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THE QUARTO GROUP, INC.

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- BUSINESS REVIEW OF 1997
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- FINANCIAL REVIEW OF 1997

ANNUAL REPORT 1997

Dear Shareholder:

We have achieved a great deal in 1997, despite some setbacks, in what has been a difficult period for the publishing industry. We have made a number of important changes internally. We have restored the UK publishing services side of our business to health. We have overcome the loss of significant business from our major customers by substituting new business. We have improved our financing by arranging a substantial, internationally syndicated five-year credit facility. We have focussed more effort on our working capital needs and have much improved upon our anticipated year-end debt position. We have tackled overhead, with the dual purposes of reducing costs and increasing the focus on priorities. Much remains to be done to improve the poorer performing areas of our business in 1998. These are all being addressed.

After five years of steady growth, from 1992 to 1996, during which Quarto's sales doubled and operating profits rose by more than 110%, I am disappointed that I have to report an interruption in 1997. On marginally-increased sales of £81.8 million (1996: £80.6 million), operating profit was £6.2 million (1996: £9.15 million), and profit before tax was £4.2 million (1996: £7.8 million), with earnings per share of 13.2p (1996: 26.5p). There are also exceptional costs of £1.09 million to cover the discontinued activities of Atlas, Strange Matter, and Packaged Goods, and a charge of £0.22 million in respect of the goodwill written back on Atlas. The non-cash element of these exceptional costs is £0.38 million. Profit for the year, after tax, exceptional costs, and minorities, was £1.8 million (1996: £5.4 million) and the Board is recommending a final dividend of 2.3p (1996: 5.8p) for a total of 4.5p (1996: 8.0p) to be paid on May 5, 1998 to shareholders on the register on April 3, 1998.

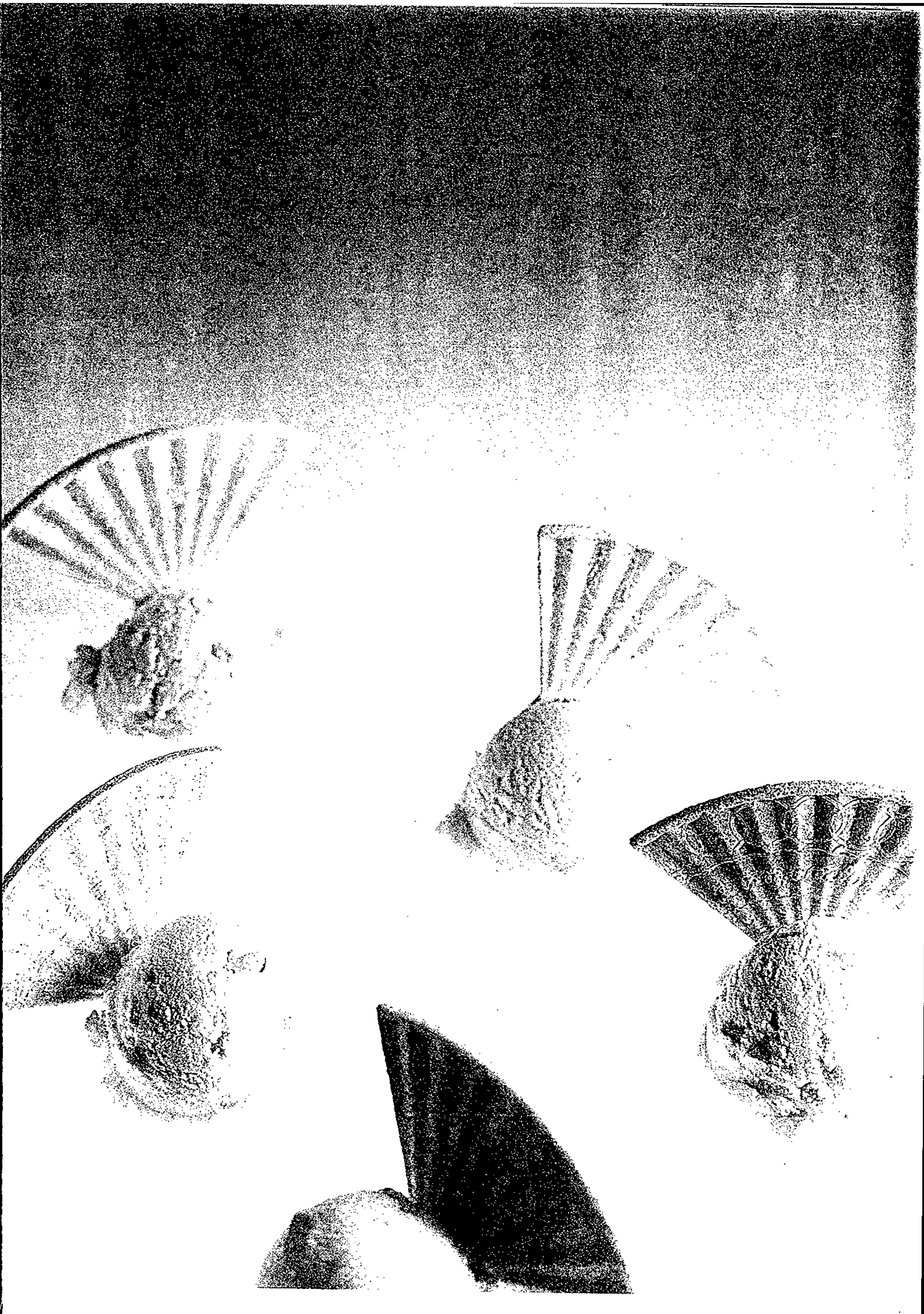
Quarto's business is world-wide and multi-currency. We were prepared for the volatility of currencies, but not for the wholesale realignments that took place during the year, first, with the dollar and sterling vis-à-vis other major currencies, and second, with the collapse of some of the east Asian economies and markets. These affected us very adversely in a number of ways: translation of overseas results into sterling; reduction in margins in the business we did in a number of our major world markets; and, inability to achieve sales expectations in some areas because of pricing problems.

In our core co-edition book publishing division, the average life of our books is well over four years. Investment decisions on new titles are based on the conservative presumption of a three-year life. Current currency problems are likely to extend that life by postponing co-editions, but we have not adjusted our accounting policy. This means that in 1997 we have been writing off our investment against lower sales than we anticipated.

In all, we fell short of our operating profit target by £4.5 million, and currency factors account for £2.5 million of this. The publishing services division performed to target, but book and magazine publishing were down by £0.7 million, and art print publishing by £1.3 million.

Debt at year end was £23.7 million, down from £26.6 million at the interim stage, and was lower than our internal projections. Interest cover was 3.2 times and, with earnings before interest, tax, depreciation, and amortisation of £12.7 million, we were well within our banking covenants.

TEMPORAL TREATISE



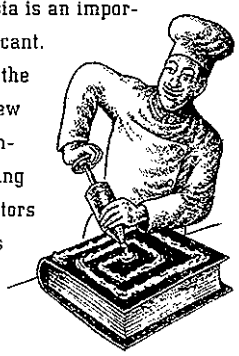
CO-EDITION BOOK PUBLISHING

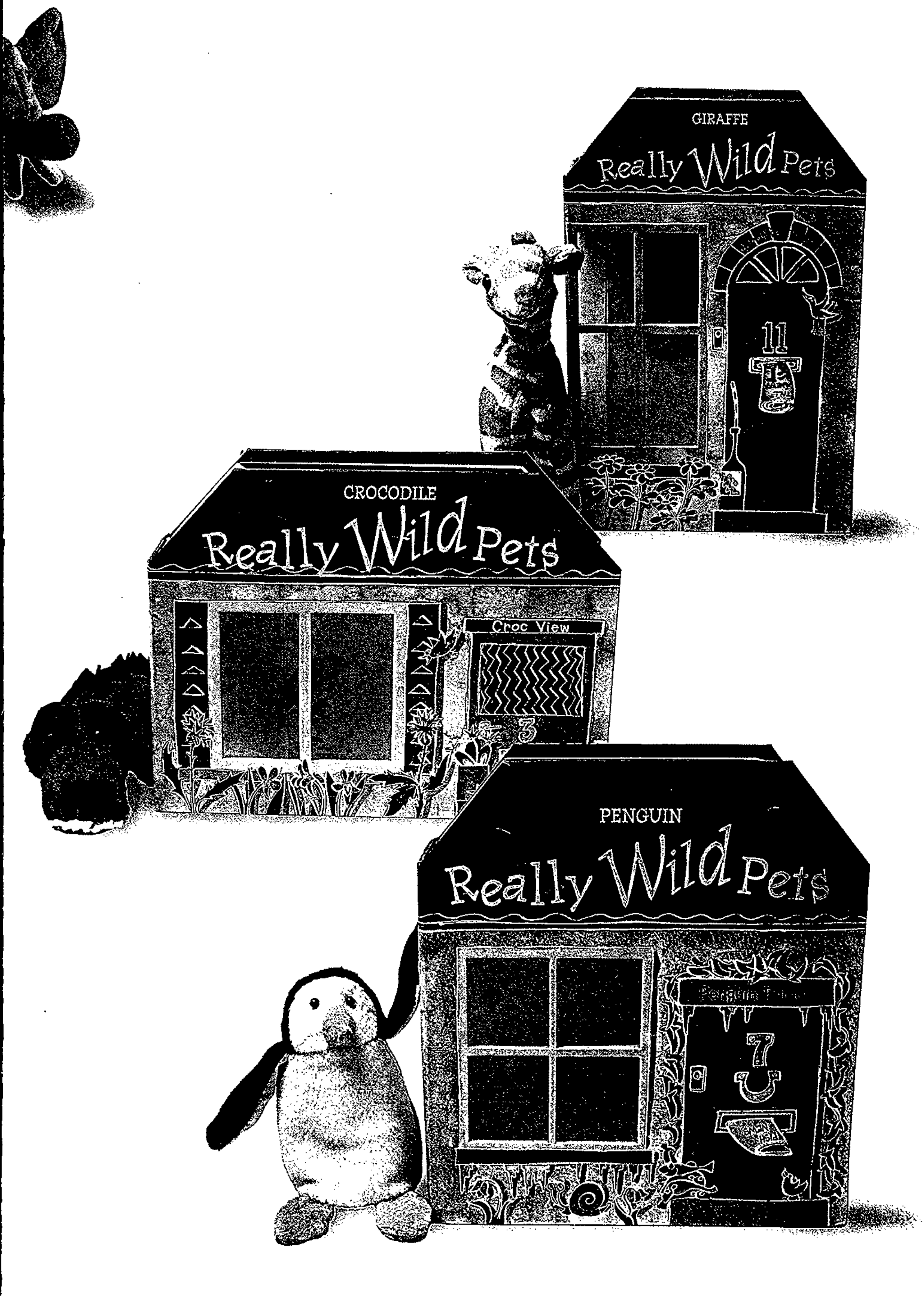
Sales were slightly down at £39.4 million, and the operating profit was £4.7 million. We have established a very demanding benchmark performance target for this division of operating profits at 15% of sales, which was achieved in 1996. This gives an excellent return on investment and is well above industry expectations. Despite an excellent performance by Rockport, good advances by RotoVision, and a great achievement by Design Eye in replacing virtually all the sales from its key customer, representing 30% of its 1996 turnover, the division was let down in 1997 by poor results at Quarto. The impact of our strong operating currencies was felt generally throughout the division, but nowhere more so than at Quarto, which has the widest spread of customers, and the deepest exposure to international markets, with more than 85% of its business in currencies other than sterling.

