

The Quarto Group Inc.

Directors' report and consolidated financial statements

Year ended 31 December 2002

Registered number FC013814



Chief Financial Officer's Report

TURNOVER AND OPERATING PROFIT BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEMS

Turnover was up 1.5% at £74.7m [2001: £73.6m]. Margins fell from 35.3% to 34.7% but overheads were down slightly leading to a flat operating profit before amortisation of goodwill and exceptional items at £6.2m. Operating profit before amortisation of goodwill and exceptional items represented 8.3% of sales compared to 8.4% in 2001.

INTEREST

The net interest charge fell from £1.7m to £1.2m due to lower interest rates, currency translation and lower borrowings. Interest cover increased by 50% to 5.4 times [2001: 3.6] based on operating profit before amortisation of goodwill and exceptional items.

TAXATION

The taxation charge on profit before amortisation of goodwill and exceptional items was 9.8% [2001: 6.7%]. The Group's tax charge benefits from taxable losses brought forward, together with low tax rates in Hong Kong and Switzerland.

SHAREHOLDER RETURN

Basic earnings per share rose 71.8% to 20.1p [2001: 11.7p]. Underlying earnings per share rose 12.2% to 21.1p [2001: 18.8p].

The proposed final dividend of 2.9p represents an increase of 15% on last year's final dividend; this results in a total dividend for the year of 5.25p, an increase of 11.0% on last year. The dividend is 4.0 times covered [2001: 4.0 times] by underlying earnings per share.

The market price of the shares of common stock on December 31, 2002 was 92.0p [2001: 68.5p], up 34.3% from last year.

GOODWILL

Goodwill arising on acquisitions is carried in the balance sheet under the category of intangible fixed assets in accordance with the accounting standard FRS 10. The goodwill arising during the year relates to the purchase of the business and assets of Marshall Editions Limited and its associated entities, an additional 5% shareholding in Book Sales Inc and a small backlist of titles.

WORKING CAPITAL

Working capital at the balance sheet dates is summarised below:

	2002	2001
	£m	£m
Stock and work in progress	18.7	20.1
Trade debtors	19.4	21.6
Trade creditors	(18.7)	(19.4)
Other net liabilities	(1.4)	(0.2)
	<u>18.0</u>	<u>22.1</u>

Stock and work in progress is down by £1.4m

Trade debtors represent 2.7 months sales, a good improvement compared to 2.9 months at the end of 2001.

CASH FLOW AND NET DEBT

Net cash inflow from operating activities was £8.4m [2001: £5.7m]. We continue to generate more than 100% of our operating profit in cash; in 2002 it was 147% [2001: 117%].

At the year end our net debt was £19.8m, down £3.9m compared to 2001 (£23.7m). Our total banking facilities at the year end were £37.5m, and of this, £32.1m was committed.

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 has not entered into interest rate swaps.
- **Currency rate exposure;** the Group's principal operating currency is the US dollar. At Group level our annual US dollar receipts and payments are approximately the same and as a consequence we have a natural hedge in place to help protect our results from exchange rate fluctuations with regard to the US dollar.

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

	2002	2001
US Dollar	1.50	1.44
Hong Kong Dollar	11.73	11.24
Swiss Franc	2.33	2.43
Australian Dollar	2.76	2.78
Singapore Dollar	2.69	2.58

FINANCIAL REPORTING

We have very tight reporting deadlines as we believe that this enables a greater degree of focus to be placed on running the business. It requires a lot of hard work and commitment and I take this opportunity to thank my staff for their continued loyalty and support.



MICHAEL J MOUSLEY
Chief Financial Officer

February 14, 2003

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

Cyrus Homi Bhote, FCA, MCSE

PRINCIPAL PLACE OF BUSINESS

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

WEBSITE

www.quarto.com

STOCKBROKERS

Collins Stewart Limited
21 New Street,
London, EC2M 4HR

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
Bourne House, 34 Beckenham Road, Beckenham, Kent, BR3 4TU

PRINCIPAL BANKERS

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

Fleet Bank

100 Federal Street, Boston, MA 02110, USA

The Royal Bank of Scotland plc

280 Bishopsgate, London, EC2M 4RB

REGISTERED NUMBER

FCO 13814

The Directors present their report and the audited financial statements of The Quarto Group, Inc., for the year ended December 31, 2002.

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 and Operational Review on pages 6 to 16.

RESULTS AND DIVIDENDS

The profit for the year after taxation and minority interests amounted to £4,040,000 [2001: £2,538,000]. The Directors propose a final ordinary dividend of 2.9p [2001: 2.53p] per share subject to approval at the Annual General Meeting. The retained profit for the year was £2,661,000 [2001: £1,243,000] 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
G. T. Y. Tai (Resigned June 14, 2002)
P. Campbell (Non-executive)
P. Waine (Non-executive)
L. Collins (Non-executive)

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 contract of more than one year's duration.

Save as disclosed in Note 21, no Director has had a material interest in any contract of significance with the Company or its subsidiaries during the year.

SHARE CAPITAL

On October 24, 2002 the Company bought back 20,000 shares of preferred stock of nominal value US \$0.10 at a price of 122p and on October 29, 2002 the Company bought back 30,000 shares of preferred stock of nominal value US \$0.10 at a price of 118p. As a US Company it is permitted to hold these shares as treasury stock, without cancelling them, and to reissue them (refer to note 16).

DIRECTORS' INTERESTS IN SHARES

The Directors who held office at December 31, 2002 had the following interests in the share capital of the Company.

