The Quarto Group, Inc.

Directors' Report and Financial Statements
For the year ended 31st December 2003

Company Number: FC013814

Chief Financial Officer's Report

2003 RESULTS

In 2003, profit before tax, exceptional item and goodwill amortisation increased by 12.2% from £5.1m to £5.7m. This improvement was driven by a strong performance from our International Co-edition Publishing Division which achieved an operating profit of £5.5m, up 21% from £4.5m last year. The Publishing Division's operating profit declined from £2.9m to £2.2m, following the loss of a major customer of the UK publishing services business in July 2002. Group overheads, before exceptional item and goodwill amortisation, were down from £1.2m to £1.1m, resulting in an overall operating profit, before exceptional item and goodwill amortisation, of £6.6m (8.8% of sales) up 5.8% compared to £6.2m (8.3% of sales) in 2002.

Profit on ordinary activities before taxation of £4.9m (2002: £4.9m) and Operating Profit of £5.8m (2002: £6.0m) were both adversely affected by exceptional costs of £595,000, comprising legal and professional fees associated with the JOHCM Tender Offer and the Group's response.

INTEREST

The net interest charge fell from £1.2m to £0.9m due to lower borrowings, lower interest rates and currency translation. Interest cover based on operating profit, before exceptional item and goodwill amortisation, was a healthy 7.4 times which was up 37.0% compared to 2002 (5.4 times). Based on operating profit, interest cover was 6.5 times, up 25.0% compared to 2002 (5.2 times).

TAXATION

The taxation charge on profit before amortisation of goodwill and exceptional items, was 16.4% [2002: 9.8%]. The Group's tax charge benefited, in particular, from taxable losses brought forward together with low tax rates in certain territories. The taxation charge on profit on ordinary activities before taxation was 15.4% [2002: 10.2%].

SHAREHOLDER RETURN

Underlying earnings per share (see note 6 on page 41) rose 5.7% to 22.3p [2002: 21.1p]. Basic earnings per share fell 6.0% to 18.9p [2002: 20.1p], principally because of the impact of the exceptional item.

The proposed final dividend of 3.25p represents an increase of 12.1% on last year's final dividend. The total dividend for the year is 5.75p, an increase of 9.5% on last year. The total dividend is 3.9 times covered [2002: 4.0 times] by underlying earnings per share; it is 3.3 times covered [2002: 3.8 times] by basic earnings per share.

The market price of the shares of common stock on December 31, 2003 was 157.5p, up 71.1% compared to last year [92.0p].

Quarto's common stock has generated a very strong total shareholder return over the five years, three years and one year ended December 31, 2003 of 251%, 114% and 80% respectively. Over the same period, Quarto's common stock has significantly outperformed the FTSE 100, the FTSE small cap index and the media sector.

FIXED ASSETS

In 2003 we spent £4.2m on fixed assets [2002: £0.8m]. The major part of this, some £3.6m, related to the purchase of a new 50,000 square feet factory and new machinery for one of our publishing services units.

WORKING CAPITAL

Working capital at the balance sheet dates is summarised below:

	2003 £m	2002 £m
Stock and work in progress	17.5	18.7
Trade debtors	18.5	19.4
Trade creditors	(19.0)	(18.7)
Other net liabilities	(1.3)	(0.9)
	15.7	18.5

Working capital is down, principally because of the weakness of the US$ (2003 year end rate was 1.79 compared to 1.60 last year)

Trade debtors represent 2.8 months sales, compared to 2.7 months at the end of 2002.

CASH FLOW AND NET DEBT

Net cash inflow from operating activities was £8.0m [2002: £8.4m]. We continue to generate more than 100% of our operating profit in cash; in 2003 it was 138% [2002: 139%].

At the year end our net debt was £17.4m, down £2.4m compared to 2002 (£19.8m). Our total banking facilities at the year end were £36.7m, and of this, £31.3m was committed for more than one year.

TREASURY

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

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

- Interest rate risk; most of the Group's borrowings are at floating rates. The Group has not entered into interest rate swaps.

- Currency rate exposure; the Group's principal operating currency is the US dollar. Approximately 70% of our sales are denominated in US dollars and a greater percentage of our expenditure. At Group level we try to match our annual US dollar receipts and payments in order to mitigate the impact that exchange rate fluctuations, with regard to the US dollar, have on our results.

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

	2003	2002
US Dollar	1.63	1.50
Hong Kong Dollar	12.72	11.73
Australian Dollar	2.52	2.76

FINANCIAL REPORTING

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

MICHAEL J MOUSLEY
Chief Financial Officer

February 13, 2004

Directors and Advisers

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

SECRETARY
Michael John Mousley, ACA

PRINCIPAL PLACE OF BUSINESS
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STOCKBROKERS
Collins Stewart Limited
88 Wood Street,
London, EC2V 7QR

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

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

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

PRINCIPAL BANKERS
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

Directors' Report

The Directors present their report and the audited financial statements of The Quarto Group, Inc., for the year ended December 31, 2003.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The Group conducts an international business whose principal activity is as a publisher of illustrated non-fiction books in co-edition and under its own imprint, for both adults and children. A detailed review of the development of the business of the Group is given in the Chairman's Letter on pages 8 to 18.

