance its operations are cash and loans The significant financial risks faced by the Group and the policies that it applies are considered below No transactions of a speculative nature are undertaken Over the past year the group has used an interest rate swap to hedge its exposure to interest rate fluctuations The Group has not used any financial instruments to hedge its exposure to foreign currency fluctuations, although natural hedges limit the exposures to these risks For the purposes of this note, other than currency disclosures, the only debtors and creditors included are bank and shareholder loans, in accordance with Financial Reporting Standard 13, Derivatives and Other Financial Instruments

FOREIGN CURRENCY RISK

The Group has an international business Its reporting currency is pounds sterling However a significant proportion of trading income and expenses is denominated in US dollars The Group also operates to a lesser extent, in a number of other currencies Within these US dollar transactions there is a matching, to some extent, of the cash inflows and outflows The majority of the Group's trading revenue is derived in US dollars, although a significant amount of revenue is also derived in other currencies Significant costs including interest costs on external borrowings, are also linked to the US dollar and movements in the value of the US dollar against pounds sterling impact these costs to the Group a strong pound sterling against the US dollar reduces these costs to the Group

The US dollar/pounds sterling exchange rates at the respective year end were as follows

	Year end exchange rate (US$ £)
December 31 2004	1 92
December 31 2003	1 79

The table below summarises the Group's exposures that give rise to the net currency gains and losses recognised in the profit and loss account Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operation to which they relate

	US DOLLARS £000	OTHER £000	TOTAL £000
Total assets	2,261	1 286	3,547
Total liabilities	(4,452)	(3,219)	(7,671)
Net liabilities as at December 31, 2004	(2,191)	(1,933)	(4,124)
Total assets	2,515	965	3,480
Total liabilities	(5,380)	(2 275)	(7,655)
Net liabilities as at December 31 2003	(2 865)	(1 310)	(4 175)

Notes to the Financial Statements

14 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

INTEREST RATE RISK

The Group's historical borrowings are analysed below between fixed rate and variable rate loans

	TOTAL £000	FIXED RATE BORROWINGS £000	VARIABLE RATE BORROWINGS £000	WEIGHTED AVERAGE INTEREST RATE FOR FIXED RATE BORROWINGS %	AVERAGE TIME OVER WHICH INTEREST RATE IS FIXED Months
US dollar borrowings	30,075	17,344	12,731	4 4%	32
Other currency borrowings	10,733	953	9,780	6 6%	35
As at December 31, 2004	40,808	18,297	22,511	4 5%	32
US dollar borrowing	22,342	-	22,342	-	
Other currency borrowings	7,535	1,275	6,260	6 9%	34
As at 31 December 31, 2003	29,877	1,275	28,602	6 9%	34

The variable rate borrowings bear interest by reference to LIBOR plus a margin

FUNDING RISK

At December 31, 2004, undrawn borrowing facilities totalled £3,322,000 (2003 £6,829,000)

As described above, in the current year the Group used interest rate swaps to hedge its future exposure to interest rate fluctuations Changes in the fair value of these instruments are not recognised in the financial statements until the hedged positions mature

The variable rate interest terms on the bank loans are agreed on an arms length basis and, therefore, the fair value of those loans approximate to their book values The fair value of the bank loans that are subject to fixed rate interest terms is not considered to be materially different from their book value on the basis that the period over which the interest terms are fixed is relatively short and that the fixed interest terms are agreed on an arms length basis

The fair value of cash approximates to its book value due to its immediate availability

In respect of the interest rate swap, at December 31, 2004 this had a book value of £nil and a fair value of £47,000 This gain is expected to crystallise after more than one year Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised

Notes to the Financial Statements

	GROUP	
	AMOUNT PROVIDED	
	2004 £000	2003 £000
15 DEFERRED TAXATION		
Deferred taxation provided in the financial statements is as follows		
Excess of capital allowances over depreciation - UK	227	220
Other timing differences - UK	(72)	(158)
	155	62
Other timing differences - overseas - US	475	803
- other	16	10
	646	875