Shareholding	Number of US\$0.10 shares of common stock	
	31 December, 2002	1 January, 2002
L. F. Orbach*	2,957,413	2,913,413
R. J. Morley	1,583,424	1,539,424
M. J. Mousley	42,700	42,000
L. Collins	337,650	337,650
P. Campbell	1,000	1,000
P. Waine	-	-

Details of the Directors options are given in the Directors' Remuneration Report on page 25

*2,678,413 shares in which L. F. Orbach is interested are owned through his family trusts. The remaining 279,000 are held by the Quarto Publishing plc pension scheme, which is for the benefit of both L. F. Orbach and R. J. Morley.

279,000 of the shares in which R. J. Morley is interested are owned through the Quarto Publishing plc pension scheme, which is for the benefit of both 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, 2002 (At January 1, 2002: L. F. Orbach: nil; M. J. Mousley: 10,000).

During the year the market price of the shares of common stock ranged between 66.0p and 115.0p. The market price at December 31, 2002 was 92.0p.

Between December 31, 2002 and February 14, 2003 there have been no changes in the interests of the Directors.

SUBSTANTIAL SHAREHOLDERS

As at February 14, 2003, 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
Aerion Fund Management Ltd	681,026	3.6%
Chelverton Fund Limited	885,000	4.7%
Herald Investment Trust	1,175,000	6.3%
Invesco English & International Trust	900,000	4.8%
J. O. Hambro Capital Management	4,968,843	26.6%
UBS Asset Management Limited	1,058,576	5.7%
L. F. Orbach	2,957,413	15.8%
R. J. Morley	1,583,424	8.5%
The Quarto Group, Inc.	750,000	4.0%

CORPORATE GOVERNANCE

The Directors have reviewed the governance arrangements of The Quarto Group, Inc. in the context of the Combined Code, issued in June 1998. The principles of the Code have been applied as follows:

- The Board of Directors represents the shareholders' interests in maintaining and growing a successful business including optimising consistent long-term financial returns.
- 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.
- The Board meets eight times a year. 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.
- All of the Directors are subject to re-election by the shareholders at the Annual General Meeting.
- The remuneration of the executive Directors is recommended by the Remuneration Committee. A separate report with respect to Directors' remuneration is included on page 25.
- The Chairman and the Finance Director are responsible for investor relations. Shareholders are invited to attend the AGM at least twenty working days in advance of that meeting.
- The Audit Committee, comprising P. Campbell, P. Waine and L. Collins, meet with the independent auditors as necessary.

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. Due to the size of the Group the Board sees no commercial benefit in splitting the roles of Chairman and 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 does not consist exclusively of non-executive Directors. The Chairman, P. Campbell, P. Waite and L. Collins fulfil the role of the Remuneration Committee for Directors.
- 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.

GOING CONCERN

The Directors, having made enquiries, consider that the Group will have adequate resources to continue in operational existence for the foreseeable 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 board 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.

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, 2002, Group creditor days amounted to 107 days [2001: 105 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 
Director
February 14, 2003

Directors' Remuneration Report

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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 Directors 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.

Performance related bonuses are not usually given.

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.

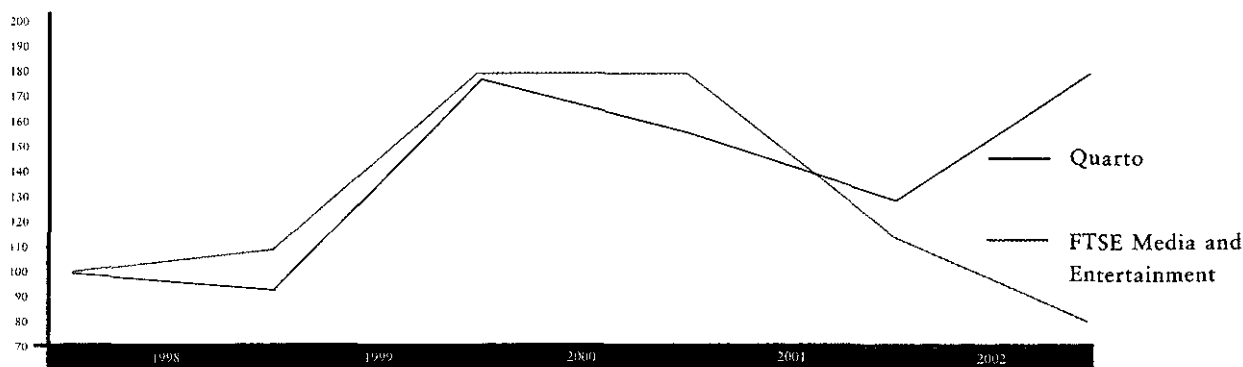
SERVICE AGREEMENTS

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. The independent non-executive Directors do not have service 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.

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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	2002 TOTAL £000	2001 TOTAL £000
L. F. Orbach	300	4	304	253
R. J. Morley	171	4	175	174
M. J. Mousley	150	2	152	136
G.T.Y. Tai (to date of resignation)	51	6	57	114
P. Campbell	23	-	23	19
P. Waine	23	-	23	19
L. Collins	23	-	23	19
	<u>741</u>	<u>16</u>	<u>757</u>	<u>734</u>

Benefits consist of benefits in kind in respect of motor vehicles (G.T.Y. Tai only) and health insurance.