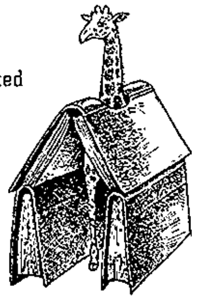
Over the past four years, since Rockport has concentrated on publishing rather than distribution, its sales and profits have increased by 140%, and major investment has been made in the publishing list, and in expanding and training the managerial, supervisory, creative, and accounting staffs. 1997 was a banner year for Rockport as sales reached $8.8 million, and operating profits leapt to $1.5 million, with particularly strong gains in its domestic US business. RotoVision expanded its own publishing program substantially, and added to its traditional high priced professional annuals, a line of more moderately priced "educational" books, finding a niche between existing instructional books and the more immediate appeal of magazines. Sales increased by over 20% and operating profits were doubled at $0.8 million. At both Rockport and RotoVision, higher reprint sales endorsed the publishing strategies. Asia is an important market, but the impact on results in 1997 was not significant.

CAPRICIOUS CUISINE
We produce a large number of cookbooks each year, from the innovative Fridge Fun magnet cookbooks to the weightier Gourmet Atlas, with much that is exotic and unusual in between.

At Design Eye, substantial sales were lost with the Penguin Putnam merger. These were replaced with sales to new customers, and the impact on the bottom line was well contained. In all, Design Eye's customer base almost doubled during the year, and sales were broadly unchanged. Currency factors and the extra cost of increased staff in the creative and sales areas to cope with the growing demand internationally for




GIRAFFE
Really Wild Pets
11
CROCODILE
Really Wild Pets
Croc View
3
PENGUIN
Really Wild Pets
7



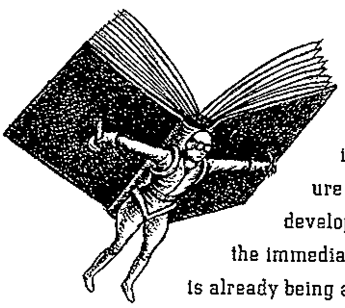
Design Eye's innovative, three-dimensional book creations, resulted in a decline in operating profits to £1.3 million. Design Eye has also altered its business strategy, in order to overcome the manufacturing problems that can accompany the initial production run of these complicated projects. Instead of building up a large number of initial orders first, projects are now put into production based upon an initial order. In this way, the manufacturing kinks can be worked out in a more considered manner. For example, the initial order for The Three Little Pigs kit was for 50,000 copies, delivered in late 1997. Based on its runaway success, Design Eye has already taken orders for a further 225,000 copies to be delivered in 1998. A series of pre-school kits, Let's Start, launched in September, is expected to pass through the million copy mark in 1998.

I have reported before on the management problems at Quarto Children's Books. These were addressed in 1997 but the recovery is taking time. The major market is the United States and, in common with many other publishers, we experienced softness among our trade publishing customers, countered by very considerable buoyancy in the direct selling and speciality markets. In addition, the manufacturing problems of co-ordinating very complex projects have not been resolved satisfactorily, and Quarto Children's Books will experiment with adopting Design Eye's new approach. Enormous changes in management, staff, and procedures took place in 1997, but they were insufficient to rectify matters by the year end. However, there was a dramatic improvement in meeting delivery dates, some of this achieved by cancelling or deferring a number of projects. New title output fell by 25%. Overall, turnover was down by 6%, and would have been considerably lower but for the strong sales of reprints, which are, of course, arguably the most important indicator of the quality and value inherent in a publishing list. Sales of Quarto Children's Books' pre-school series, Fit-A-Shape, are now approaching two million copies, in just over three years.

HUMOROUS HABITATS
Children can enjoy the houses we have built for them and adults find our monographs on architects very enlightening.

Quarto Adult also suffered in the United States, with takeovers and mergers causing a hiatus in decision making by some customers. In addition, though, Quarto Adult was the victim of its own success. Instead of reinvigorating its publishing program in new directions, too much emphasis was placed in areas traditionally strong for Quarto, and excessive specialization contributed to a fall in

sales. A new publisher was appointed in October, and her energy and enthusiasm, coupled with the guiding hand of the founding partner, Bob Morley, Group Creative Director, is beginning to have an effect. Quarto Adult's performance was severely down in 1997, with turnover off by 16% and profits down by £1.1 million. Profits were still almost 10% of sales, well above the industry norm, demonstrating its solidity, even in an "off" year. Of all the publishing lists within the co-edition division, Quarto Adult has been most adversely affected by currency changes, because it has the widest spread of sales internationally. Margins were squeezed significantly, and it was difficult to conclude certain co-edition deals, leading to a failure to meet sales expectations. But there were significant positive developments as well. The 1997 publishing program was broader than in the immediately preceding years, creating potential for more reprints, and this is already being achieved. A great deal of work went into new projects to ensure that their international appeal was not Anglocentric, readership was targeted more carefully, and solid and innovative approaches were taken. The new publisher has brought a fresh look to the oldest operating business within the Group, and has made changes that eliminated excess overhead and refined the focus of the list.



Aerial Activities
High flying publishing successes include earth bound subjects, such as snowboarding, and more ethereal titles on the stars, the sun, and the moon.

Building upon the increasing success of its Fridge Fun series, of which two million copies have now been sold in less than three years, Quintet Publishing increased sales in 1997 and operating profits rose to £0.95 million. The progress made was on all fronts. Revenue and profitability per new title increased and, by squeezing margins, Quintet was able to enlarge its considerable foreign language co-edition base. In addition, Quintet's publisher embarked on initiatives to rework old material to which Quintet holds the copyright, and to build a male-oriented list, both of which will produce results in 1998. Quintet's list has been strengthened and is now recognized as being of high quality.

Packaged Goods settled its litigation with HarperCollins and the licensor of Peanuts. The Peanuts license was not a success, and the settlement has avoided an expensive and time-consuming trial. An unfortunate chapter has been closed, but not without cost. Operating losses were $0.2 million, an adverse swing of $0.6 million. Packaged Goods has also discontinued its new publishing program, leading to a reduction in its sales of $3.75 million.

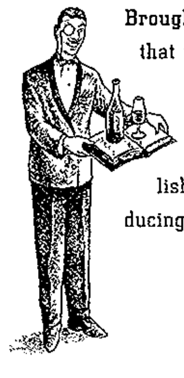
Quantum Books exists to exploit the copyrights in older titles that are not actively being marketed by the originating publishing list. In a few short years it has built up a good business with publishers and distributors around the world. Its performance in 1997 was held back by soft markets in the United States and the UK. Sales into Europe increased.

BOOK AND MAGAZINE PUBLISHING

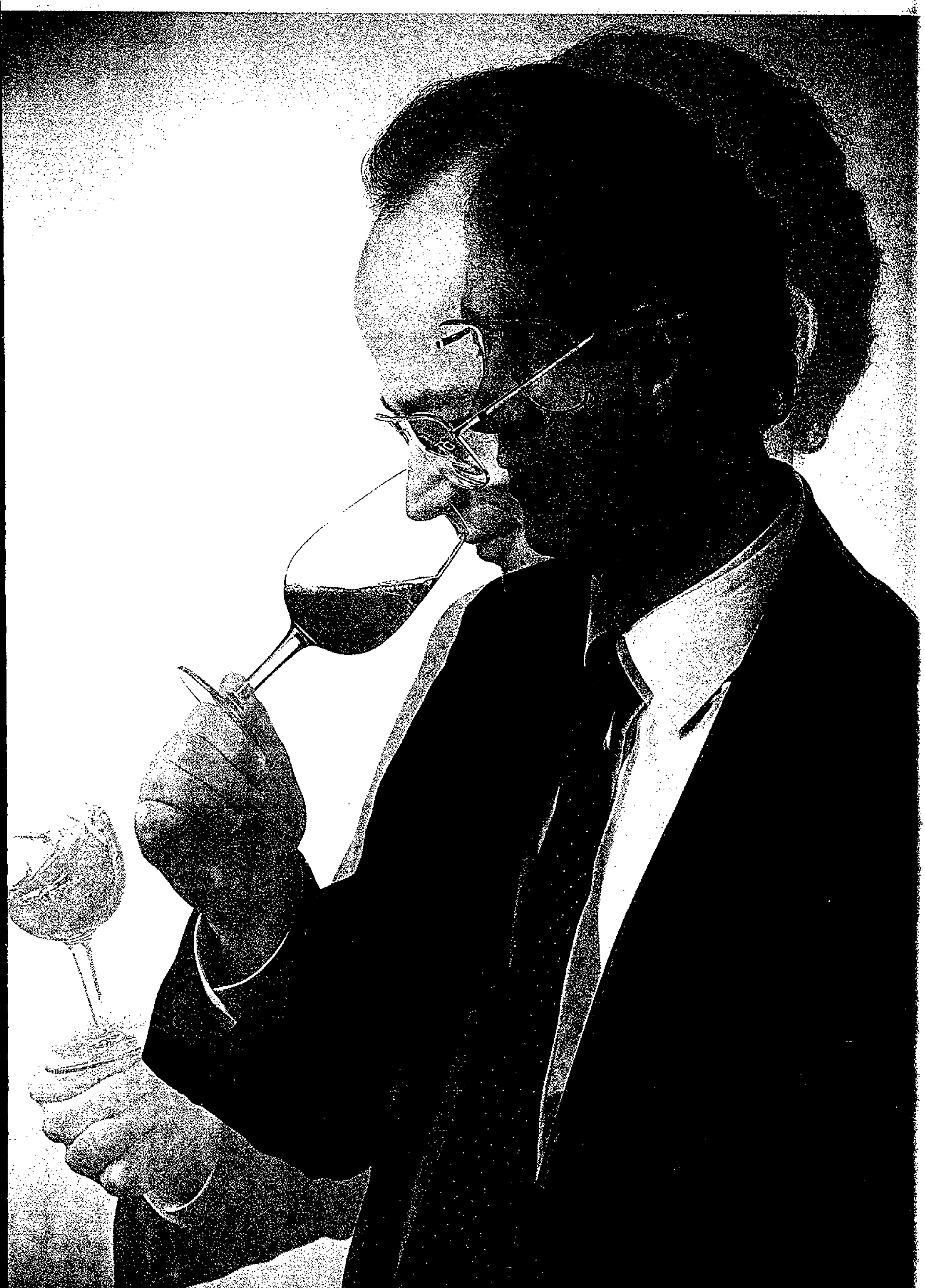
The Group publishes books, and a magazine, in the US and the UK, under five imprints. The largest is Book Sales, located in New York, and publishing for the American market. The book and magazine publishing division had sales of £23.5 million, and operating profits of £1.7 million. This was a good achievement, but is below our target of 10% of sales.