RESULTS AND DIVIDENDS

The profit for the year after taxation and minority interests amounted to £3,809,000 [2002: £4,040,000]. The Directors propose a final ordinary dividend of 3.25p [2002: 2.9p] per share subject to approval at the Annual General Meeting. The retained profit for the year was £2,351,000 [2002: £2,661,000] which has been transferred to reserves.

DIRECTORS

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

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

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

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

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

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

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

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

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

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

DIRECTORS' INTERESTS IN SHARES

The Directors who held office at December 31, 2003 had the following interests in the share capital of the Company.

	Number of US$0.10 shares of common stock	
Shareholding	31 December, 2003	1 January, 2003
L. F. Orbach*	2,957,413	2,957,413
R. J. Morley	1,583,424	1,583,424
M. J. Mousley	42,700	42,700
L. Collins	337,650	337,650
P. Campbell	1,000	1,000
P. Waine	-	-

Details of the Director's options are given in the Director's Remuneration Report on page 28

*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, 2003 (At January 1, 2003: L. F. Orbach: 5,000; M. J. Mousley: 15,000).

During the year the market price of the shares of common stock ranged between 83.0p and 161.5p. The market price at December 31, 2003 was 157.5p.

Between December 31, 2003 and February 13, 2004 there have been no changes in the interests of the Directors.

SUBSTANTIAL SHAREHOLDERS

As at February 13, 2004, 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	907,500	4.9%
Herald Investment Trust	1,435,000	7.7%
Invesco English & International Trust	770,000	4.1%
J. O. Hambro Capital Management	4,968,843	26.6%
Liontrust	1,273,700	6.8%
L. F. Orbach	2,957,413	15.8%
R. J. Morley	1,583,424	8.5%
The Quarto Group, Inc.	740,000	4.0%

CORPORATE GOVERNANCE

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

a) The Board of Directors represents the shareholders' interests in maintaining and growing a successful business including optimising consistent long-term financial returns.
b) The Board comprises three executive Directors and three non-executive Directors. The non-executive Directors, P. Campbell, P. Waine and L. Collins are considered by the Board to be independent, not withstanding the fact that P. Campbell receives £15,000 per annum for consulting fees and that L. Collins has 337,650 shares.
c) The Board meets eight times a year. A formal agenda is prepared for each meeting and all board papers and information are circulated to the Board forty-eight hours before the meetings.
d) All of the Directors are subject to re-election by the shareholders at the Annual General Meeting.
e) The remuneration of the executive Directors is recommended by the Remuneration Committee. A separate report with respect to Directors' remuneration is included on page 27.

f) The Chairman and the Finance Director are responsible for investor relations. They meet with major shareholders during the course of the year to ensure that they develop an understanding of their views. Shareholders are invited to attend the AGM at least twenty working days in advance of that meeting.
g) The Audit Committee, comprising P. Campbell, P. Waine and L. Collins, meet with the independent auditors at least twice a year.

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

a) The Chairman of the Company is also the Chief Executive.
b) A formal schedule of matters specifically reserved for the Board is not required, since the Board forms the executive management of the Group.
c) The Company does not have any formal arrangements for Directors, in the furtherance of their duties, to take independent professional advice.
d) The Remuneration Committee consists of the three independent non-executive Directors, but, it does not have responsibility for the remuneration of senior management below main Board Level.
e) Performance related bonuses are not normally given.
f) There is no nominated senior non-executive Director.
g) The Company does not have a Nominations Committee. The Board as a whole is responsible for the appointment of its own members.

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

GOING CONCERN

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

INTERNAL CONTROLS

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

The main elements of the internal control system are:

a) The results of individual operating units are reported monthly and reviewed by the Board at its eight board meetings a year.
b) The management reports of each operating unit are tailored to suit the business and management needs of local management. Each operating unit has its own performance indicators and these are regularly reviewed and assessed.
c) In addition to the monthly reporting, individual operating units report certain management information more frequently where it is considered appropriate.
d) All operating units report their bank balances twice weekly and a report is produced summarising the Group position.
e) The Board and the finance department make frequent visits to all operating units. These visits include a review of the internal control system.
f) All operating units prepare annual budgets and cash flow forecasts which are reviewed by the Board.

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

a) Group Board meetings.
b) Quarterly subsidiary 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.

AUDIT COMMITTEE

The duties of the Audit Committee include:

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

These duties were formalised in February 2004. The Audit Committee will be reviewing arrangements for 'whistle blowing channels' during the current year.

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, 2003, Group creditor days amounted to 108 days (2002: 102 days). The holding company does not have any trade creditors.