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

	2002 £000	2001 £000
L. F. Orbach	55	46
R. J. Morley	26	26
M. J. Mousley	22	19
G.T.Y. Tai (to date of resignation)	<u>2</u>	<u>4</u>
	<u>105</u>	<u>95</u>

SHARE OPTIONS

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

	At January 1, 2002	Awarded	Lapsed	At December 31, 2002	Exercise price	Earliest date of exercise	Expiry date
L. F. Orbach	50,000	-	(50,000)	-	£1.30424	10.4.1995	9.4.2002
	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
G.T.Y. Tai	5,000	-	-	5,000*	£1.115	22.2.2003	21.2.2010

* At time of resignation

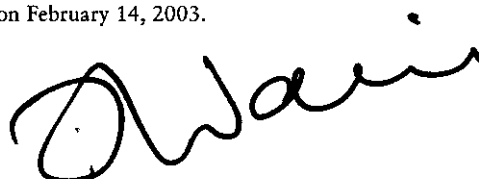
No gains were made by Directors on the exercise of the share options in the current or prior year.

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 115p and 66p respectively. The price at the year end was 92p.

This report was approved by the Board of Directors on February 14, 2003.

P. WAINE
Chairman of Remuneration Committee



Statement of Directors' Responsibilities

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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 overseas 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, with the exception of accounting for treasury stock as explained in note 16.

The Directors are responsible 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 are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the 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 enable them to ensure that the financial statements comply with the relevant requirements of UK company law. They have assumed 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 29 to 48. 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 are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 27, 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, except that own shares are shown as a deduction from shareholders' funds. 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.

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.

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.

In addition to our audit of the financial statements, the Directors have instructed 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 statement on pages 22 to 24 reflects the Company's compliance with the seven provisions of the Combined 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.

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, 2002 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 on the basis set out in the accounting policies.

KPMG Audit Plc
Chartered Accountants
London
February 14, 2003

KPMG Audit Plc

Consolidated profit and loss account for the year ended December 31, 2002

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GROUP

	Notes	2002 £000	2001 £000
TURNOVER			
Continuing operations	1	72,552	73,620
Acquisitions		2,183	-
TOTAL TURNOVER	1	74,735	73,620
Cost of sales		(48,796)	(47,624)
GROSS PROFIT		25,939	25,996
Distribution costs		(2,366)	(2,381)
Administration expenses			
-Before exceptional items and goodwill amortisation		(17,514)	(17,532)
-Exceptional items	2	-	(1,200)
-Goodwill amortisation		(175)	(74)
Total administrative expenses		(17,689)	(18,806)
Other operating income		147	114
GROUP OPERATING PROFIT		6,031	4,923
Net interest payable and similar charges	3	(1,151)	(1,733)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	2	4,880	3,190
Tax on profit on ordinary activities	4	(497)	(300)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		4,383	2,890
Minority interests – equity		(343)	(352)
PROFIT FOR THE YEAR		4,040	2,538
Dividends (including non-equity)	5	(1,379)	(1,295)
RETAINED PROFIT FOR THE YEAR		2,661	1,243
EARNINGS PER SHARE	6	20.1p	11.7p
UNDERLYING EARNINGS PER SHARE	6	21.1p	18.8p
DILUTED EARNINGS PER SHARE	6	19.3p	11.7p
DILUTED UNDERLYING EARNINGS PER SHARE	6	20.1p	18.1p

Balance Sheets at December 31, 2002

		GROUP		COMPANY	
	Notes	2002 £000	2001 £000	2002 £000	2001 £000
FIXED ASSETS					
Intangible assets	7	3,376	1,395	-	-
Tangible assets	7	5,875	6,267	-	-
Investments	8	-	-	13,791	11,209
		<u>9,251</u>	<u>7,662</u>	<u>13,791</u>	<u>11,209</u>
CURRENT ASSETS					
Stocks and work in progress	9	18,675	20,118	-	-
Debtors	10	21,519	23,509	-	-
Cash and deposits	11	11,315	8,679	-	-
		<u>51,509</u>	<u>52,306</u>	<u>-</u>	<u>-</u>
CREDITORS: Amounts falling due within one year	12	(24,576)	(54,225)	(520)	(453)
NET CURRENT ASSETS / (LIABILITIES)		<u>26,933</u>	<u>(1,919)</u>	<u>(520)</u>	<u>(453)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>36,184</u>	<u>5,743</u>	<u>13,271</u>	<u>10,756</u>
CREDITORS: Amounts falling due after more than one year	13	(29,056)	(517)	-	-
PROVISION FOR LIABILITIES AND CHARGES					
Deferred taxation	14	(1,235)	(1,175)	-	-
NET ASSETS		<u>5,893</u>	<u>4,051</u>	<u>13,271</u>	<u>10,756</u>
CAPITAL AND RESERVES					
Called up share capital	15	1,341	1,341	1,341	1,341
Treasury stock	16	(698)	(638)	(698)	(638)
Reserves – Paid in surplus	17	23,891	23,891	23,891	23,891
– Revaluation	17	988	998	-	-
– Profit and loss	17	(22,135)	(25,090)	(11,263)	(13,838)
SHAREHOLDERS' FUNDS		<u>3,387</u>	<u>502</u>	<u>13,271</u>	<u>10,756</u>
Equity		(1,817)	(4,702)	8,067	5,552
Non-equity		<u>5,204</u>	<u>5,204</u>	<u>5,204</u>	<u>5,204</u>
		<u>3,387</u>	<u>502</u>	<u>13,271</u>	<u>10,756</u>
MINORITY INTERESTS – EQUITY		<u>2,506</u>	<u>3,549</u>	<u>-</u>	<u>-</u>
		<u>5,893</u>	<u>4,051</u>	<u>13,271</u>	<u>10,756</u>