The Directors estimate that £305,000 would be payable in respect of previous revaluations of freehold property if the property was sold at the revalued amount

The movement on the provision for deferred taxation is as follows

	2004 £000	2003 £000
Provision at January 1, 2004	875	1,235
Exchange difference	(30)	(69)
Acquisitions	(9)	-
Credit to profit and loss account	(190)	(291)
Provision at December 31 2004	646	875

16 SHARE CAPITAL

Authorised

28 000,000 [2003 28,000,000] shares of common stock of par value US$0 10 each ("shares of common stock") with an aggregate nominal value of US$2,800,000 [2003 US$2,800,000]

5,212,587 [2003 5,212,587] 8 75p (net) convertible cumulative redeemable shares of preferred stock of US$0 10 each ("shares of preferred stock") with an aggregate nominal value of US$521,258 [2003 US$521,258]

	2004 £000	2003 £000
Equity share capital		
Allotted, called up and fully paid		
18,676 206 shares of common stock of par value US$0 10 each [2003 18,676,206]	1,063	1,063
Non-equity share capital		
Allotted, called up and fully paid		
5,202 524 shares of preferred stock of US$0 10 each [2003 5,202,524]	278	278
	1,341	1 341

Notes to the Financial Statements

At December 31, 2004, the following options over shares of common stock were outstanding under the Company's Executive Share Option Schemes

NUMBER OF SHARES	DATE EXERCISABLE	OPTION PRICE PER SHARE
15,000	March 31, 2001 – March 30, 2008	£0 685
10,000	March 31, 2001 – March 30, 2005	£0 685
23 000	February 22, 2003 – February 21, 2007	£1 115
30,000	February 22, 2003 – February 21, 2010	£1 115
22,500	March 29, 2004 – March 28, 2011	£0 825
11,000	February 15, 2005 – February 14, 2009	£0 67
17,000	February 15, 2005 – February 14, 2012	£0 67
11,100	February 26, 2005 – February 25, 2009	£0 775
3,900	February 26, 2005 – February 25, 2012	£0 775
33,000	February 14, 2006 – February 13, 2010	£0 83
53,000	February 14, 2006 – February 13, 2013	£0 83
42,686	September 30, 2007 – September 29, 2011	£1 63
37,814	September 30, 2007 – September 29 2014	£1 63

The movement in outstanding options from December 31, 2003 comprises (a) new options granted on September 30 2004, as identified above (b) 4,000 shares exercisable between February 14, 2006 and February 13, 2013 lapsed and (c) 1,000 shares exercisable between March 31, 2001 and March 30, 2008, 5,000 shares exercisable between March 31, 2001 and March 30, 2005, 5000 shares exercisable between February 22, 2003 and February 21, 2007 and 15,000 shares exercisable between February 22, 2003 and February 21, 2010 were exercised

The shares of preferred stock are convertible into shares of common stock on June 1, 1990 and annually thereafter at a rate of 60 shares of common stock for every 100 shares of preferred stock The Company may at any time purchase shares of preferred stock in accordance with the rights attaching to such shares The Company is obliged to redeem all outstanding shares of preferred stock in 2005 at a price of £1 The holders of the preferred stock are not entitled to vote at any meeting of shareholders unless their dividend payment is more than six months overdue or the meeting is being held to consider a resolution for liquidation, dissolution, winding up or the appointment of a receiver On liquidation dissolution or other winding up the holders of the preferred stock are entitled to be paid out of the available assets of the Company the sum of £1 per share and the amount of all accrued dividends payable in priority to any payment being made to the holders of common stock There are no special rights to dividends in respect of holders of common stock