AUDITOR

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

M. J. MOUSLEY
Secretary
February 13, 2004

Directors' Remuneration Report

The remuneration committee is responsible for making recommendations on behalf of the Board on the remuneration policy with regard to the Company's executive Directors. It consists of the Chairman and the three non-executive Directors. The remuneration committee is constituted within the relevant provisions of Section B of the Combined Code, save that it does not consist exclusively of non-executive Directors and its terms of reference are not formally documented. The remuneration committee has given full consideration to Section B of the Combined Code in framing its remuneration policy. This report sets out the committee's policy and disclosures on 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. This determination is carried out internally, but, the Remuneration Committee intend to consider using external advisers in 2004.

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

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

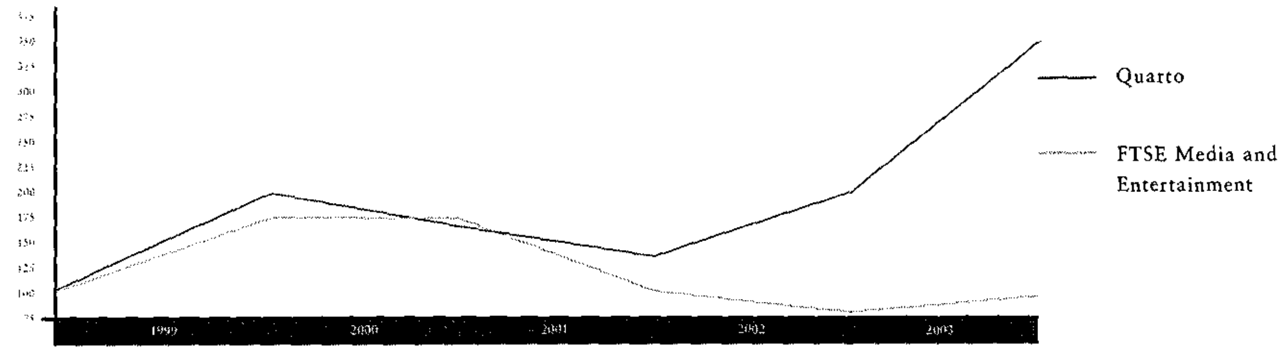
SERVICE AGREEMENTS

The executive Directors have service agreements which provide for 12 months' notice by the Director or the Company. There are no provisions for compensation other than the notice period. The independent non-executive Directors will be entering into annual rolling contract in 2004. Their fees are reviewed by the Board.

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

TOTAL SHAREHOLDER RETURN

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



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

DETAILS OF DIRECTORS' REMUNERATION

The auditors are required to report on the information contained in this page of the remuneration report.
The remuneration in respect of each Director who served as a Director during the year was as follows:

	SALARY / FEES £000	BENEFITS £000	2003 TOTAL £000	2002 TOTAL £000
L. F. Orbach	300	13	313	313
R. J. Morley	171	8	179	179
M. J. Mousley	160	2	162	152
G.T.Y. Tai (to date of resignation)	-	-	-	57
P. Campbell	46	-	46	23
P. Waine	33	-	33	23
L. Collins	33	-	33	23
	743	23	766	770

Benefits consist of benefits in kind in respect of health and life insurance. The remuneration of the three non-executive Directors comprises £23,000 fees for their ongoing role as a non-executive Director and £10,000 additional fees as non-executive Directors to reflect the additional workload resulting from the JOHCM tender offer. In addition, P. Campbell received £13,000 of consulting fees on an arm's length basis.

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

	2003 £000	2002 £000
L. F. Orbach	71	55
R. J. Morley	26	26
M. J. Mousley	24	22
G.T.Y. Tai (to date of resignation)	-	2
	121	105

SHARE OPTIONS

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

	At January 1, 2003	Awarded	At December 31, 2003	Exercise* price	Earliest date of exercise	Expiry date
L. F. Orbach	10,000	-	10,000	£1.115	22.2.2003	21.2.2007
R.J. Morley	5,000	-	5,000	£1.115	22.2.2003	21.2.2010
M.J Mousley	10,000	-	10,000	£1.115	22.2.2003	21.2.2010
	5,000	-	5,000	£0.685	31.3.2001	30.3.2008
	15,000	-	15,000	£0.825	29.3.2004	28.3.2011
	3,900	-	3,900	£0.775	26.2.2005	25.2.2012
	11,100	-	11,100	£0.775	26.2.2005	25.2.2009
	-	7,500	7,500	£0.83	14.2.2006	13.2.2010

* *Market price at date of award*
No gains were made by Directors on the exercise of the share options in the current or prior year.

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

The highest and lowest prices of the Company's shares during the year were 161.5p and 83.0p respectively. The price at the year end was 157.5p.

This report was approved by the Board of Directors on February 13, 2004.