The financial statements on pages 29 to 48 were approved by the Board of Directors on February 14, 2003 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, 2002

31

	GROUP	
	2002	2001
	£000	£000
PROFIT FOR THE FINANCIAL YEAR	4,040	2,538
Currency translation differences		
on foreign currency net investments	284	(501)
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR	4,324	2,037

Reconciliation of consolidated movement in shareholders' funds for the Year Ended December 31, 2002

	2002	2001
	£000	£000
PROFIT FOR THE FINANCIAL YEAR	4,040	2,538
Dividends	(1,379)	(1,295)
Retained profit for the financial year	2,661	1,243
Other recognised gains and losses relating to the year	284	(501)
Purchase of shares	(60)	(177)
Net movement in shareholders' funds	2,885	565
Shareholders' funds (deficit) at December 31, 2001	502	(63)
SHAREHOLDERS FUNDS AT DECEMBER 31, 2002	3,387	502

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

Consolidated Cash Flow Statement for the Year Ended December 31, 2002

	GROUP	
	2002	2001
	£000	£000
NET CASH INFLOW FROM OPERATING ACTIVITIES	8,396	5,746
RETURN ON INVESTMENT AND SERVICING OF FINANCE		
Interest received	63	239
Interest paid	(1,071)	(2,525)
Interest element of hire purchase payments	(40)	(53)
Preference dividend paid	(437)	(447)
Dividend paid to minority shareholder	(850)	-
NET CASH OUTFLOW FROM RETURN ON INVESTMENT AND SERVICING OF FINANCE	(2,335)	(2,786)
TAXATION		
UK and overseas corporation tax paid	(504)	(348)
CAPITAL EXPENDITURE		
Purchase of tangible fixed assets	(654)	(715)
Sale of tangible fixed assets	55	67
	(599)	(648)
ACQUISITIONS		
Purchase of businesses	(1,767)	(544)
EQUITY DIVIDENDS PAID		
Dividends paid	(875)	(807)
MANAGEMENT OF LIQUID RESOURCES		
Movement in short term deposits	(1,895)	477
FINANCING		
Purchase of shares	(60)	(177)
Capital element of finance leases	(314)	(529)
Decrease in debt	(162)	(277)
NET CASH OUTFLOW FROM FINANCING	(536)	(983)
(DECREASE) INCREASE IN CASH	(115)	107
RECONCILIATION OF NET CASHFLOW TO MOVEMENT IN NET DEBT		
(Decrease) increase in cash	(115)	107
Decrease in debt and lease financing	476	806
Management of liquid resources	1,895	(477)
	2,256	436
New finance leases	(123)	(552)
Translation differences	1,721	(523)
	3,854	(639)
MOVEMENT IN DEBT FOR YEAR		
Net debt at beginning of year	(23,637)	(22,998)
Net debt at end of year	(19,783)	(23,637)

See note 20 for an analysis of certain of the items included above.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements except as noted below. The Group has adopted FRS 19 "Deferred Tax" in these financial statements. This change in accounting policy did not have a material effect on the comparative figures.

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, with the exception of accounting for treasury stock as explained in note 16.

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 a December 31 year end.

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 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 (not more than 20 years). 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.

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.

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 as ordinary trading items.

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 against 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.

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) 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 arise.

FINANCIAL INSTRUMENTS

Page 17 of the Financial Review 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

3

GROUP	
2002	2001
£000	£000

I SEGMENTAL ANALYSIS

GEOGRAPHICAL ANALYSIS OF TURNOVER BY DESTINATION

United Kingdom	16,557	14,024
United States of America	41,879	41,927
Canada	1,794	1,683
Europe	7,956	8,536
Australasia and the Far East	5,212	5,793
Rest of the World	1,337	1,657
	<u>74,735</u>	<u>73,620</u>

Turnover from acquisitions relates to the purchase of the business and assets of Marshall Editions Limited and its associated entities in February 2002. The business was integrated into the existing businesses of the Group and it has not been possible to separately identify the contribution to the gross and operating profit for the period.

CLASS OF BUSINESS	TURNOVER		PROFIT BEFORE TAX		NET OPERATING ASSETS	
	2002 £000	2001 £000	2002 £000	2001 £000	2002 £000	2001 £000
Co-edition Publishing	41,856	41,570	4,528	5,044	13,506	15,137
Publishing	32,879	32,050	2,864	2,295	13,973	14,383
	<u>74,735</u>	<u>73,620</u>	<u>7,392</u>	<u>7,339</u>	<u>27,479</u>	<u>29,520</u>
Amortisation of goodwill: Co-edition Publishing			(175)	(74)		
Group overheads			(1,186)	(1,142)		
Exceptional items: Co-edition Publishing			-	(1,200)		
Net interest payable			(1,151)	(1,733)		
			<u>4,880</u>	<u>3,190</u>		

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

ANALYSIS BY GEOGRAPHICAL AREA OF ORIGIN

	TURNOVER		OPERATING PROFIT		NET OPERATING ASSETS	
	2002 £000	2001 £000	2002 £000	2001 £000	2002 £000	2001 £000
United Kingdom	31,012	28,543	3,878	3,583	8,462	7,592
United States of America	30,669	30,733	2,823	2,822	12,810	15,063
Rest of the World	13,054	14,344	691	934	6,207	6,865
	<u>74,735</u>	<u>73,620</u>	<u>7,392</u>	<u>7,339</u>	<u>27,479</u>	<u>29,520</u>