Book Sales continues to grow. The marketplace was generally soft. By paying careful attention to the size of print runs, and by good inventory control and successful publishing decisions, Book Sales prospered in a difficult year for the book trade. The work of the last several years to improve operations has certainly paid off. Walter Foster, which is America's leading publisher of art instruction books sold in the art and craft market, shifted strategy, establishing an in-house creative team, and early benefits came through in 1997. The publishing program involved 66 new products, and Walter Foster added the Muppets to its existing Disney, Warner, Marvel, and other valuable licenses. Sales to the core art and craft marketplace only grew slightly, as new products take time to get established in this very traditional market, and most of Walter Foster's new products were introduced in the second half of the year. With the core titles in the Walter Foster list still in print after 50 years, we are comfortable at the progress made in 1997. Co-edition international sales are increasing, and domestic sales in the US to the book trade have been taken on by Book Sales, with rapidly improving results. Overall, sales increased by 20% and operating profits doubled to $500,000.

INTERESTING INTOXICANTS
Books on Port, Vodka, Cognac, and Wine have been added to our successful Companion series. Whether you drink to celebrate or to drown your sorrows, we can give helpful advice!



Broughton Hall maintained its sales, but management was slow to recognize that the buoyant US economy dictated a change in its publishing program. Corrective action has now been taken and, since the beginning of this year, new management has been installed, with a brief to make the necessary changes. This involves changing the emphasis of the publishing program, professionalizing the media buying function, and introducing a much more aggressive sales approach.



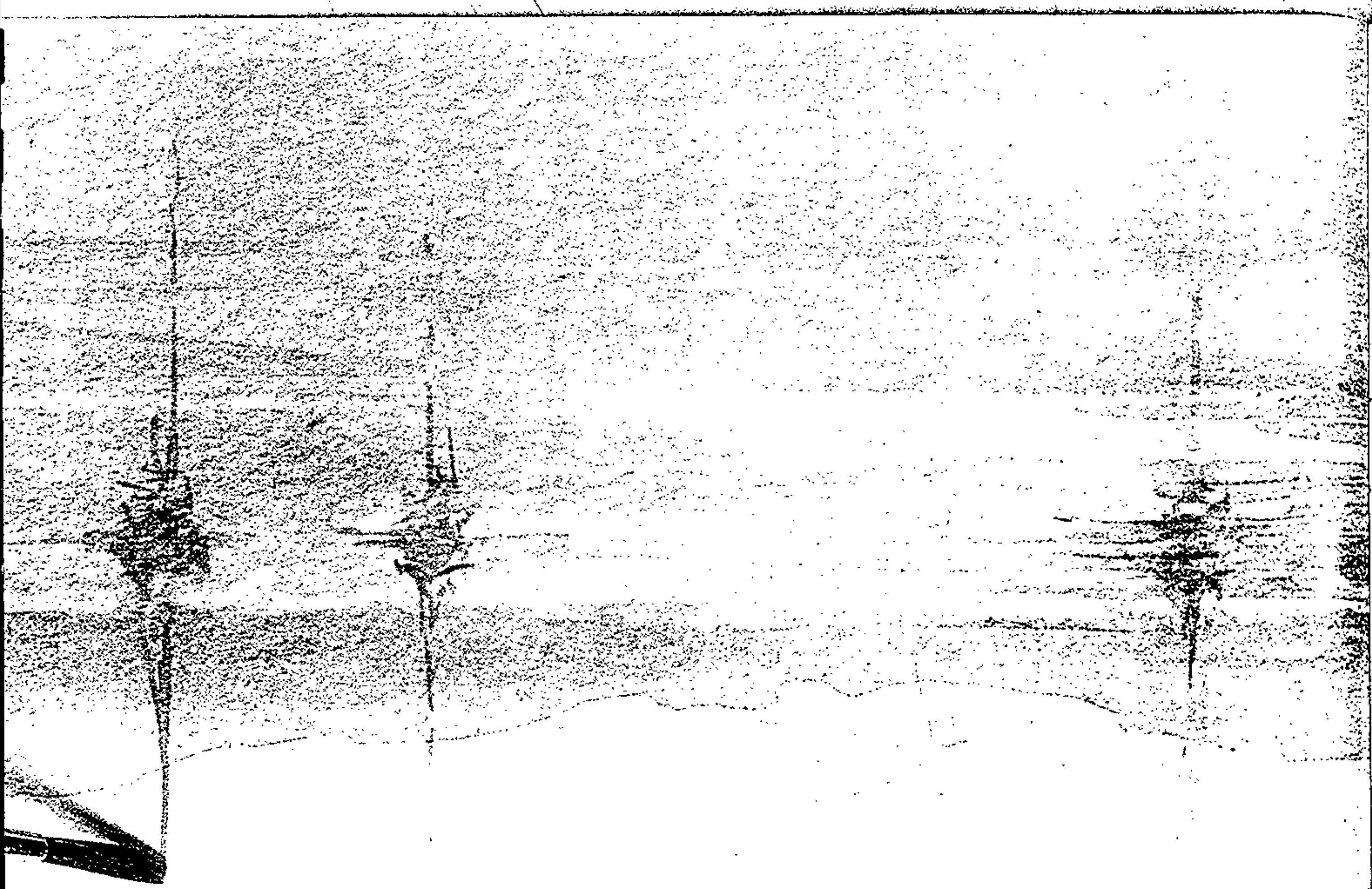
In the UK, the Apple Press broke even for the first time, and the Artists & Illustrators Magazine benefited by bringing its annual Fine Arts Materials Exhibition back to London from the NEC in Birmingham. The magazine's sales and readership increased, and attendance at the annual show was at a record. This effort of relocating the show, while costly in marketing terms, was worthwhile, and London will be its permanent venue. The UK book trade is in a more robust state than it was a year ago, but remains cautious about marketing its products energetically, with the exception of a few price promotions. The more determined entry of the big American book retailers may shake up what is still a rather staid retailing atmosphere. Apple has been publishing Quintet's Fridge Fun range in the UK, and has also taken on the Walter Foster list. Both of these have sold successfully into garden centres, gift shops, cookware shops, and department stores, opening up much new business, and paving the way for good expansion in 1998.

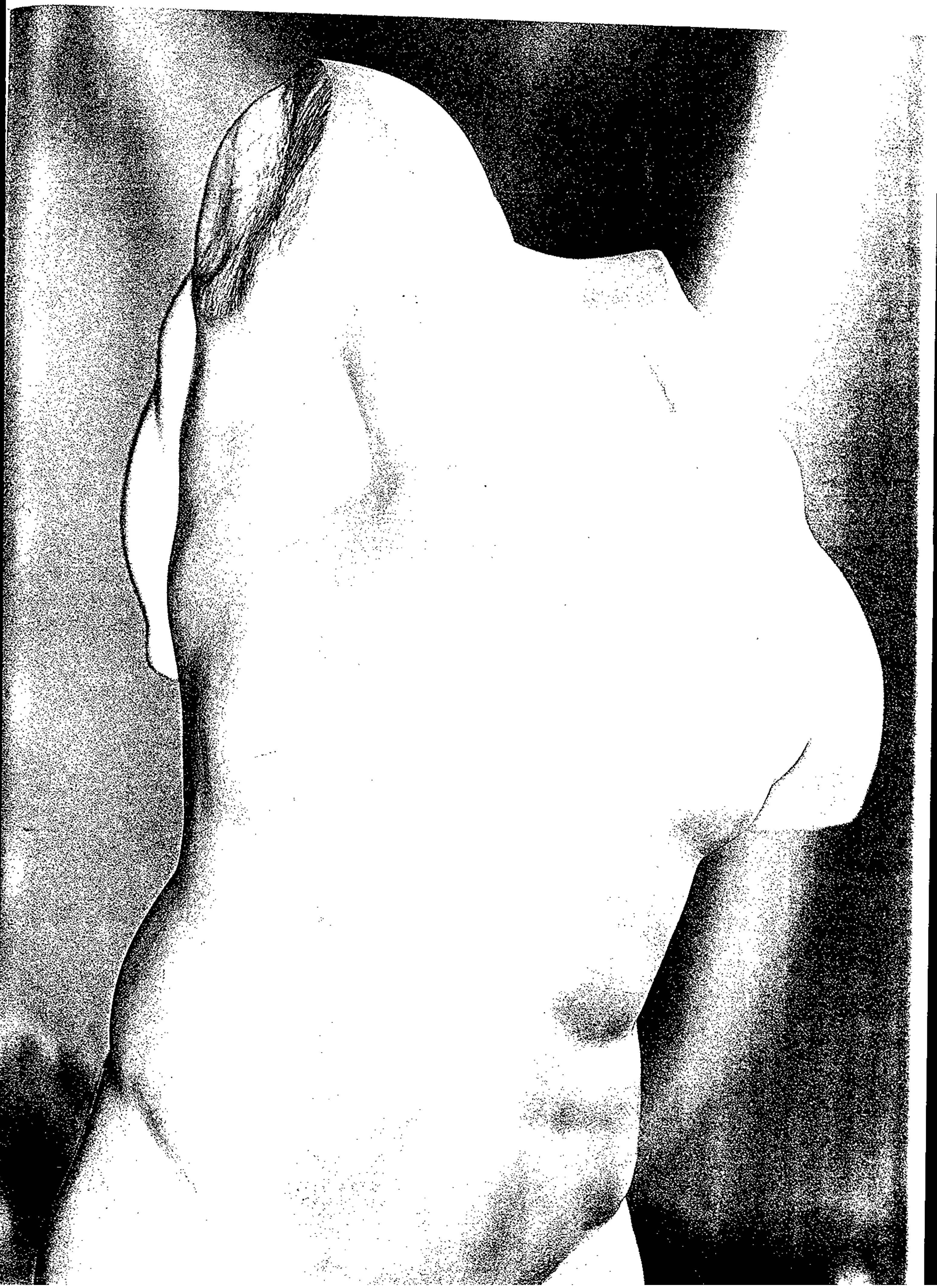
WATERY WHEREABOUTS
From the Coastal Guide to New England, to our broad program of publishing marine images, we speed on the surface of the waves.