P. WAINE
Chairman of Remuneration Committee

Statement of Directors' Responsibilities

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

The Company is an "oversea company" within the meaning of the Companies Act 1985. The Directors have elected to adopt UK Generally Accepted Accounting Principles and to prepare the financial statements in accordance with applicable United Kingdom accounting standards. The Directors have also elected to prepare the accounts in accordance with the requirements of the Companies Act 1985, as if the full requirements of that Act were to apply, with the exception of accounting for treasury stock, except that own shares purchased prior to December 1, 2003 are shown as a deduction from shareholders' funds, 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 have assumed responsibility to:

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

The Directors 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 and Delaware company law. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Independent Auditor's Report to The Quarto Group, Inc

We have audited the financial statements on pages 31 to 50. 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 29, 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.

In addition to our audit of the financial statements, the directors have engaged us to review their corporate governance statement as if the Company were required to comply with the Listing Rules of the Financial Services Authority in relation to these matters. We review whether the statement on pages 24 to 26 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.

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

BASIS OF OPINION

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

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

OPINION

In our opinion

- the financial statements give a true and fair view of the state of affairs of the company and the group as at December 31, 2003 and of the profit of the group for the year then ended; and
- the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985, as if the full requirements of that Act had applied to the financial statements, with the exception of accounting for treasury stock prior to December 1, 2003 as explained in note 16.

KPMG Audit Plc, Chartered Accountants
London, February 13, 2004

KPMG Audit Plc

Consolidated profit and loss account for the year ended December 31, 2003

	Notes	GROUP 2003 £000	GROUP 2002 £000
TURNOVER	1	74,623	74,735
Cost of sales		(49,240)	(48,796)
GROSS PROFIT		25,383	25,939
Distribution costs		(2,535)	(2,366)
Administration expenses			
-Before exceptional items and goodwill amortisation		(16,395)	(17,514)
-Exceptional item	2	(595)	-
-Goodwill amortisation		(206)	(175)
Total administrative expenses		(17,196)	(17,689)
Other operating income		113	147
GROUP OPERATING PROFIT		5,765	6,031
Net interest payable and similar charges	3	(892)	(1,151)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	2	4,873	4,880
Tax on profit on ordinary activities	4	(750)	(497)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		4,123	4,383
Minority interests – equity		(314)	(343)
PROFIT FOR THE YEAR		3,809	4,040
Dividends (including non-equity)	5	(1,458)	(1,379)
RETAINED PROFIT FOR THE YEAR	17	2,351	2,661
EARNINGS PER SHARE	6	18.9p	20.1p
UNDERLYING EARNINGS PER SHARE	6	22.3p	21.1p
DILUTED EARNINGS PER SHARE	6	18.2p	19.3p
DILUTED UNDERLYING EARNINGS PER SHARE	6	21.2p	20.1p

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

Balance Sheets at December 31, 2003

	Notes	GROUP 2003 £000	GROUP 2002 £000	COMPANY 2003 £000	COMPANY 2002 £000
FIXED ASSETS					
Intangible assets	7	3,337	3,376	-	-
Tangible assets	7	8,909	5,875	-	-
Investments	8	-	-	12,294	13,791
		12,246	9,251	12,294	13,791
CURRENT ASSETS					
Stocks and work in progress	9	17,451	18,675	-	-
Debtors	10	20,667	21,519	-	-
Cash and deposits	11	12,490	11,315	-	-
		50,608	51,509	-	-
CREDITORS: *Amounts falling due within one year*	12	(24,303)	(24,576)	(583)	(520)
NET CURRENT ASSETS / (LIABILITIES)		26,305	26,933	(583)	(520)
TOTAL ASSETS LESS CURRENT LIABILITIES		38,551	36,184	11,711	13,271
CREDITORS: Amounts falling due after more than one year	13	(29,588)	(29,056)	-	-
PROVISION FOR LIABILITIES AND CHARGES					
Deferred taxation	14	(875)	(1,235)	-	-
NET ASSETS		8,088	5,893	11,711	13,271
CAPITAL AND RESERVES					
Called up share capital	15	1,341	1,341	1,341	1,341
Treasury stock	16	(802)	(698)	(802)	(698)
Reserves – Paid in surplus	17	23,893	23,891	23,893	23,891
– Revaluation	17	978	988	-	-
– Profit and loss	17	(19,758)	(22,135)	(12,721)	(11,263)
SHAREHOLDERS' FUNDS		5,652	3,387	11,711	13,271
Equity		448	(1,817)	6,507	8,067
Non-equity		5,204	5,204	5,204	5,204
		5,652	3,387	11,711	13,271
MINORITY INTERESTS – EQUITY		2,436	2,506	-	-
		8,088	5,893	11,711	13,271

The financial statements on pages 31 to 50 were approved by the Board of Directors on February 13, 2004 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, 2003

	GROUP	
	2003	2002
	£000	£000
PROFIT FOR THE FINANCIAL YEAR	3,809	4,040
Currency translation differences on foreign currency net investments	16	284
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR	3,825	4,324

There are no other recognised gains and losses for the company (2002: nil), apart from the loss (2002: profit) for the financial year as disclosed below.