	GROUP 2004 £000	GROUP 2003 £000	COMPANY 2004 £000	COMPANY 2003 £000
17 TREASURY STOCK				
At January 1, 2004	802	698	802	698
Issued in satisfaction of options exercised during the year	(16)	(6)	(16)	(6)
Purchase during the year	-	110	-	110
At December 31, 2004	786	802	786	802

The Company purchased 750,000 (for £461,000) of its own shares of common stock during 1998 and 180,000, 50,000 and 100,000 of its own shares of preferred stock during 2001, 2002 and 2003 respectively As a US company, it is permitted to hold these shares as treasury stock, without cancelling them and to reissue them On March 9, 2004 the Company issued 15,000 shares of common stock in satisfaction of the exercise of 15 000 options at 111 5p per share, on March 11 2004 the Company issued 1,000 shares of common stock in satisfaction of the exercise of 1,000 options at 68 5p per share and on May 14, 2004 the company issued 10 000 shares of common stock in satisfaction of the exercise of 5,000 options at 68 5p per share and 5,000 options at 111 5p per share

Notes to the Financial Statements

	GROUP		
	PAID IN SURPLUS	REVALUATION RESERVE	PROFIT AND LOSS ACCOUNT
	£000	£000	£000
18 RESERVES			
At beginning of the year	23,893	978	(19,758)
On shares issued during the year	10	-	-
Retained profit for the year	-	-	2,736
Difference on translation of net assets and profit and loss accounts of non-UK companies	-	-	33
Transfers	-	(10)	10
At the end of year	23,903	968	(16,979)
Analysed as follows			
Profit and loss account			7,735
Goodwill previously written off to reserves			(24,714)
			(16 979)

	COMPANY	
	PAID IN SURPLUS	PROFIT AND LOSS ACCOUNT
	£000	£000
At beginning of year	23,893	(12,721)
On shares issued during the year	10	-
Loss for the year	-	(1 549)
At the end of year	23 903	(14,270)

	GROUP			
	LAND AND BUILDINGS	OTHER	LAND AND BUILDINGS	OTHER
	2004	2004	2003	2003
	£000	£000	£000	£000
19 FINANCIAL COMMITMENTS				
At December 31, 2004, the Group had annual commitments to make payments under operating leases during the next year as follows for leases expiring				
Within one year	161	108	447	14
Between two and five years	710	31	600	119
Over five years	210	-	-	
	1,081	139	1,047	133

The land and buildings leases are subject to rent reviews

Capital commitments at the end of the year for which no provision had been made amounted to nil (2003 £28,000)

Notes to the Financial Statements

20 CONTINGENT COMMITMENTS AND LIABILITIES

The Group has an agreement to purchase the common stock from the minority shareholder in Book Sales Inc, at his option, at the end of a five year period, which was October 1996 The purchase price shall be based on the shareholders investment in Book Sales Inc, adjusted for subsequent earnings At December 31, 2004, there was a potential liability, based on Book Sales Inc s financial statements, of approximately US$2,213,000 No provision has been made because the minority shareholder has not exercised his option At December 31, 2004 the minority interest relating to Book Sales Inc in the consolidated financial statements of The Quarto Group, Inc was US$1 776 000

The Quarto Group, Inc has issued guarantees in respect of £1,967,000 of overdrafts of subsidiaries [2003 £35,000] and bank loans of £36,169,000 [2003 £28,551,000] The Group has also issued guarantees in respect of £953 000 of hire purchase creditors and a loan note of subsidiaries [2003 £1,275,000] There are other contingent liabilities, arising in the ordinary course of business, in respect of litigation, which the Directors believe will not have a significant effect on the financial position of the Group

21 NOTES ON THE CONSOLIDATED CASH FLOW STATEMENT

	GROUP 2004 £000	GROUP 2003 £000
RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOWS FROM OPERATING ACTIVITIES		
Operating profit	7,194	5,765
Depreciation and amortisation charge	1 483	1,162
(Profit) Loss on sale of fixed assets	(1)	8
(Increase) Decrease in stocks and work in progress	(675)	(148)
Increase in creditors	(1,713)	1 214
(Increase) Decrease in debtors	215	(36)
Net cash inflow from operating activities	6,503	7,965