Notes to the Financial Statements

	GROUP	
	2002	2001
	£000	£000
1 SEGMENTAL ANALYSIS (CONTINUED)		
The net operating assets can be reconciled to the consolidated balance sheet as follows:		
Net operating assets	27,479	29,520
Total bank loans and other borrowings	(31,098)	(32,316)
Cash at bank and in hand	11,315	8,679
Corporation tax and deferred tax	(1,283)	(1,379)
Dividends payable	(520)	(453)
Net assets	5,893	4,051
2 PROFIT ON ORDINARY ACTIVITIES		
BEFORE TAXATION IS STATED AFTER CHARGING:		
Depreciation	990	1,105
Auditors' remuneration : audit	186	180
: other	7	27
Operating lease rentals in respect of:		
plant and machinery	138	98
other assets	1,281	1,212
Exceptional items: (2001: bad debt)	-	1,200
Included under auditors' remuneration are audit fees in respect of the Company, amounting to £40,000 [2001: £39,000]. The fees have been dealt with through the financial statements of Quarto Publishing plc.		
A profit of £2,575,000 [2001: Loss £1,295,000] has been dealt with in the accounts of the Company.		
EMPLOYEES		
STAFF COSTS INCLUDING DIRECTORS' EMOLUMENTS COMPRISE:		
Wages and salaries	11,668	11,395
Social security costs	931	914
Pension costs	349	320
	12,948	12,629
THE AVERAGE MONTHLY NUMBER OF PERSONS		
EMPLOYED BY THE GROUP DURING THE YEAR WAS:		
Co-edition Publishing	184	186
Publishing	225	229
Group administration	16	15
	425	430

		GROUP	
		2002	2001
		£000	£000
2	PROFIT ON ORDINARY ACTIVITIES (CONTINUED)		
	DIRECTORS' REMUNERATION		
	EMOLUMENTS:		
	Fees to non-executive Directors	69	57
	Executive Directors – remuneration including benefits in kind in respect of motor vehicles and health insurance	688	677
	– pension contributions	105	95
		<u>862</u>	<u>829</u>
The Directors' remuneration disclosed above included the following amounts paid in respect of the Chairman, who was also the highest paid Director:			
	Remuneration	304	253
	Pension contributions	55	46
		<u>359</u>	<u>299</u>

Details of Directors' remuneration are given in the directors' remuneration report on page 26.

	GROUP	
	2002 £000	2001 £000
3 NET INTEREST PAYABLE AND SIMILAR CHARGES		
Interest payable:		
On bank overdrafts and other loans repayable within 5 years by instalments	1,168	1,939
Hire purchase	40	53
	1,208	1,992
Interest receivable	(57)	(259)
	<u>1,151</u>	<u>1,733</u>
4 TAXATION		
United Kingdom corporation tax at 30%	-	(36)
Overseas tax	354	378
Total current tax	354	342
Deferred taxation – UK	(6)	29
– Overseas	149	(71)
	<u>497</u>	<u>300</u>
The current tax charge for the year is lower than the standard rate of corporation tax in the UK [30%; 2001: 30%]. The differences are explained below:		
Profit on ordinary activities before tax	<u>4,880</u>	<u>3,190</u>
Current tax at 30%	1,464	957
Effects of:		
Utilization of tax losses	(906)	(771)
Lower tax rates on overseas earnings	(190)	(232)
Tax losses not utilized	137	409
Other (including temporary and permanent timing differences)	(151)	(21)
Total current tax charge	<u>354</u>	<u>342</u>
Future tax charges may be affected by the utilization of tax losses and low tax rates in Hong Kong and Switzerland.		
5 DIVIDENDS		
Equity: Ordinary: Interim paid of 2.35p per share [2001: 2.2p per share]	422	395
Ordinary: Final proposed of 2.9p per share [2001: 2.53p per share]	520	453
	942	848
Non-equity: Preference	437	447
	<u>1,379</u>	<u>1,295</u>

6 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the earnings attributable to common stock holders 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.

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	2002 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE	EARNINGS £000	2001 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE
Basic earnings per share	3,603	17,925,306	20.1	2,091	17,925,306	11.7
Effect of dilutive options	-	31,423	-	-	4,138	-
Dilutive preference shares	437	2,989,414	14.6	-	-	-
Diluted earnings per share	<u>4,040</u>	<u>20,946,143</u>	<u>19.3</u>	<u>2,091</u>	<u>17,929,444</u>	<u>11.7</u>
Underlying earnings per share figures						
Basic earnings per share	3,603	17,925,306	20.1	2,091	17,925,306	11.7
Effect of:						
Exceptional items	-	17,925,306	-	1,200	17,925,306	6.7
Goodwill amortisation	175	17,925,306	1.0	74	17,925,306	0.4
Basic earnings per share before goodwill amortisation and exceptional items	<u>3,778</u>	<u>17,925,306</u>	<u>21.1</u>	<u>3,365</u>	<u>17,925,306</u>	<u>18.8</u>
Underlying basic earnings per share	3,778	17,925,306	21.1	3,365	17,925,306	18.8
Effect of:						
Dilutive options	-	31,423	-	-	4,138	-
Dilutive preference shares	437	2,989,414	14.6	447	3,086,414	14.5
Diluted underlying earnings per share before goodwill amortisation and exceptional items	<u>4,215</u>	<u>20,946,143</u>	<u>20.1</u>	<u>3,812</u>	<u>21,015,858</u>	<u>18.1</u>