Reconciliation of consolidated movement in shareholders' funds for the Year Ended December 31, 2003

	GROUP		COMPANY	
	2003	2002	2003	2002
	£000	£000	£000	£000
PROFIT FOR THE FINANCIAL YEAR	3,809	4,040	-	3,954
Dividends	(1,458)	(1,379)	(1,458)	(1,379)
Retained profit (loss) for the financial year	2,351	2,661	(1,458)	2,575
Other recognised gains and losses relating to the year	16	284	-	-
Issues of shares (notes 15-17)	8	-	8	-
Purchase of shares (note 16)	(110)	(60)	(110)	(60)
Net movement in shareholders' funds	2,265	2,885	(1,560)	2,515
Shareholders' funds at December 31, 2002	3,387	502	13,271	10,756
SHAREHOLDERS FUNDS AT DECEMBER 31, 2003	5,652	3,387	11,711	13,271

Consolidated Cash Flow Statement for the Year Ended December 31, 2003

	GROUP	
	2003 £000	2002 £000
NET CASH INFLOW FROM OPERATING ACTIVITIES	7,965	8,396
RETURN ON INVESTMENT AND SERVICING OF FINANCE		
Interest received	107	63
Interest paid	(961)	(1,071)
Interest element of hire purchase payments	(39)	(40)
Preference dividend paid	(426)	(437)
Dividend paid to minority shareholder	(103)	(850)
NET CASH OUTFLOW FROM RETURN ON INVESTMENT AND SERVICING OF FINANCE	(1,422)	(2,335)
TAXATION		
UK and overseas corporation tax paid	(371)	(504)
CAPITAL EXPENDITURE		
Purchase of tangible fixed assets	(2,532)	(654)
Sale of tangible fixed assets	30	55
Net cash outflow from capital expenditure	(2,502)	(599)
ACQUISITIONS		
Purchase of businesses	(179)	(1,767)
EQUITY DIVIDENDS PAID		
Dividends paid	(969)	(875)
NET CASH INFLOW BEFORE USE OF LIQUID RESOURCES AND FINANCING	2,522	2,316
MANAGEMENT OF LIQUID RESOURCES		
Movement in short term deposits	(1,593)	(1,895)
FINANCING		
Issue of shares	8	-
Purchase of shares	(110)	(60)
Capital element of finance leases	(632)	(314)
Increase (Decrease) in debt	2,365	(162)
NET CASH OUTFLOW FROM FINANCING	1,631	(536)
INCREASE (DECREASE) IN CASH	2,560	(115)
RECONCILIATION OF NET CASHFLOW TO MOVEMENT IN NET DEBT		
Increase (Decrease) increase in cash	2,560	(115)
(Increase) Decrease in debt and lease financing	(1,733)	476
Management of liquid resources	1,593	1,895
	2,420	2,256
New finance leases	(1,631)	(123)
Translation differences	1,607	1,721
MOVEMENT IN DEBT FOR YEAR	2,396	3,854
Net debt at beginning of year	(19,783)	(23,637)
Net debt at end of year	(17,387)	(19,783)

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

Accounting Policies

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

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, prior to 1 December 2003, 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 each of 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 fair value attributable to the Group's share of such net assets, the difference is treated as purchased goodwill and for accounting periods up to December 31, 1997 this was written off directly to reserves in the year of acquisition. Goodwill on acquisitions subsequent to December 31, 1997 is capitalised as an intangible fixed asset and written off over its useful economic life, being 20 years for acquisitions of businesses and 10 years for acquisitions of backlists. Reorganisation and integration costs resulting from the acquisition are charged to the profit and loss account. 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.

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

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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. The Quarto Publishing plc pension scheme is a personal defined contribution pension scheme.

FINANCIAL INSTRUMENTS

Page 21 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

	GROUP 2003 £000	GROUP 2002 £000
1 SEGMENTAL ANALYSIS		
GEOGRAPHICAL ANALYSIS OF TURNOVER BY DESTINATION		
United Kingdom	14,983	16,557
United States of America	41,624	41,879
Canada	1,955	1,794
Europe	8,270	7,956
Australasia and the Far East	6,721	5,212
Rest of the World	1,070	1,337
	74,623	74,735

	TURNOVER		PROFIT BEFORE TAX		NET OPERATING ASSETS	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
CLASS OF BUSINESS						
Co-edition Publishing	45,413	41,856	5,482	4,528	15,476	13,506
Publishing	29,210	32,879	2,218	2,864	12,211	13,973
	74,623	74,735	7,700	7,392	27,687	27,479
Amortisation of goodwill			(206)	(175)		
Group overheads			(1,134)	(1,186)		
Exceptional item			(595)	-		
Net interest payable			(892)	(1,151)		
			4,873	4,880		