	OPENING BALANCE £000	CASH FLOW £000	EXCHANGE DIFFERENCE £000	CLOSING BALANCE £000
ANALYSIS OF NET DEBT				
Cash at bank and in hand	7,463	2 729	(462)	9 730
Bank overdrafts < 1 year	(35)	(1,932)	-	(1,967)
	7,428	797	(462)	7 763
HP creditors	(1,275)	322	-	(953)
Current loan instalments < 1 year	(14)	10	-	(134)
Bank loans > 1 year	(27,276)	(11,372)	1,968	(36,680)
Mortgages	(1 147)	73	-	(1,074)
	(29,842)	(10,967)	1,968	(38,841)
Liquid resources	5,027	(1 927)	(252)	2,848
Net Debt	(17,387)	(12,097)	1,254	(28,230)

22 RELATED PARTY TRANSACTIONS

During the year R J Morley maintained a current account with the Group The debit balance on this account was less than £5 000 throughout the year The balance at the year end was £3,300 During the year L F Orbach loaned money to the Group and has earned an arm s length return of 2 5% The total amount of interest earned during the year was £4,000 (2003 £16,000) The balance outstanding at the beginning of the year, which was also the highest amount outstanding was £327,000 and the balance at the year end was £94,000

Historical cost five-year summary

	GROUP				
	2000 £000	2001 £000	2002 £000	2003 £000	2004 £000
PROFIT AND LOSS ACCOUNT					
Turnover	73,564	73,620	74,735	74,623	79 835
Operating profit	5,573	4 923	6 031	5 765	7 194
Net interest	(2,023)	(1,733)	(1,151)	(892)	(1,169)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3,550	3,190	4 880	4 873	6 025
Taxation	(314)	(300)	(497)	(750)	(1,337)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION	3,236	2,890	4,383	4,123	4,688
Minority interests	(413)	(352)	(343)	(314)	(403)
PROFIT FOR THE FINANCIAL YEAR	2,823	2,538	4,040	3,809	4,285
Dividends	(1,262)	(1,295)	(1,379)	(1,458)	(1 549)
RETAINED PROFIT	1,561	1,243	2,661	2,351	2,736
EARNINGS PER SHARE					
Underlying	16 1p	18 8p	21 1p	22 3p	23 8p
Basic	13 2p	11 7p	20 1p	18 9p	21 5p
DIVIDENDS PER SHARE	4 5p	4 73p	5 25p	5 75p	6 25p
BALANCE SHEET					
Fixed assets	7,342	7,662	9,251	12,246	21 987
Other net assets	18,721	20,026	16,425	13,229	17,410
	26,063	27,688	25,676	25,475	39,397
NET BORROWINGS	(22,998)	(23 637)	(19 783)	(17,387)	(28,230)
NET ASSETS	3,065	4,051	5,893	8,088	11,167
CASH FLOW					
Net cash inflow from operating activities	6,409	5,746	8,396	7,965	6,503
Return on investment and servicing of finance	(2,478)	(2,786)	(2 335)	(1 422)	(1 805)
Taxation	(627)	(348)	(504)	(371)	(1 062)
Capital expenditure and financial investment	(450)	(648)	(599)	(2 502)	(982)
Acquisition and disposals	(1,471)	(544)	(1,767)	(179)	(13 700)
Equity dividends paid	(877)	(807)	(875)	(969)	(1 077)
Other	(2,610)	(1,252)	1,538	(126)	1 280
Movement in (debt) funds for year	(2,104)	(639)	3,854	2 396	(10,843)
Net debt at beginning of year	(20,894)	(22,998)	(23,637)	(19,783)	(17,387)
Net debt at end of year	(22 998)	(23,637)	(19,783)	(17,387)	(28,230)