ART PRINT PUBLISHING

1997 was a very disappointing year. We publish art prints in New York, San Diego, and Sydney. Following a strategic review of the businesses, late in the year, we decided that each of the businesses required substantial overhaul. Their activity is right at the heart of The Quarto Group's involvement in publishing in the art and art instruction areas. Historically, the businesses have demonstrated that they can sustain a high level of profitability, of the order of 15% of sales. We are determined to get them back on course, following a year in which they have, collectively, contributed a small loss on sales of $13.7 million. In all three instances we identified common problems of tired and poor publishing decisions, reliance on outdated sales approaches, and a lack of focus.

Scafa experienced some management turmoil in 1997. Following the retirement from full-time employment of its president, Art Castillo, (who remains involved with the Group on a part-time basis) we made a poor selection as his successor. With the appointment of a new president, the move to a new and more efficient warehouse, the enhancement and relocation of its publishing staff to New York City, and a focus on the upper end of its market, we expect Scafa to return to the level of sales





and profits it has achieved historically. There was a great deal of change, too, at Front Line, in San Diego, and by the end of the year we had a vigorous new team in place. Much had to be done to refocus the business. The children's fiction publishing program, which consumed an enormous amount of management time, emotion, and financial resources was discontinued. The previous management had attempted to "fix" problems in the core business by turning to alternative activities. This has all been stripped away, and the new president and creative director have a clear sense of where they are taking the business. Costs have been reined in, a more aggressive sales approach has been introduced, operation deficiencies have been overcome, and the publishing program is being revived.

THERAPEUTIC THESIS
After you have benefited from our Complete Book of Relaxation Techniques, try Start Sculpting.

In Australia, the action taken has been even more radical, taking us back to our roots. In 1989 we started with an art print publishing business. We then acquired a couple of our distributors, merged them all together, and, following the departure of the art print publisher, put the head of distribution in charge of the entire operation. This was a bad decision. It had a negative impact on the distribution business, and brought nothing positive to the publishing side. Quarto Australia recorded a trading loss of £140,000 in 1997, and we have additionally written down the inventory by £350,000. Since November, we have split the business into its constituent parts and have installed young and capable management in both areas.

PUBLISHING SERVICES

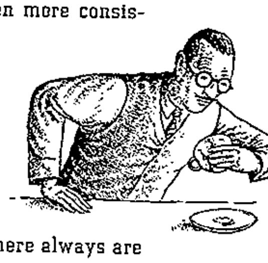
With sales of £10.7 million, and operating profits of £1.05 million, the publishing services division was right on target. As I have explained in the past, this division, through Regent in Hong Kong, and ProVision in Singapore, provides benefits not adequately reflected in the consolidated turnover, as one-third of their work is for other group businesses. Once again, they had a good year, and adroit leadership has kept them in a strong position, despite the turmoil raging in East Asian markets. As they own no production facilities themselves, and their customers are largely in the West, paying in dollars or sterling, they are not adversely exposed to the economic problems of the region. To the extent that our presence in the area, and strong local and international reputation allow us to drive better bargains, the Group as a whole will benefit from the current developments.

I am pleased to report that our UK-based publishing services businesses are no longer making losses, and we can now look forward to a much brighter future. AP did particularly well, easily absorbing the extra costs connected with its earlier move to new, expanded, premises and, by the end of the year, Western was well on the way to good health. We have finally exited from the photographic processing and digital imaging areas, which were a major drain on resources.

PROSPECTS

The Board has reviewed the Group's corporate strategy. As a result of this review, we have determined to focus our resources on areas of publishing activity where we have traditionally been strong. These involve the conception and creation of books and products, suitable for wide sales internationally, where the bulk of the traditional marketing and sales effort to the end user is carried out by licensees and distributors. This is very much the low-profile and low-risk end of the publishing industry, so much so that we are rarely identified with the success many of our books and products enjoy. Occasional setbacks aside, we have been more consistently good at this than any other firm in the industry.

We took some hard decisions in 1997, in discontinuing a number of significant activities which were problematic for the Group. In addition to the exceptional costs associated with these decisions, we absorbed about £0.75 million in non-recurring trading losses and excess overheads in these, and other, areas of our business. Of course, there always are initiatives that disappoint, and unanticipated losses that have to be absorbed, but the pain in 1997 is unlikely to be repeated.



DISCREET DIVINATION
Whether you prefer to read tea leaves, or follow astrological indications, or learn to tell fortunes, our books can give you insight into the future.

This, together with the benefits that will flow from the action taken, in the last quarter of 1997, to bring down overheads, place us in a good position. The Asian turmoil and the continued strength of the dollar and sterling remain problems, but our major markets are buoyant and we know what it takes to increase our business in them. Many of the continental European markets are in better shape now than a year ago, and early indications are that we are picking up business at a reasonable pace. Trading in January has been generally encouraging. Sales are modestly ahead but, in truth, January is a quiet month. With a better focus in each of our operating units, and new leadership in some of those that had problems in 1997, we can look forward to an overall improvement in 1998.

The Board has decided to seek authority to buy in up to 15% of the company's shares.

Laurence F Orbach
February 17, 1998

JUDICIOUS JUGGLING
Recognizing the need to utilize our cash resources effectively, we appointed a Treasurer at the beginning of 1997.

FINANCIAL REVIEW OF 1997

CHIEF FINANCIAL OFFICER'S REPORT

Operating Performance

Sales for the year ended 31 December 1997 were £81.8m, an increase of 1.5% compared to 1996 (£80.6 million). The impact of currency has masked an underlying volume growth. Sales at constant currency rates would have amounted to approximately £87.2m, an increase of 8.2% compared to 1996. Operating profits were £6.2 million (7.6% of sales) (1996: £9.1 million (11.3% of sales)).

An analysis of the operating performance by division is given below:

	1997 Sales £000	Operating Profit £000		1996 Sales £000	Operating Profit £000	
Co-edition Publishing	39,415	4,675	(11.9%)	39,561	6,679	(16.9%)
Book and Magazine Publishing	23,487	1,671	(7.1%)	22,095	1,893	(8.6%)
Art Print Publishing	8,248	(105)	(-)	8,932	1,040	(11.6%)
Publishing Services	10,670	1,048	(9.8%)	10,031	376	(3.7%)
Group Overheads	-	(1,106)	(-)	-	(842)	(-)
	81,820	6,183	(7.6%)	80,619	9,146	(11.3%)

The performance of our co-edition publishing division was adversely affected by the strength of sterling and a substantially reduced level of business with a few of our major US customers. Whilst the shortfall in sales to the USA was made up by increased sales into Europe it was at lower margins. The strength of sterling affected us in two ways. Firstly deals contracted for last year came in at reduced margins. Secondly it made it difficult to achieve sales at our required minimum margins.

The operating profit margin of the book and magazine publishing division fell because of lower margins at Book Sales, where we targeted and achieved an inventory turn of two times, and at Broughton Hall where the less effective advertising led to lower margins.

The performance of art print publishing reflects a disappointing sales performance and a large inventory writedown (£350,000) at Quarto Australia.

The improved performance of our publishing services division demonstrates sharply better performances at each operating unit. Regent's sales were down slightly, but as a result of focusing strongly on overheads and margins, profit was ahead. The results for this division include a loss of £231,000 (1996: £445,000) with respect to the discontinued digital imaging business, Atlas.

The major part of the increase in group overheads relates to salary costs. We hired a Group Treasurer at the beginning of 1997 and there is a full year charge for Harvey Goldstein who was appointed mid way through 1996 as President, Quarto North America.

CHIEF FINANCIAL OFFICER'S REPORT

Currency

As the Chairman's letter emphasises Quarto's business is worldwide and multi-currency with over eighty-five percent of sales outside the UK. The strength of sterling during 1997 had a direct impact on our profits of approximately £1.2m. I set out below a table showing average exchange rates for those markets where we have a significant amount of business.

	1997	1996	Movement
US$	1.65	1.56	5.8%
HK$	12.68	12.08	5.0%
Swiss Fr	2.37	1.93	22.8%
Aus$	2.21	1.99	11.1%
DM	2.83	2.35	20.4%
Ffr	9.54	7.99	19.4%
DFl	3.19	2.64	20.8%

Exceptional Costs

Exceptional costs comprise the closure costs with regard to the discontinued activities of Atlas, Strange Matter and Packaged Goods and a £215,000 write back of goodwill.

Interest

The interest charge increased by £612,000. Of this some £250,000 related to the full year impact of debt taken on with respect to acquisitions made in 1996. Interest was 3.2 times covered (1996: 6.9 times) by operating profit.

Taxation

The taxation charge on profit before exceptional items was 18.9% (1996: 24.4%). The Group's tax charge benefits from tax relief on the write-off of intangible assets in the US and low tax rates in HK and Switzerland. The lower tax rate for 1997 compared to 1996 principally reflects lower profits in the US and UK where the tax rates are higher than our average rate.

Minority Interests

The Group has four subsidiaries in which there are minority interests. The fall this year incorporates a loss compared to a profit last year at Packaged Goods, where there is a 20% minority shareholding.

Dividends

The recommended dividend for the year is 4.5p (1996: 8.0p). The dividend is 2.9 times covered (1996: 3.3 times).

Cash Flow

The Group requires a high level of working capital, particularly in the core business activity of co-edition publishing. The working capital at the balance sheet date is summarised below:

	1997 £m	1996 £m
Stocks and work in progress	27.8	26.5
Trade debtors	28.7	25.0
Trade creditors	(21.4)	(16.8)
Other net liabilities	(1.6)	(1.4)
	33.5	33.3

Working capital as a percentage of sales for 1997 was 41.0% (1996: 41.3%). It should be noted that 1996's working capital was flattered by the impact of currency. In particular in 1996 US$ assets and liabilities were converted at 1.71 in the year end balance sheet whereas the average rate for the profit and loss account for the year was 1.56. In 1997 the balance sheet rate and the average for the year were 1.65.

CHIEF FINANCIAL OFFICER'S REPORT

Stocks and work in progress represents 6.3 months cost of sales (1996: 6.3 months).

Trade debtors represents 3.5 months sales (based on second half sales of £49.2m) compared to 3.0 months in 1996 (based on second half sales of £49.7m). As mentioned above, last year's figure was flattered by the year end exchange rate. In addition, after a disappointing third quarter this year, we had a strong fourth quarter performance.

Our year-end net debt was £23.7m (£24.5m per cash flow less £0.8m of interest bearing debtors). Our total banking facilities at this point were £44.7m and of this £38m was committed.

Treasury

We hired a Group Treasurer at the beginning of 1997 to establish treasury policies, strategies and procedures. During the year we signed a five year, $55,000,000 multi-currency revolving credit agreement with a syndicate of banks on both sides of the Atlantic, arranged on our behalf by BZW. This facility gives us a very secure basis on which to finance our plans for the future. In addition, it reduces our cost of funds. Our bankers have recognised the ongoing strength of our business. The facility was signed in August. In the latter part of the year the Group Treasurer started to focus on our working capital needs and this will be a continued focus during the current year.