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	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
United Kingdom	28,939	31,012	2,801	3,878	10,165	8,462
United States of America	29,681	30,669	3,535	2,823	11,284	12,810
Rest of the World	16,003	13,054	1,364	691	6,238	6,207
	74,623	74,735	7,700	7,392	27,687	27,479

Notes to the Financial Statements

	GROUP 2003 £000	GROUP 2002 £000
1 SEGMENTAL ANALYSIS (CONTINUED)		
The net operating assets can be reconciled to the consolidated balance sheet as follows:		
Net operating assets	27,687	27,479
Total bank loans and other borrowings	(29,877)	(31,098)
Cash at bank and in hand	12,490	11,315
Corporation tax and deferred tax	(1,629)	(1,283)
Dividends payable	(583)	(520)
Net assets	8,088	5,893
2 PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION IS STATED AFTER CHARGING:		
Depreciation	956	990
Goodwill amortisation	206	175
Auditors' remuneration : audit	191	186
: other	11	7
Operating lease rentals in respect of:		
plant and machinery	142	138
other assets	1,144	1,281
Exceptional item: Comprises US and UK legal and professional charges associated with the JOHCM tender offer and the Group's response	595	-

Included under auditors' remuneration are audit fees in respect of the Company, amounting to £40,000 (2002: £40,000). The fees have been dealt with through the financial statements of Quarto Publishing plc.

A loss of £1,458,000 (2002: Profit £2,575,000) has been dealt with in the accounts of the Company.

	2003 £000	2002 £000
EMPLOYEES		
STAFF COSTS INCLUDING DIRECTORS' EMOLUMENTS COMPRISE:		
Wages and salaries	11,528	11,668
Social security costs	974	931
Pension costs	351	349
	12,853	12,948

Substantially all of the Group's pension costs consist of contributions to personal pension plans

	2003 Number	2002 Number
THE AVERAGE MONTHLY NUMBER OF PERSONS EMPLOYED BY THE GROUP DURING THE YEAR WAS:		
Co-edition Publishing	198	184
Publishing	213	225
Group administration	16	16
	427	425

Notes to the Financial Statements

	GROUP	
	2003 £000	2002 £000
2 PROFIT ON ORDINARY ACTIVITIES (CONTINUED)		
DIRECTORS' REMUNERATION		
EMOLUMENTS:		
Fees to non-executive Directors	112	69
Executive Directors – remuneration including benefits in kind in respect of motor vehicles and health and life insurance	654	701
– pension contributions	121	105
	887	875

The Directors' remuneration disclosed above included the following amounts paid in respect of the Chairman, who was also the highest paid Director:

	2003 £000	2002 £000
Remuneration	313	313
Pension contributions	71	55
	384	368

Details of Directors' remuneration are given in the directors' remuneration report on page 28.

Notes to the Financial Statements

	GROUP 2003 £000	GROUP 2002 £000
3 NET INTEREST PAYABLE AND SIMILAR CHARGES		
Interest payable:		
On bank loans and overdrafts repayable within 5 years by instalments	952	1,168
On bank loans repayable after more than 5 years by instalments	10	-
Hire purchase	39	40
	1,001	1,208
Interest receivable	(109)	(57)
	892	1,151
4 TAXATION		
United Kingdom corporation tax at 30% : Current	62	-
: Adjustment to prior periods	29	-
Overseas tax	950	354
Total current tax	1,041	354
Deferred taxation – UK	26	(6)
– Overseas: For the period	(232)	149
: Adjustment to prior periods	(85)	-
	750	497

The current tax charge for the year is lower than the standard rate of corporation tax *in the UK [30%; 2002: 30%]. The differences are explained below:*

	2003 £000	2002 £000
Profit on ordinary activities before tax	4,873	4,880
Current tax at 30%	1,462	1,464
Effects of:		
Utilization of tax losses	(507)	(906)
Lower tax rates on overseas earnings	(250)	(190)
Tax losses not utilized	58	137
Other (including temporary and permanent timing differences)	278	(151)
Total current tax charge	1,041	354

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

	2003 £000	2002 £000
5 DIVIDENDS		
Equity: Ordinary: Interim paid of 2.5p per share [2002: 2.35p per share]	449	422
Ordinary: Final proposed of 3.25p per share [2002: 2.9p per share]	583	520
	1,032	942
Non-equity: Preference	426	437
	1,458	1,379