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, 2002	3,012	1,056	6,456	1,121	11,645
Exchange differences	(57)	(55)	(235)	(67)	(414)
Additions	104	3	544	126	777
Disposals	-	(220)	(1,092)	(389)	(1,701)
At December 31, 2002	<u>3,059</u>	<u>784</u>	<u>5,673</u>	<u>791</u>	<u>10,307</u>
Depreciation:					
At January 1, 2002	94	550	3,918	816	5,378
Exchange differences	(7)	(22)	(198)	(56)	(283)
Charge for the year	42	92	804	52	990
Disposals	-	(219)	(1,038)	(396)	(1,653)
At December 31, 2002	<u>129</u>	<u>401</u>	<u>3,486</u>	<u>416</u>	<u>4,432</u>
Net book value:					
At December 31, 2002	<u>2,930</u>	<u>383</u>	<u>2,187</u>	<u>375</u>	<u>5,875</u>
At December 31, 2001	<u>2,918</u>	<u>506</u>	<u>2,538</u>	<u>305</u>	<u>6,267</u>

The net book value of plant, equipment and motor vehicles included £1,547,000 [2001: £1,059,000] in respect of assets held under hire purchase contracts. The depreciation charged on these assets during the year was £108,000 [2001: £176,000]. Included in leasehold property at cost is £360,000 [2001: £391,000] in respect of a long leasehold property; the net book value was £279,000 [2001: £315,000].

As stated in the accounting policy note on page 33, 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.

GROUP			
	COST £000	AMORTISATION £000	NET BOOK VALUE £000
INTANGIBLE FIXED ASSETS			
GOODWILL			
At January 1, 2002	1,539	(144)	1,395
Additions	2,156	-	2,156
Amortisation for the year	-	(175)	(175)
At December 31, 2002	<u>3,695</u>	<u>(319)</u>	<u>3,376</u>

Notes to the Financial Statements

4

7 FIXED ASSETS (CONTINUED) INTANGIBLE FIXED ASSETS GOODWILL

The additions to goodwill arose from acquisitions made during the year as set out below:

	ACQUISITIONS		
	MARSHALL EDITIONS £000	OTHERS £000	TOTAL £000
Fair value of consideration	1,265	385	1,650
Acquisition costs	105	12	117
	<u>1,370</u>	<u>397</u>	<u>1,767</u>
Fair value of assets and liabilities acquired :			
Stock	45	-	45
Current liabilities	(725)	-	(725)
Minority interest	-	291	291
	<u>(680)</u>	<u>291</u>	<u>(389)</u>
Goodwill arising on acquisition	<u>2,050</u>	<u>106</u>	<u>2,156</u>

The business and liabilities of Marshall Editions and its associated entities was acquired on February 7, 2002. Other acquisitions consist of the acquisition of an additional 5% shareholding in Book Sales Inc and a small backlist of titles.

No fair value adjustments were made to book value as the effect is not material.

The goodwill arising on the acquisition is to be amortised over the useful economic life of the business and assets acquired, which management consider to be 20 years for Marshall Editions and the additional shareholding in Book Sales Inc, and 10 years for the backlist of titles.

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, 2002	10,471	738	11,209
Additions	1,182	1,400	2,582
At December 31, 2002	11,653	2,138	13,791

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
Quarto Children's Books Limited	England 6 January, 1976	2 shares of £1 each	100	Co-edition Publishing
Scafa-Tornabene Art Publishing Co., Inc.	Delaware, USA 29 June, 1987	1,210 shares of no par value	100	Publishing
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	100*	Co-edition Publishing
Global Book Publishing Pty. Limited	Australia 4 November, 1999	1,000 shares of A\$1 each	100*	Co-edition Publishing

Notes to the Financial Statements

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	GROUP		COMPANY	
	2002	2001	2002	2001
	£000	£000	£000	£000
9 STOCKS AND WORK IN PROGRESS				
Finished goods	13,035	14,906	-	-
Work in progress	5,670	5,126	-	-
Raw materials	339	404	-	-
Less: Payments on account	(369)	(318)	-	-
	<u>18,675</u>	<u>20,118</u>	<u>-</u>	<u>-</u>
10 DEBTORS				
Trade debtors	19,444	21,569	-	-
Prepayments and accrued income	1,809	1,797	-	-
Other debtors	266	143	-	-
	<u>21,519</u>	<u>23,509</u>	<u>-</u>	<u>-</u>
11 CASH AND DEPOSITS				
Cash at bank	7,323	6,324	-	-
Short term deposits	3,992	2,355	-	-
	<u>11,315</u>	<u>8,679</u>	<u>-</u>	<u>-</u>
12 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR				
Bank overdrafts	2,013	480	-	-
Current loan instalments	71	31,301	-	-
Hire purchase creditors	197	275	-	-
Total borrowings	2,281	32,056	-	-
Trade creditors	18,741	19,431	-	-
Other creditors including taxation and social security:				
Corporation tax	48	204	-	-
Dividend payable	520	453	520	453
Social security	497	531	-	-
Other creditors	1,154	703	-	-
Accruals and deferred income	1,335	847	-	-
	<u>24,576</u>	<u>54,225</u>	<u>520</u>	<u>453</u>

Notes to the Financial Statements

	GROUP		COMPANY	
	2002	2001	2002	2001
	£000	£000	£000	£000
13 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Bank and other loans	28,738	68	-	-
Hire purchase liabilities	79	192	-	-
Total borrowings	28,817	260	-	-
Other creditors	239	257	-	-
	<u>29,056</u>	<u>517</u>	<u>-</u>	<u>-</u>

Total borrowings are repayable as follows:

Bank loans and overdrafts:

In one year or less, or on demand	2,084	31,781	-	-
Between one and two years	16	55	-	-
Between two and five years	28,722	13	-	-
	<u>30,822</u>	<u>31,849</u>	<u>-</u>	<u>-</u>

Other borrowings (hire purchase liabilities):

In one year or less, or on demand	197	275	-	-
Between one and two years	68	150	-	-
Between two and five years	11	42	-	-
	<u>276</u>	<u>467</u>	<u>-</u>	<u>-</u>

Total loans and other borrowings:

In one year or less, or on demand	2,281	32,056	-	-
Between one and two years	84	205	-	-
Between two and five years	28,733	55	-	-
	<u>31,098</u>	<u>32,316</u>	<u>-</u>	<u>-</u>

The above borrowings carry interest at commercial rates ranging from 1.33% to 5.25%. Of the total borrowings £26,834,000 (2001: £29,417,000) was denominated in US dollars, the remainder being denominated in a variety of currencies.

The Group has a 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:

- Total consolidated net indebtedness shall not exceed 3.33 times EBITDA, as defined in the facility agreements. For the year ended December 31, 2002, EBITDA, as defined in the facility agreements, was £11,998,000 giving a maximum indebtedness of £39,953,000.
- The consolidated operating profit before exceptional items and goodwill amortization shall exceed three times net interest payable. For the year ended December 31, 2002, net interest payable was 5.4 times covered under this covenant.
- The consolidated operating profit before goodwill amortization shall exceed 1.5 times net interest payable. For the year ended December 31, 2002, net interest payable was 5.4 times covered under this covenant.

Notes to the Financial Statements

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GROUP

AMOUNT PROVIDED
2002 2001
£000 £000

14 DEFERRED TAXATION

Deferred taxation provided in the financial statements is as follows:

Excess of capital allowances over depreciation	137	145
Other-UK	(101)	(103)
Other-overseas	1,199	1,133
	<u>1,235</u>	<u>1,175</u>

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:

	2002	2001
	£000	£000
Provision at January 1, 2002	1,175	1,202
Exchange difference	(83)	15
Charge / (credit) profit and loss account	143	(42)
Provision at December 31, 2002	<u>1,235</u>	<u>1,175</u>

15 SHARE CAPITAL

Authorised:

28,000,000 [2001: 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 [2001: US\$2,800,000].

5,212,587 [2001: 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 [2001: US\$521,258].

	2002	2001
	£000	£000
Equity share capital		
Allotted, called up and fully paid:		
18,675,306 shares of common stock of par value US\$0.10 each [2001: 18,675,306]	1,063	1,063
Non-equity share capital		
Allotted, called up and fully paid:		
5,204,024 shares of preferred stock of US\$0.10 each [2001: 5,204,024]	278	278
	<u>1,341</u>	<u>1,341</u>

Notes to the Financial Statements

At December 31, 2002, 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
34,000	October 26, 1996 – October 25, 2003	£2.82
23,000	March 31, 2001 – March 30, 2008	£0.685
15,000	March 31, 2001 – March 30, 2005	£0.685
28,000	February 22, 2003 – February 21, 2007	£1.115
48,000	February 22, 2003 – February 21, 2010	£1.115
22,500	March 29, 2004 – March 28, 2011	£0.825
41,000	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

The movement in outstanding options from December 31, 2001 comprises (a) new options granted on February 15, 2002 and February 26, 2002, as identified above (b) 65,000 shares exercisable between April 10, 1995 and April 9, 2002 lapsed.

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		COMPANY	
	2002 £000	2001 £000	2002 £000	2001 £000
16 TREASURY STOCK				
At January 1, 2002	638	461	638	461
Purchase during the year	60	177	60	177
At December 31, 2002	698	638	698	638

The Company purchased 750,000 of its own shares of common stock during 1998 and 180,000 and 50,000 of its own shares of preferred stock during 2001 and 2002 respectively. As a US company, it is permitted to hold these shares as treasury stock, without cancelling them, and to reissue them. Companies are not permitted to own their own shares in the same way under UK law and therefore the directors consider that the presentation of own shares as fixed asset investments that is required by paragraph 8 of Schedule 4 to the Companies Act 1985 would not give a true and fair view in the case of this company. In accordance with section 226 of that Act, the directors have overridden the detailed requirement and adopted the presentation normally used by US companies in order to show a true and fair view. The effect is to reduce fixed asset investments and shareholders' funds in the balance sheets of the Group and of Company by £698,000.

Notes to the Financial Statements

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GROUP			
	PAID IN SURPLUS	REVALUATION RESERVE	PROFIT AND LOSS ACCOUNT
	£000	£000	£000
17 RESERVES			
At beginning of the year	23,891	998	(25,090)
Retained profit for the year	-	-	2,661
Difference on translation of net assets and profit and loss accounts of non-UK companies	-	-	284
Transfers	-	(10)	10
At the end of year	23,891	988	(22,135)
Analysed as follows:			
Profit and loss account			2,579
Goodwill previously written off to reserves			(24,714)
			(22,135)

COMPANY		
	PAID IN SURPLUS	PROFIT AND LOSS ACCOUNT
	£000	£000
At beginning of year	23,891	(13,838)
Profit for the year	-	2,575
At the end of year	23,891	(11,263)

GROUP				
	LAND AND BUILDINGS	OTHER	LAND AND BUILDINGS	OTHER
	2002	2002	2001	2001
	£000	£000	£000	£000
18 FINANCIAL COMMITMENTS				
At December 31, 2002, the Group had annual commitments to make payments under operating leases during the next year as follows for leases expiring:				
Within one year	392	4	430	4
Between two and five years	626	112	519	89
Over five years	-	-	121	-
	1,018	116	1,070	93

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 [2001: £30,000]. This expenditure was authorised and contracted for.