Financial Reporting

I am pleased to report that we have again brought forward the year end reporting timetable. It was a job well done and I take this opportunity to thank my staff for their continued loyalty, hard work and commitment to the Group.

M J Mousley
17 February, 1998

DIRECTORS AND ADVISERS

Directors
Laurence Francis Orbach (Chairman and Chief Executive) (USA)
Robert John Morley
Michael John Mousley, ACA
Geoffrey Banks
George Tai (Hong Kong)
Harvey Goldstein (USA)
Eric de Bellaigue (Non-executive)

Secretary
Cyrus Homi Bhote, FCA

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Auditors
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Solicitors
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6 Snow Hill, London EC1A 2AL

Registrars and Transfer Office
IRG plc
Bourne House, 34 Beckenham Road
Beckenham, Kent BR3 4TU

Principal Bankers
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11-12 Old Jewry, London EC2 8DP

Barclays Bank plc
8/9 Hanover Square, London W1A 4ZW

Fleet Bank
1 Federal Street, Boston, Massachusetts 022110-2010, USA

National Westminster Bank plc
65 Piccadilly, London W1A 2PP

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 31 December, 1997.

Principal activities and business review
The Group conducts an international business whose principal activity is the creation and marketing of high quality illustrated books covering a wide range of topics. The Group's activities also embrace production services, silkscreen printing, consumer magazines, informational directories, visual art books and fine art reproductions. A detailed review of the development of the business of the Group is given in the Chairman's Letter on pages 1 to 17.

Results and dividends
The profit for the year after taxation and minority interests amounted to £1,766,000 (1996: £5,377,000). The directors propose a final ordinary dividend of 2.3p per share subject to approval at the Annual General Meeting. The retained profit for the year was £470,000 (1996: £3,433,000) which has been transferred to reserves.

Directors
The directors of the Company, who served as directors throughout the year, are as follows:

L. F. Orbach
R. J. Morley
M. J. Mousley
G. Banks
G. T. Y. Tai
H.Goldstein
E. de Bellaigue (Non-executive)

None of the directors has a service contract of more than one year's duration.

Save as disclosed in Note 23 no director has had a material interest in any contract of significance with the Company or its subsidiaries during the year.

Born in France in 1931 and brought up in England and Canada, where he graduated from McGill University, Eric de Bellaigue started his working life as a reporter on the Montreal Star. His subsequent career has been in banking and stock broking and has included spells with the Bank of Montreal and merchant bankers, Schroder Wagg. Following his retirement from stockbrokers Panmure Gordon, he joined the board of The Quarto Group Inc. as a non-executive director. He is the author of "The Business of Books – the de Bellaigue Report" Hutchinson, 1984.

Directors' interests in shares
The directors who held office at 31 December, 1997 had the following interests in the share capital of the Company.

	Number of US$0.10 shares of common stock	
	31 December, 1997	1 January, 1997
L. F. Orbach*	2,678,413	2,678,413
R. J. Morley	1,300,000	1,300,000
M. J. Mousley	32,000	28,000
G. Banks	8,500	6,500
G. T. Y. Tai	25,477	10,477
H. Goldstein	—	—
E. de Bellaigue	4,875	4,875

*The shares in which L. F. Orbach is interested are owned through his family trusts.

M. J. Mousley held 5,000 convertible cumulative redeemable shares of preferred stock of par value US$0.10 each at 31 December 1997 (At 1 January, 1997:1,309)

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 1997

	GROUP	
	1997	1996
	£000	£000
Net cash inflow from operating activities	4,903	1,807
Return on investment and servicing of finance		
Interest received	172	257
Interest paid	(2,066)	(1,416)
Interest element of hire purchase payments	(78)	(77)
Preference dividend paid	(455)	(455)
Net cash outflow from return on investment and servicing of finance	(2,427)	(1,691)
Taxation		
UK and overseas corporation tax paid	(1,453)	(996)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(648)	(1,208)
Sale of tangible fixed assets	620	199
	(28)	(1,009)
Acquisitions and disposals		
Purchase of businesses/subsidiaries	(565)	(6,696)
Net cash balance acquired with subsidiaries	—	16
Purchase of associate	—	(872)
	(565)	(7,552)
Equity dividends paid		
Dividends paid	(1,587)	(1,386)
Management of liquid resources		
Movement in short term deposits	(1,268)	—
Financing		
Issue of shares	90	10
Increase in debt	15,185	4,961
Net cash inflow from financing	15,275	4,971
Increase/(decrease) in cash	12,850	(5,856)
Reconciliation of net cashflow to movement in (debt)/funds		
Increase/(decrease) in Cash	12,850	(5,856)
(Increase) in debt	(15,185)	(4,961)
Management of liquid resources	1,268	—
	(1,067)	(10,817)
Loans and finance leases acquired with subsidiaries	—	(154)
New Finance Leases	(519)	(394)
Translation differences	(418)	1,418
Movement in debt for year	(2,004)	(9,947)
Net debt at beginning of year	(22,444)	(12,497)
Net debt at end of year	(24,448)	(22,444)

See note 22 for an analysis of certain of the items included above.

ACCOUNTING POLICIES

The significant accounting policies that have been adopted in the preparation of the financial statements, which are presented under the historical cost basis of accounting, 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. However, the Company has not taken advantage of the available exemptions and the financial statements have been prepared in accordance with the accounting and disclosure requirements of the Companies Act 1985.

Adoption of new accounting standard

These financial statements comply with the new accounting standard FRS1, (Revised), Cash Flow Statements, issued by the Accounting Standards Board. In accordance with this revised standard, liquid resources are defined as current asset investments which are readily convertible into known amounts of cash without curtailing or disrupting the business. Prior year cash flows have been restated to ensure compliance with this standard.

Basis of consolidation

The consolidated financial statements represent a consolidation of the audited accounts of The Quarto Group Inc. and its subsidiaries all of which have been made up to 31 December.

The results of subsidiaries acquired during the year and requiring to be acquisition accounted 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 tangible assets. Where the fair value of the purchase consideration exceeds the values attributable to the Group's share of such net assets, the difference is treated as purchased goodwill and is written off directly to reserves in the year of acquisition. Reorganisation and integration costs resulting from the acquisition are charged to the profit and loss account. The profit or loss on the disposal or discontinuation 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.

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 as ordinary trading items.

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:

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 properties because the directors consider that the lives of these properties and their residual values (determined at the time of acquisition or subsequent valuation) are such that their depreciation is not material. Any permanent diminution in the carrying value of fixed assets is charged against the profit and loss account.

ACCOUNTING POLICIES

Investments in associates

An associated undertaking (associate) is one in which the group has a long term equity interest, usually from 20% to 50%, and over which it exercises significant influence. The Group's share of the profits less losses of associates is included in the consolidated profit and loss account and its interest in their net assets, other than goodwill, is included in investments in the consolidated balance sheet.

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 portion of overheads, in respect of a book are written off over its estimated economic life (not more than three years) commencing from the date of first printing and are disclosed in the financial statements as work in progress.

Deferred taxation

Provision is made, using the liability method, for deferred taxation on all material timing differences which are expected to crystallise.

Turnover

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

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 by finance leases (including hire purchase contracts) 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 in the period to which it relates.

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 arise.

DIRECTORS' REPORT

Directors' interests in shares (continued)

At 1 January, 1997 and 31 December, 1997 L.F.Orbach held options over 50,000 shares at an exercise price of 130.424p. The options are exercisable between 10 April 1995 and 9 April 2002

At 1 January, 1997 and 31 December, 1997 H.Goldstein held options over 30,000 shares at an exercise price of 257.5p. The options are exercisable between 23 December, 1999 and 22 December, 2006.

During the year the market price of the shares of common stock ranged between 66.5p and 257.5p. The market price at 31 December, 1997 was 70.5p.

Between 31 December, 1997 and 17 February, 1998 there have been no changes in the interests of the directors.

Substantial shareholders
As at 17 February, 1998 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
British Gas Pension Fund	760,000	4.1%
Clerical Medical Investment Group	1,126,132	6.0%
Commercial Union	853,182	4.6%
Co-operative Insurance	702,945	3.8%
Equitable Life Assurance Society	1,705,000	9.1%
Herald Investment Trust	632,690	3.4%
Prudential Corporation Group of Companies	655,524	3.5%
Scottish Mutual	752,500	4.0%
L.F.Orbach	2,678,413	14.40%
R.J.Morley	1,300,000	7.0%

Corporate governance
The Directors have reviewed the governance arrangements of The Quarto Group Inc. in the context of the Cadbury Committee Report and report that the Group was in compliance throughout the year with most of those paragraphs of the code which are currently applicable.The following areas have been identified where it is not appropriate to change current practice due to the size and constitution of the Board:

a) The Chairman of your Company is also Chief Executive. The Board sees no value in splitting the roles of Chairman and Chief Executive.

b) The Company has one Non-executive Director which is considered adequate in view of the overall size of the Board and the requirements of the Company, albeit that the code requires three Non-executive Directors.

c) A formal schedule of matters specifically reserved for the Board is not required since the Board forms the executive management of the Group.

d) The Company does not have any formal arrangements for Directors, in the furtherance of their duties, to take independent professional advice.

e) The Chairman and E. de Bellaigue fulfil the role of Remuneration Committee for Directors.

f) E. de Bellaigue (Non-executive) fulfils the role of the Audit Committee.

DIRECTORS' REPORT

Going concern
The Directors, having made enquiries, consider that the Group has 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 financial control
The board of directors has overall responsibility for the Group's system of internal financial control. The system of internal financial control is designed to provide reasonable but not absolute assurance against material misstatement or loss.

The main elements of the internal financial control system are:

a) The results of individual operating units are reported monthly and reviewed by the Board at monthly board meetings.

b) The management accounts 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) Frequent visits by the Board and the finance department to all operating units. These visits include a review of the internal financial control system.

The Board has reviewed the operation and effectiveness of the internal financial control system.

Report of the Remuneration Committee
The remuneration committee sets the remuneration and other terms of employment of executive directors and reports:

a) 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.

b) Performance related bonuses are not given.

c) Each director has a defined contribution personal pension plan.

d) No director has a service contract of more than one year's duration.

e) Full details of directors' remuneration and benefits are given in note 2 to the financial statements on page 35

The remuneration committee is constituted in accordance with Section A of the Best Practice Provisions annexed to the Listing Rules 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 Best Practice Provisions in framing its remuneration policy.

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 31 December, 1997 Group creditor days amounted to 87 days (1996: 72 days). The holding company did not have any trade creditors on 31st December 1997 (1996: NIL).

Auditors
Our auditors KPMG Audit Plc, are 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 auditors of the Company.

C. H. Bhote Cyrus H. Bhote
Secretary

17 February, 1998

Quarto

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

AUDITORS' REPORT TO THE MEMBERS OF THE QUARTO GROUP INC.