Notes to the Financial Statements

6 EARNINGS PER SHARE

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

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

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	2003 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE	EARNINGS £000	2002 WEIGHTED AVERAGE NUMBER OF SHARES	PER SHARE AMOUNT PENCE
Basic earnings per share	3,383	17,926,756	18.9	3,603	17,925,306	20.1
Effect of dilutive options	-	66,305	-	-	31,423	-
Dilutive preference shares	426	2,933,965	14.6	437	2,989,414	14.6
Diluted earnings per share	3,809	20,927,026	18.2	4,040	20,946,143	19.3
Underlying earnings per share figures						
Basic earnings per share	3,383	17,926,756	18.9	3,603	17,925,306	20.1
Effect of:						
Exceptional item*	416	17,926,756	2.3	-	17,925,306	-
Goodwill amortisation	206	17,926,756	1.1	175	17,925,306	1.0
Basic earnings per share before goodwill amortisation and exceptional items	4,005	17,926,756	22.3	3,778	17,925,306	21.1
Underlying basic earnings per share	4,005	17,926,756	22.3	3,778	17,925,306	21.1
Effect of:						
Dilutive options	-	66,305	-	-	31,423	-
Dilutive preference shares	426	2,933,965	14.6	437	2,989,414	14.6
Diluted underlying earnings per share before goodwill amortisation and exceptional items	4,431	20,927,026	21.2	4,215	20,946,143	20.1

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

Notes to the Financial Statements

	GROUP				
	FREEHOLD PROPERTY £000	LEASEHOLD PROPERTY £000	PLANT EQUIPMENT AND MOTOR VEHICLES £000	FIXTURES AND FITTINGS £000	TOTAL £000
7 FIXED ASSETS					
TANGIBLE FIXED ASSETS					
Group					
Cost or valuation:					
At January 1, 2003	3,059	784	5,673	791	10,307
Exchange differences	(65)	(54)	(163)	(58)	(340)
Additions	2,206	78	1,663	216	4,163
Disposals	-	(6)	(314)	(66)	(386)
At December 31, 2003	5,200	802	6,859	883	13,744
Depreciation:					
At January 1, 2003	129	401	3,486	416	4,432
Exchange differences	-	(24)	(136)	(45)	(205)
Charge for the year	38	78	693	147	956
Disposals	-	(6)	(286)	(56)	(348)
At December 31, 2003	167	449	3,757	462	4,835
Net book value:					
At December 31, 2003	5,033	353	3,102	421	8,909
At December 31, 2002	2,930	383	2,187	375	5,875

The net book value of plant, equipment and motor vehicles included £1,786,000 [2002: £547,000] in respect of assets held under hire purchase contracts. The depreciation charged on these assets during the year was £163,000 [2002: £108,000]. Included in leasehold property at cost is £322,000 [2002: £360,000] in respect of a long leasehold property; the net book value was £241,000 [2002: £279,000].

The total cost of freehold property comprises £2,984,000 in respect of buildings and £2,216,000 in respect of land. The freehold property acquired during the year is secured against a mortgage.

As stated in the accounting policy note on page 35, the Directors have chosen to hold the cost of freehold properties at previous valuations with effect from January 2000. The cost of freehold property held at previous valuations comprises buildings £1,593,000 and land £1,321,000. The principal freehold property in the UK, with a historical cost of £382,000, was revalued on the basis of an open market value for existing use at December 31, 1989 by Conway Kersh, independent Professional Valuers. The valuation was £1.7 million but the Directors ascribed a value of £1.4 million, on the grounds of prudence. The valuation was in accordance with RICS Statements of Asset Valuation Practice and Guidance Notes.

Notes to the Financial Statements

7 FIXED ASSETS (CONTINUED)
INTANGIBLE FIXED ASSETS
GOODWILL

	GROUP		
	COST	AMORTISATION	NET BOOK VALUE
	£000	£000	£000
INTANGIBLE FIXED ASSETS			
GOODWILL			
At January 1, 2003	3,695	(319)	3,376
Additions	167	-	167
Amortisation for the year	-	(206)	(206)
At December 31, 2003	3,862	(525)	3,337

Additions to goodwill in the year arose from the acquisition of a backlist business and represents the difference between the cost of the acquisition and the fair value of the assets acquired.

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, 2003	11,653	2,138	13,791
Loans repaid	-	(1,497)	(1,497)
At December 31, 2003	11,653	641	12,294

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
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

	GROUP		COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
9 STOCKS AND WORK IN PROGRESS				
Finished goods	11,949	13,035	-	-
Work in progress	5,376	5,670	-	-
Raw materials	429	339	-	-
Less: Payments on account	(303)	(369)	-	-
	17,451	18,675	-	-
10 DEBTORS				
Trade debtors	18,532	19,444	-	-
Prepayments and accrued income	1,733	1,809	-	-
Other debtors	402	266	-	-
	20,667	21,519	-	-
11 CASH AND DEPOSITS				
Cash at bank	7,463	7,323	-	-
Short term deposits	5,027	3,992	-	-
	12,490	11,315	-	-
12 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR				
Bank overdrafts	35	2,013	-	-
Current loan instalments	144	71	-	-
Hire purchase creditors	349	197	-	-
Total borrowings	528	2,281	-	-
Trade creditors	19,019	18,741	-	-
Other creditors including taxation and social security:				
Corporation tax	754	48	-	-
Dividend payable	583	520	583	520
Social security	457	497	-	-
Other creditors	1,626	1,154	-	-
Accruals and deferred income	1,336	1,335	-	-
	24,303	24,576	583	520