Notes to the Financial Statements

19 CONTINGENT COMMITMENTS AND LIABILITIES

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 December 31, 2002 there was a potential liability, based on Book Sales Inc's financial statements, of approximately US \$1,793,000. No provision has been made because the minority shareholder has not exercised his option. At December 31, 2002 the minority interest relating to Book Sales Inc in the consolidated financial statements of The Quarto Group, Inc was US\$1,414,000.

The Quarto Group, Inc. has issued guarantees in respect of £2,013,000 of overdrafts of subsidiaries [2001: £480,000] and bank loans of £28,722,000 [2001: £31,248,000]. The Group has also issued guarantees in respect of £276,000 of hire purchase creditors of subsidiaries [2001: £467,000]. 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.

20 NOTES ON THE CONSOLIDATED CASH FLOW STATEMENT

RECONCILIATION OF OPERATING PROFIT

TO NET CASH INFLOWS FROM OPERATING ACTIVITIES

	GROUP	
	2002	2001
	£000	£000
Operating profit	6,031	4,923
Depreciation and amortisation charge	1,165	1,179
(Profit) loss on sale of fixed assets	(7)	1
Decrease (increase) in stocks and work in progress	26	(1,381)
Increase (decrease) in creditors	498	(1,694)
Decrease in debtors	683	2,718
Net cash inflow from operating activities	8,396	5,746

	OPENING BALANCE £000	CASH FLOW £000	EXCHANGE DIFFERENCE £000	NEW HIRE PURCHASE £000	CLOSING BALANCE £000
ANALYSIS OF NET DEBT					
Cash at bank and in hand	6,324	999	-	-	7,323
Bank overdrafts < 1 year	(480)	(1,114)	(419)	-	(2,013)
	5,844	(115)	(419)	-	5,310
HP creditors	(467)	314	-	(123)	(276)
Current loan instalments < 1 year	(31,301)	31,230	-	-	(71)
Bank loans > 1 year	-	(31,120)	2,398	-	(28,722)
Mortgages	(68)	52	-	-	(16)
	(31,836)	476	2,398	(123)	(29,085)
Liquid resources	2,355	1,895	(258)	-	3,992
Net Debt	(23,637)	2,256	1,721	(123)	(19,783)

21 RELATED PARTY TRANSACTIONS

During the year L. F. Orbach and R. J. Morley maintained a current account with the Group. The debit balance on these accounts was less than £5,000 throughout the year. During the year L. F. Orbach loaned £728,000 to the Group and has earned a return at 2.5%.

Historical cost five-year summary

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GROUP

	1998 £000	1999 £000	2000 £000	2001 £000	2002 £000
PROFIT AND LOSS ACCOUNT					
Turnover	79,156	76,456	73,564	73,620	74,735
Operating profit	4,994	5,813	5,573	4,923	6,031
Net interest	(1,931)	(1,716)	(2,023)	(1,733)	(1,151)
Profit before loss on closure of operations and taxation	3,063	4,097	3,550	3,190	4,880
LOSS ON CLOSURE OF OPERATIONS	(580)	(5,230)	-	-	-
PROFIT (LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	2,483	(1,133)	3,550	3,190	4,880
Taxation	(849)	(390)	(314)	(300)	(497)
PROFIT (LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION	1,634	(1,523)	3,236	2,890	4,383
Minority interests	(555)	(440)	(413)	(352)	(343)
PROFIT (LOSS) FOR THE FINANCIAL YEAR	1,079	(1,963)	2,823	2,538	4,040
Dividends	(1,278)	(1,262)	(1,262)	(1,295)	(1,379)
RETAINED PROFIT (LOSS)	(199)	(3,225)	1,561	1,243	2,661
EARNINGS PER SHARE					
Underlying	4.9p	15.8p	16.1p	18.8p	21.1p
Basic	3.3p	(13.5p)	13.2p	11.7p	20.1p
DIVIDENDS PER SHARE					
	4.5p	4.5p	4.5p	4.73p	5.25p
BALANCE SHEET					
Fixed assets	6,408	7,133	7,342	7,662	9,251
Other net assets	18,516	16,208	18,721	20,026	16,425
	24,924	23,341	26,063	27,688	25,676
NET BORROWINGS	(23,818)	(20,894)	(22,998)	(23,637)	(19,783)
NET ASSETS	1,106	2,447	3,065	4,051	5,893
CASH FLOW					
Net cash inflow from operating activities	5,907	8,259	6,409	5,746	8,396
Return on investment and servicing of finance	(2,417)	(2,191)	(2,478)	(2,786)	(2,335)
Taxation	(678)	(594)	(627)	(348)	(504)
Capital expenditure and financial investment	(878)	(465)	(450)	(648)	(599)
Acquisition and disposals	30	(67)	(1,471)	(544)	(1,767)
Equity dividends paid	(955)	(928)	(877)	(807)	(875)
Other	(379)	(1,090)	(2,610)	(1,252)	1,538
Movement in (debt) funds for year	630	2,924	(2,104)	(639)	3,854
Net debt at beginning of year	(24,448)	(23,818)	(20,894)	(22,998)	(23,637)
Net debt at end of year	(23,818)	(20,894)	(22,998)	(23,637)	(19,783)



THE QUARTO GROUP, INC.

NOTES