We have audited the financial statements on pages 27 to 46.

Respective responsibilities of Directors and Auditors

As described above, the Company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

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. 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 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.

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 31 December, 1997 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc   KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
17 February, 1998

Quarto

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 1997

	Notes	Group 1997 £000	Group 1996 £000
Turnover	1	81,820	80,619
Cost of sales		(52,838)	(50,124)
Gross Profit		28,982	30,495
Distribution costs		(2,601)	(2,603)
Administration expenses		(20,298)	(18,914)
Other operating income		100	168
Operating Profit	2	6,183	9,146
Share of loss of associate		(34)	(6)
Exceptional Items: Loss on closure of operations	2	(1,306)	—
		4,843	9,140
Net interest payable and similar charges	3	(1,941)	(1,329)
Profit on ordinary activities before taxation		2,902	7,811
Tax on profit on ordinary activities	4	(636)	(1,906)
Profit on ordinary activities after taxation		2,266	5,905
Minority interests – equity		(500)	(528)
Profit for the financial year		1,766	5,377
Dividends (including non-equity)	5	(1,296)	(1,944)
Retained profit for the year		470	3,433
Earnings per share	6		
Basic		7.0p	26.5p
Adjusted (excluding exceptional items)		13.2p	26.5p
Fully diluted		—	24.6p

BALANCE SHEETS AT 31 DECEMBER 1997

	Notes	Group 1997 £000	Group 1996 £000	Company 1997 £000	Company 1996 £000
Fixed Assets					
Tangible assets	7	**6,539**	7,078	—	—
Investments	8	**220**	314	**19,839**	20,455
		6,759	7,392	**19,839**	20,455
Current Assets					
Stocks and work in progress	9	**27,794**	26,449	—	—
Debtors	10	**32,082**	27,787	**365**	1,080
Investments	11	**1**	1	—	—
Cash and deposits	12	**5,470**	3,537	—	—
		65,347	57,774	**365**	1,080
Creditors: Amounts falling due within one year	13	**(30,349)**	(41,132)	**(611)**	(1,080)
Net current assets/(liabilities)		**34,998**	16,642	**(246)**	—
Total assets less current liabilities		**41,757**	24,034	**19,593**	20,455
Creditors: Amounts falling due after more than one year	14	**(26,693)**	(9,201)	—	—
Provision for liabilities and charges					
Deferred taxation	15	**(1,324)**	(1,532)	—	—
Net assets		**13,740**	13,301	**19,593**	20,455
Capital and reserves					
Called up share capital	16	**1,341**	1,337	**1,341**	1,337
Reserves – Paid in surplus	17	**23,891**	23,805	**23,891**	23,805
– Revaluation		**1,018**	1,018	—	—
– Profit and loss	18	**14,618**	14,684	**(5,639)**	(4,687)
– Goodwill	19	**(29,311)**	(29,507)	—	—
Shareholders' funds		**11,557**	11,337	**19,593**	20,455
Equity		**6,353**	6,133	**14,389**	15,251
Non-equity		**5,204**	5,204	**5,204**	5,204
		11,557	11,337	**19,593**	20,455
Minority interests – equity		**2,183**	1,964	—	—
		13,740	13,301	**19,593**	20,455

The financial statements on pages 27 to 46 were approved by the Board of Directors on 17 February, 1998 and were signed on its behalf by :

M. J. MOUSLEY
Director

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

for the Year Ended 31 December 1997

	Group	
	1997	1996
	£000	£000
Profit for the financial year	1,766	5,377
Currency translation differences on foreign currency net investments	(536)	(650)
Total recognised gains and losses relating to the year	1,230	4,727

RECONCILIATION OF CONSOLIDATED MOVEMENT IN SHAREHOLDERS' FUNDS

for the Year Ended 31 December 1997

	1997	1996
	£000	£000
Profit for the financial year	1,766	5,377
Dividends	(1,296)	(1,944)
Retained profit for the financial year	470	3,433
Other recognised gains and losses relating to the year	(536)	(650)
New share capital subscribed	90	10
Goodwill arising on acquisitions	(19)	(7,896)
Goodwill on closure of operations written back to reserves	215	—
Net movement in shareholders' funds	220	(5,103)
Shareholders' funds at 31 December, 1996	11,337	16,440
Shareholders' funds at 31 December, 1997	11,557	11,337

NOTES TO THE FINANCIAL STATEMENTS

1 Segmental analysis

Geographical analysis of turnover by destination

	Group 1997 £000	Group 1996 £000
United Kingdom	11,828	11,909
United States of America	43,074	45,269
Canada	1,326	1,070
Europe	14,544	12,152
Australasia and the Far East	8,614	8,169
Rest of the World	2,434	2,050
	81,820	80,619

Class of business	Turnover 1997 £000	Turnover 1996 £000	Profit before tax 1997 £000	Profit before tax 1996 £000	Net operating assets 1997 £000	Net operating assets 1996 £000
Publishing	71,150	70,588	5,135	8,770	37,442	36,088
Publishing services	10,670	10,031	1,048	376	3,122	3,645
	81,820	80,619	6,183	9,146	40,564	39,733
Share of loss of associate			(34)	(6)		
Loss on closure of operations			(1,306)	—		
Net interest payable			(1,941)	(1,329)		
			2,902	7,811		

The group interest expense is arranged centrally and is not attributable to individual activities or geographical areas.

Analysis by geographical area of origin

	Turnover 1997 £000	Turnover 1996 £000	Operating profit 1997 £000	Operating profit 1996 £000	Net operating assets 1997 £000	Net operating assets 1996 £000
United Kingdom	32,903	30,062	2,208	3,217	7,192	10,471
United States of America	36,002	38,111	2,691	4,769	27,438	23,426
Other	12,915	12,446	1,284	1,160	5,934	5,836
	81,820	80,619	6,183	9,146	40,564	39,733

"Other" is not analysed further because the directors consider that such disclosure would be prejudicial to the interests of the Company.

NOTES TO THE FINANCIAL STATEMENTS

	GROUP	
	1997 £000	1996 £000
1 Segmental analysis (continued)		
The net operating assets can be reconciled to the consolidated balance sheet as follows:		
Net operating assets	40,564	39,733
Total bank loans and other borrowings	(29,918)	(25,981)
Cash at bank and in hand	5,470	3,537
Corporation tax, deferred tax and advance corporation tax	(1,831)	(2,812)
Dividends payable	(545)	(1,176)
Net assets	13,740	13,301
2 Operating profit		
Operating profit is stated after charging		
Depreciation	1,129	1,060
Auditors' remuneration: audit	208	204
: other	9	11
Operating lease rentals in respect of:		
Plant and machinery	32	24
Other assets	1,149	770
Exceptional items:		
Closure costs	1,091	—
Goodwill written back	215	—
	1,306	

Exceptional items comprise losses on the closure of the operations of The Atlas Image Factory, Strange Matter and Packaged Goods.

A retained loss of £952,000 (1996: loss £850,000) has been dealt with in the accounts of the Company.

	1997	1996
Employees		
Staff costs including directors' emoluments comprise:		
Wages and salaries	12,170	11,933
Social security costs	969	996
Pension costs	314	282
	13,453	13,211

	1997 Number	1996 Number
The average weekly number of persons employed by the group during the year was:		
Publishing	402	388
Publishing services	111	132
Group administration	16	16
	529	536

NOTES TO THE FINANCIAL STATEMENTS

2 Operating profit (continued)
Directors' remuneration

	Group 1997 £000	Group 1996 £000
Emoluments:		
Fee to non-executive director	13	13
Executive directors – remuneration including benefits in kind in respect of motor vehicles and health insurance	761	647
– pension contributions	70	52
	844	712

The directors' remuneration disclosed above included the following amounts paid in respect of the Chairman who is also the highest paid director.

	1997 £000	1996 £000
Remuneration	190	177
Pension contributions	30	23
	220	200

Details of directors' share options are given in the directors' report. During the year certain of the directors maintained current accounts with the company. Details of these current accounts can be found under Note 23 on page 46.

The remuneration of the executive directors was as follows:

	SALARY/ FEES £000	* BENEFITS £000	PENSION CONTRIBUTION £000	1997 TOTAL £000	1996 TOTAL £000
L.F.Orbach	189	1	30	220	200
R.J.Morley	151	2	22	175	152
M.J.Mousley	102	1	15	118	107
G.Banks	65	5	3	73	73
G.Y.Tai	109	—	—	109	104
H. Goldstein	136	—	—	136	63
	752	9	70	831	699

*The Company's policy with regard to the provision of company cars to directors and employees was changed on 1 January 1997. Company cars are now only provided to directors and employees who use them for more than 7,000 business miles a year. The salaries of directors and employees who no longer receive a car have been appropriately adjusted. The following directors purchased their company cars which were provided to them at their written down values as stated.

	WDV £000
L.F.Orbach	16
R.J.Morley	19
M.J.Mousley	14

NOTES TO THE FINANCIAL STATEMENTS

	Group 1997 £000	Group 1996 £000
3 Net interest payable and similar charges		
Interest payable:		
On bank overdrafts and other loans repayable within 5 years by instalments	1,985	1,472
On loans repayable after more than 5 years	48	36
Hire purchase	78	78
	2,111	1,586
Interest receivable	(170)	(257)
	1,941	1,329
4 Taxation		
On profit for the year:		
United Kingdom corporation tax at 31.5%	367	925
Deferred taxation – UK	(12)	44
– Overseas	(28)	778
Overseas tax	309	159
	636	1,906

The Group's low taxation charge reflects the benefit of tax relief on the write-off of intangible assets in the US and low tax rates in Hong Kong and Switzerland.

	Group 1997 £000	Group 1996 £000
5 Dividends		
Equity: Ordinary: Interim paid of 2.2p per share (1996: 2.2p per share)	411	409
: Ordinary: Final proposed of 2.3p per share (1996: 5.8p per share)	430	1,080
	841	1,489
Non-equity: Preference	455	455
	1,296	1,944

6 Earnings per share

The calculation of earnings per share is based on 18,655,306 shares (1996: 18,608,639) and earnings, after minority interests and preference dividends, of £1,311,000 (1996: £4,922,000).

Fully diluted earnings per share in 1996 allows for the conversion of preference shares and the exercise of all outstanding options and is calculated on adjusted earnings of £5,401,000 and 21,968,053 shares. In 1997 fully diluted earnings per share is not shown because it exceeds basic and adjusted earnings per share.

The calculation of adjusted earnings per share is based on earnings of £2,459,000 calculated as follows:

	1997 £000
Earnings after minority interests and preference dividends	1,311
Exceptional items	1,306
Taxation credit on exceptional items	(158)
Earnings after minority interests and preference dividends before exceptional items	2,459

NOTES TO THE FINANCIAL STATEMENTS

	FREEHOLD PROPERTY £000	LEASEHOLD PROPERTY £000	PLANT EQUIPMENT AND MOTOR VEHICLES £000	FIXTURES AND FITTINGS £000	TOTAL £000
7 Tangible fixed assets					
Group					
Cost or valuation:					
At 1 January, 1997	3,111	838	5,989	855	10,793
Exchange differences	(19)	20	19	2	22
Additions	23	48	895	194	1,160
Disposals	(196)	(71)	(1,452)	(105)	(1,824)
At 31 December, 1997	2,919	835	5,451	946	10,151
Depreciation:					
At 1 January, 1997	33	218	2,954	510	3,715
Exchange differences	—	6	(3)	—	3
Charge for the year	—	67	893	169	1,129
Disposals	(3)	(54)	(1,078)	(100)	(1,235)
At 31 December, 1997	30	237	2,766	579	3,612
Net book value:					
At 31 December, 1997	2,889	598	2,685	367	6,539
At 31 December, 1996	3,078	620	3,035	345	7,078
Cost or valuation at 31 December, 1997 is represented by:					
Surplus on valuation	1,018	—	—	—	1,018
Cost	1,901	835	5,451	946	9,133
	2,919	835	5,451	946	10,151

The net book value of plant, equipment and motor vehicles included £894,000 (1996: £1,025,000) in respect of assets held under hire purchase contracts. The depreciation charged on these assets during the year was £203,000 (1996: £265,000). Included in leasehold property at cost is £344,000 (1996: £331,000) in respect of a long leasehold property. The net book value at 31 December, 1997 was £311,000 (1996: £305,000). The principal freehold property in the UK, with an historic cost of £382,000, was revalued on the basis of an open market value for existing use at 31 December, 1989 by Conway Kersh, Professional Valuers. The valuation was £1.7 million but the directors ascribed a value of £1.4 million, on the grounds of prudence.

As noted in the Accounting Policies no depreciation is provided on Freehold property.

NOTES TO THE FINANCIAL STATEMENTS

	GROUP	COMPANY		
	INVESTMENT IN ASSOCIATE £000	SHARES AT COST £000	LOANS £000	TOTAL £000
8 Fixed asset investments				
At 1 January, 1997	314	8,846	11,609	20,455
Share of retained losses/additions	(34)	(40)	(576)	(616)
Goodwill adjustment	(70)	—	—	—
Exchange difference	10	—	—	—
At 31 December, 1997	220	8,806	11,033	19,839

Investments in associates of £220,000 (1996:£314,000) comprises cost of shares, less goodwill written off on acquisition of £927,000 (1996:£857,000) less the Group's share of post acquisition losses of £40,000 (1996:£6,000). The Company has the following principal trading subsidiaries and associates (*Directly held by the Quarto Group Inc.), all of which operate principally 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*	Publishing
Quarto Inc.	Delaware, USA 16 October, 1986	60 shares of no par value	100*	Publishing
Western Screen and Sign Limited	England 24 November, 1961	1,500 shares of £1 each	100*	Publishing Services
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	Publishing Services
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 Services
RotoVision S.A.	Switzerland 18 July, 1977	1,500 shares of SFr500 each	100*	Publishing
Broughton Hall Inc.	Delaware, USA 16 March, 1989	100 shares of US$1 each	100	Publishing
Rockport Publishers Inc.	Massachusetts, USA 4 December, 1985	4,000 shares of no par value	100	Publishing
Book Sales Inc.	Delaware, USA 13 December, 1972	85 shares of no par value	80	Publishing
Quarto Children's Books Limited	England 6 January, 1976	2 shares of £1 each	100	Publishing
Scafa-Tornabene Art Publishing Co., Inc.	Delaware, USA 29 June, 1987	1,210 shares of no par value	100	Publishing
Packaged Goods Incorporated	New York, USA 8 October, 1992	100 shares of no par value	80	Publishing
Pro-Vison Pte Ltd.	Singapore 11 June, 1990	7,502 shares of S$1 each	100	Publishing Services
Front Line Graphics, Inc.	Delaware, USA 29 April, 1994	1,000 shares of US$1 each	100	Publishing
Walter Foster Publishing, Inc	Delaware, USA 10 February, 1988	19,625 shares of US$0.01 each	100	Publishing
Design Eye Holdings Limited	England 22 June, 1992	200 shares of £1 each	75*	Publishing
Boulder Interactive Group Inc	Colorado, USA 3 June, 1994	5,740 shares of no par value	30	Publishing

NOTES TO THE FINANCIAL STATEMENTS

	GROUP		COMPANY	
	1997	1996	1997	1996
	£000	£000	£000	£000
9 Stocks and work in progress				
Finished goods	14,467	13,484	—	—
Work in progress	13,113	12,729	—	—
Raw materials	934	555	—	—
Less: Payments on account	(720)	(319)	—	—
	27,794	26,449	—	—
10 Debtors				
Trade debtors	28,673	25,045	—	—
Amounts due from subsidiaries	—	—	365	1,080
Prepayments and accrued income	2,022	1,632	—	—
Other debtors	1,055	289	—	—
Corporation tax and advance corporation tax recoverable	332	821	—	—
	32,082	27,787	365	1,080

Other debtors include £792,000 which is interest bearing.

11 Current asset investments				
Listed investments at cost (market value £1,000) (1996: £1,000)) Listed other than on The International Stock Exchange in London	1	1	—	—
12 Cash and deposits				
Cash at bank	4,202	3,537	—	—
Short term deposits	1,268	—	—	—
	5,470	3,537	—	—
13 Creditors: Amounts falling due within one year				
Bank overdrafts	2,461	14,568	—	—
Current loan instalments	1,075	2,771	—	—
Hire purchase creditors	341	376	—	—
Total borrowings	3,877	17,715	—	—
Trade creditors	21,440	16,781	—	—
Other creditors including taxation and social security:				
Corporation tax	548	1,648	—	—
Advance corporation tax payable	291	453	181	—
Dividend payable	430	1,080	430	1,080
Dividend payable to minority shareholders	115	96	—	—
Social security	167	89	—	—
Other creditors	909	1,364	—	—
Accruals and deferred income	2,572	1,906	—	—
	30,349	41,132	611	1,080

NOTES TO THE FINANCIAL STATEMENTS

	Group 1997 £000	Group 1996 £000	Company 1997 £000	Company 1996 £000
14 Creditors: Amounts falling due after more than one year				
Bank and other loans	25,808	7,955	—	—
Hire purchase liabilities	233	311	—	—
Total borrowings	26,041	8,266	—	—
Other creditors	652	935	—	—
	26,693	9,201	—	—
Total borrowings are repayable as follows:				
Bank loans and overdrafts:				
In one year or less, or on demand	3,536	17,339	—	—
Between one and two years	217	1,214	—	—
Between two and five years	25,518	6,109	—	—
In five years or more	73	632	—	—
	29,344	25,294	—	—
Other borrowings (hire purchase liabilities):				
In one year or less, or on demand	341	376	—	—
Between one and two years	176	271	—	—
Between two and five years	57	40	—	—
	574	687	—	—
Total loans and other borrowings:				
In one year or less, or on demand	3,877	17,715	—	—
Between one and two years	393	1,485	—	—
Between two and five years	25,575	6,149	—	—
In five years or more	73	632	—	—
	29,918	25,981	—	—

The above borrowings carry interest at commercial rates ranging from 4.9 % to 8.5 %. The total amount repayable in five years or more relates to a bank loan repayable by instalments secured on freehold premises.

NOTES TO THE FINANCIAL STATEMENTS

	Group			
	Amount provided 1997 £000	1996 £000	Potential liability 1997 £000	1996 £000
15 Deferred taxation				
Deferred taxation provided in the financial statements is as follows:				
Excess of capital allowances over depreciation	**166**	170	**166**	170
Other-UK	**(142)**	(134)	**(142)**	(134)
Other-overseas	**1,300**	1,496	**1,566**	1,660
Revaluation of freehold property	—	—	**316**	336
	1,324	1,532	**1,906**	2,032

The movement on the provision for deferred taxation is as follows:

	Group £000
Provision at 1 January, 1997	1,532
Exchange difference	(90)
Acquisitions	(78)
Transfer to profit and loss account	(40)
Provision at 31 December, 1997	1,324

16 Share capital

Authorised:

28,000,000 (1996: 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 (1996: US$2,800,000).

5,212,587 (1996:5,212,587) 8.75% (net) convertible cumulative redeemable shares of preferred stock of US$0.10 each ("shares of preferred stock") with an aggregate nominal value of US$521,588 (1996:US$521,588).

	1997 £000	1996 £000
Equity share capital		
Allotted, called up and fully paid:		
18,675,306 shares of common stock of par value US$0.10 each (1996: 18,615, 306)	**1,063**	1,059
Non-equity share capital		
Allotted, called up and fully paid:		
5,204,024 shares of preferred stock of US$0.10 each (1996: 5,204,024)	**278**	278
	1,341	1,337

NOTES TO THE FINANCIAL STATEMENTS

16 Share capital (continued)

30,000 shares of common stock were issued following the exercise of options under the Company's Executive Share Option Scheme on 24 March 1997 and a further 30,000 on 1 April 1997.

At 31 December, 1997, the following options over shares of common stock were outstanding under The Quarto Group Inc. Executive Share Option Schemes.

Number of Shares	Date exercisable	Options price per share
1,000	12 April, 1992 – 11 April, 1999	£1.73264
5,000	14 November, 1992 – 13 November, 1999	£1.5232
65,000	10 April, 1995 – 9 April, 2002	£1.30424
50,000	26 October, 1997 – 25 October, 2003	£2.82
30,000	23 December, 1999 – 22 December, 2006	£2.575

The shares of preferred stock are convertible into shares of common stock on 1 June, 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. The holders of preferred stock are entitled to an annual dividend amounting to 8.75%. The holders of common stock do not have any special rights to dividends.

	Group		Company	
	1997	1996	**1997**	1996
	£000	£000	**£000**	£000
17 Reserves – paid in surplus				
At 1 January, 1997	**23,805**	23,795	**23,805**	23,795
On shares issued during year:				
Exercise of share options	**86**	10	**86**	10
At 31 December, 1997	**23,891**	23,805	**23,891**	23,805

NOTES TO THE FINANCIAL STATEMENTS

18 Reserves – profit and loss account	Group 1997 £000	Group 1996 £000	Company 1997 £000	Company 1996 £000
At 1 January, 1997	14,684	11,901	(4,687)	(3,837)
Retained profit for the year	470	3,433	(952)	(850)
Difference on translation of net assets and profit and loss accounts of non-UK companies	(536)	(650)	—	—
At 31 December, 1997	14,618	14,684	(5,639)	(4,687)

19 Reserves – goodwill	Group 1997 £000	Group 1996 £000
At 1 January, 1997	29,507	21,611
Goodwill arising on acquisitions - businesses/subsidiaries	19	7,441
- associate	—	857
Goodwill relating to closure of operations written back to reserves	(215)	—
Goodwill adjustment	—	(402)
At 31 December, 1997	29,311	29,507

The goodwill adjustment relates to prior year aquisitions.

NOTES TO THE FINANCIAL STATEMENTS

	Group			
	LAND AND BUILDINGS 1997 £000	OTHER 1997 £000	LAND AND BUILDINGS 1996 £000	OTHER 1996 £000
20 Financial commitments				
At 31 December, 1997, the Group had commitments to make payments under operating leases during the next year as follows for leases expiring:				
Within one year	31	213	144	25
Between two and five years	953	241	682	111
Over five years	192	—	192	—
	1,176	454	1,018	136

The land and buildings leases are subject to rent reviews.

21 Contingent commitments and liabilities

On 28 February, 1996, the Group acquired Walter Foster Publishing Inc. Of the purchase price US $ 966,242 was settled by the issue of promissory notes. The principal values of the promissory notes is adjustable upwards to reflect the increase, if any, in the value (in US dollars) of The Quarto Group Inc's common stock over US $ 3.83. As at 17 February, 1998 the value of the common stock was US $1.18 and accordingly no adjustment has been made in these financial statements.

Quarto Inc has an agreement to purchase the common stock from the minority shareholder in Book Sales Inc 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 31 December, 1997 there was a potential liability, based on Book Sales Inc's financial statements, of approximately US $2,012,000. No provision has been made because the minority shareholder has not exercised their option. At 31 December, 1997 the minority interest in the consolidated financial statements of The Quarto Group Inc was US $1,067,000.

The Quarto Group Inc. has issued guarantees in respect of £2,028,000 of overdrafts of subsidiaries (1996: £14,568,000) and bank loans of £4,046,000 (1996: £9,352,000).

The Group has also issued guarantees in respect of £574,000 of hire purchase creditors of subsidiaries (1996: £687,000).

There are no other contingent liabilities, arising in the ordinary course of business, in respect of litigation, which the directors believe will have a significant effect on the financial position of the Group.

NOTES TO THE FINANCIAL STATEMENTS

22 Notes on the consolidated cash flow statement

	1997 £000	1996 £000
RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOWS FROM OPERATING ACTIVITIES		
Operating profit	6,183	9,146
Exceptional costs: cash outflows resulting from the closure of operations	(1,091)	—
Depreciation charge	1,129	1,060
(Profit) on sale of fixed assets	(31)	(13)
(Increase) in stocks and work in progress	(1,182)	(4,611)
Increase/(decrease) in creditors	4,240	(1,112)
(Increase) in debtors	(4,345)	(2,663)
Net cash inflow from operating activities	4,903	1,807

	As at 1 January 97 £000	Cash Flow £000	Exchange difference £000	New Hire Purchase £000	As at 31 December 97 £000
ANALYSIS OF NET DEBT					
Cash at Bank and In Hand	3,537	665			4,202
Bank overdrafts < 1 year	(14,568)	12,185	(78)		(2,461)
	(11,031)	12,850	(78)		1,741
HP Creditors	(687)	632		(519)	(574)
Current loan instalments < 1 year	(2,771)	1,696			(1,075)
Bank loans > 1 year	(7,582)	(17,619)	(340)		(25,541)
Mortgages	(373)	106			(267)
	(11,413)	(15,185)	(340)	(519)	(27,457)
Management of liquid resources	—	1,268			1,268
Net (Debt)	(22,444)	(1,067)	(418)	(519)	(24,448)

22 Notes on the consolidated cash flow statement (continued)

PURCHASE OF BUSINESSES/SUBSIDIARIES

The goodwill arising on acquisition of £19,000 relates to the purchase of 5% of Regent Publishing Services Limited.

The cash outflow in respect of the purchase of businesses / subsidiaries consists of cash paid £244,000 in respect of the acquisition of 5% of Regent Publishing Services Limited and £321,000 deferred consideration paid.

23. Related party transactions

The related party transactions for the year are as summarised below.

a) Sale of company cars to Directors as explained in note 2 on page 35.

b) Loans to Directors

	G. T. Y. Tai £000
As at 1 January, 1997	23
As at 31 December, 1997	—
Maximum outstanding during the year	23

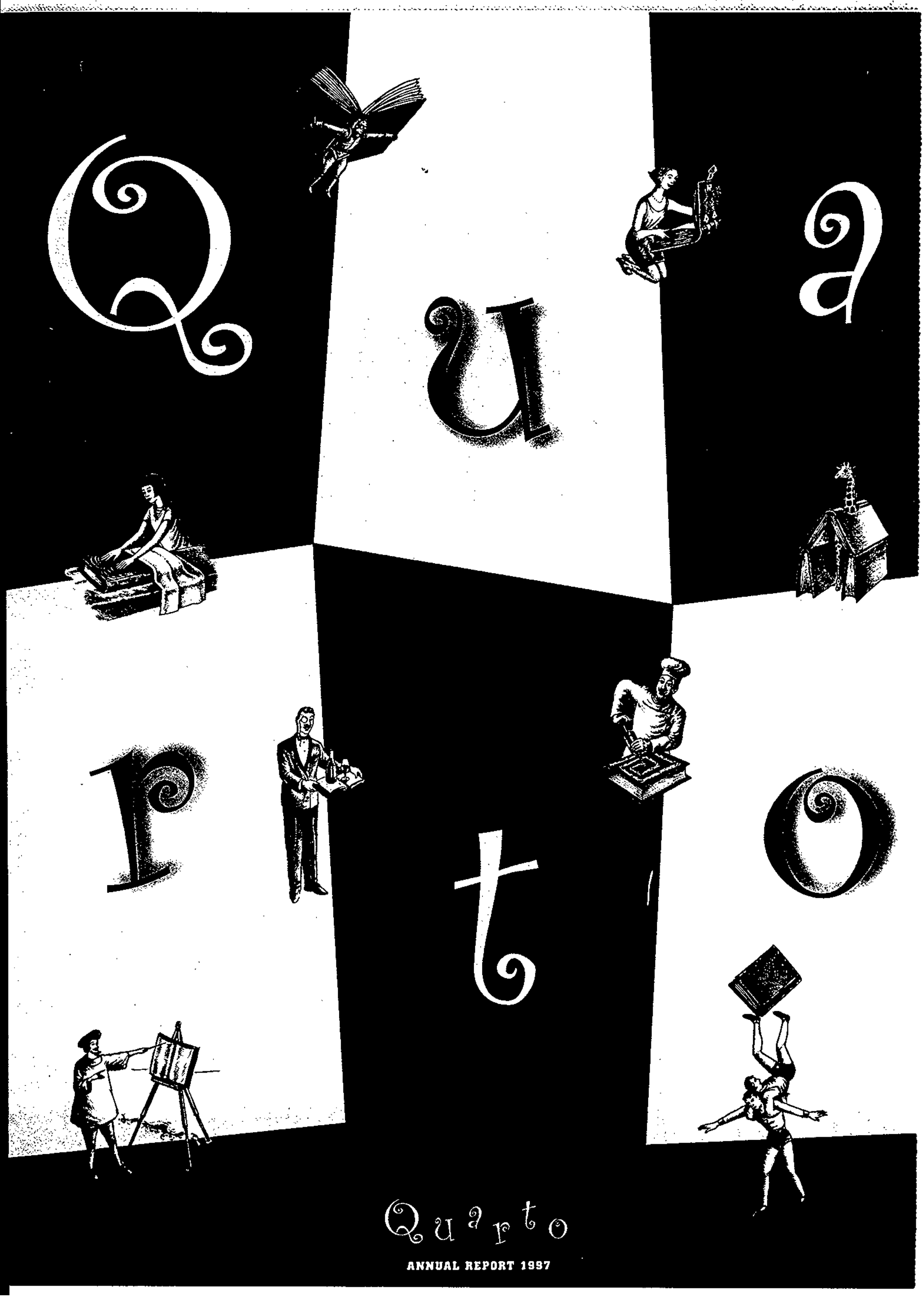
During the year L. F. Orbach and R. J. Morley maintained current accounts with the company. The balances on these accounts were less than £5,000 throughout the year.

c) £244,000 was paid to G. T. Y. Tai for the purchase of 5% of Regent Publishing Services Limited.

HISTORICAL COST FIVE-YEAR SUMMARY

	GROUP				
	1993 £000	1994 £000	1995 £000	1996 £000	**1997 £000**
Profit and loss account					
Turnover	49,590	57,927	66,469	80,619	**81,820**
Operating profit before exceptional charges	5,441	6,949	7,854	9,140	**6,149**
Net interest	(421)	(669)	(840)	(1,329)	**(1,941)**
Profit before exceptional charges and taxation	5,020	6,280	7,014	7,811	**4,208**
Loss on closure of operations	—	—	—	—	**(1,306)**
Profit on ordinary activities before taxation	5,020	6,280	7,014	7,811	**2,902**
Taxation	(1,301)	(1,741)	(1,747)	(1,906)	**(636)**
Profit on ordinary activities after taxation	3,719	4,539	5,267	5,905	**2,266**
Minority interests	(224)	(258)	(241)	(528)	**(500)**
Profit for the financial year	3,495	4,281	5,026	5,377	**1,766**
Dividends	(1,467)	(1,614)	(1,800)	(1,944)	**(1,296)**
Retained profit	2,028	2,667	3,226	3,433	**470**
Earnings per share					
Before exceptional charges	19.7p	20.8p	24.8p	26.5p	**13.2p**
After exceptional charges	19.7p	20.8p	24.8p	26.5p	**7.0p**
Dividends per share	6.0p	6.3p	7.25p	8.0p	**4.5p**
Balance sheet					
Fixed assets	4,908	5,736	6,787	7,392	**6,759**
Other net assets	13,702	19,415	23,809	28,353	**31,429**
	18,610	25,151	30,596	35,745	**38,188**
Net borrowings	(3,915)	(11,684)	(12,497)	(22,444)	**(24,448)**
	14,695	13,467	18,099	13,301	**13,740**
Cash flow					
Net cash inflow from operating activities				1,807	**4,903**
Return on investment and servicing of finance				(1,691)	**(2,427)**
Taxation				(996)	**(1,453)**
Capital expenditure and financial investment				(1,009)	**(28)**
Acquisition and disposals				(7,552)	**(565)**
Equity dividends paid				(1,386)	**(1,587)**
Other				880	**(847)**
Movement in (debt)/funds for year				(9,947)	**(2,004)**
Net (debt)/funds at beginning of year				(12,497)	**(22,444)**
Net (debt)/funds at end of year				(22,444)	**(24,448)**

The summary cash flow information in respect of the 1993 to 1995 is not readily available in the manner required by the new accounting standard, FRS1, Cash Flow Statements.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