Notes to the Financial Statements

	GROUP		COMPANY	
	2003	2002	2003	2002
	£000	£000	£000	£000
13 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Bank loans	28,423	28,738	-	-
Hire purchase liabilities	926	79	-	-
Total borrowings	29,349	28,817	-	-
Other creditors	239	239	-	-
	29,588	29,056	-	-
Total borrowings are repayable as follows:				
Bank loans and overdrafts:				
In one year or less, or on demand	179	2,084	-	-
Between one and two years	128	16	-	-
Between two and five years	27,658	28,722	-	-
Over five years	637	-	-	-
	28,602	30,822	-	-
Other borrowings (hire purchase liabilities):				
In one year or less, or on demand	349	197	-	-
Between one and two years	291	68	-	-
Between two and five years	635	11	-	-
	1,275	276	-	-
Total loans and other borrowings:				
In one year or less, or on demand	528	2,281	-	-
Between one and two years	419	84	-	-
Between two and five years	28,293	28,733	-	-
Over five years	637	-	-	-
	29,877	31,098	-	-

The above borrowings carry interest at commercial rates ranging from 1.31% to 5.0%. Of the total borrowings £22,310,000 (2002: £26,834,000) was denominated in US dollars, the remainder being denominated in a variety of currencies. Bank loans include £1,275,000 which is secured on the freehold property acquired during the year. All other bank loans are unsecured.

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:

(a) Total consolidated net indebtedness shall not exceed 3.33 times the consolidated operating profit before depreciation, goodwill amortization, exceptional items and development costs (production costs excluding printing) charged to the profit and loss but not paid in cash in the year. This measure amounted to £12,878,000 giving a maximum indebtedness of £42,884,000.

(b) The consolidated operating profit before exceptional items and goodwill amortization shall exceed three times net interest payable. For the year ended December 31, 2003, net interest payable was 7.4 times covered under this covenant.

(c) The consolidated operating profit before goodwill amortization shall exceed 1.5 times net interest payable. For the year ended December 31, 2003, net interest payable was 6.7 times covered under this covenant.

Exchange, interest and liquidity risk are discussed in the Chief Financial Officer's Report on pages 20 to 21.

Notes to the Financial Statements

14 DEFERRED TAXATION

	GROUP	
	AMOUNT PROVIDED	
	2003 £000	2002 £000
Deferred taxation provided in the financial statements is as follows:		
Excess of capital allowances over depreciation - UK	220	137
Other timing differences - UK	(158)	(101)
	62	36
Other timing differences - overseas - US	803	1,188
- other	10	11
	875	1,235

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:

	2003 £000	2002 £000
Provision at January 1, 2003	1,235	1,175
Exchange difference	(69)	(83)
(Credit) Charge to profit and loss account	(291)	143
Provision at December 31, 2003	875	1,235

15 SHARE CAPITAL

Authorised:

28,000,000 [2002: 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 [2002: US$2,800,000].

5,212,587 [2002: 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 [2002: US$521,258].

	2003 £000	2002 £000
Equity share capital		
Allotted, called up and fully paid:		
18,676,206 shares of common stock of par value US$0.10 each [2002: 18,675,306]	1,063	1,063
Non-equity share capital		
Allotted, called up and fully paid:		
5,202,524 shares of preferred stock of US$0.10 each [2002: 5,204,024]	278	278
	1,341	1,341

On June 9, 2003, 1,500 shares of prefered stock were converted, in accordance with the rights attaching to those shares, into 900 shares of common stock.

Notes to the Financial Statements

At December 31, 2003, 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
16,000	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
45,000	February 22, 2003 – February 21, 2010	£1.115
22,500	March 29, 2004 – March 28, 2011	£0.825
11,000	February 15, 2005 – February 14, 2009	£0.67
17,000	February 15, 2005 – February 14, 2012	£0.67
11,100	February 26, 2005 – February 25, 2009	£0.775
3,900	February 26, 2005 – February 25, 2012	£0.775
33,000	February 14, 2006 – February 13, 2010	£0.83
57,000	February 14, 2006 – February 13, 2013	£0.83

The movement in outstanding options from December 31, 2002 comprises (a) new options granted on February 14, 2003, as identified above (b) 30,000 shares exercisable between February 15, 2005 and February 14, 2009 and 34,000 shares exercisable between October 26, 1996 and October 25, 2003 lapsed and (c) 7,000 shares exercisable between March 31, 2001 and March 30, 2008 and 3,000 shares exercisable between February 22, 2003 and February 21, 2010 were exercised.

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

	GROUP		COMPANY	
	2003 £000	2002 £000	2003 £000	2002 £000
16 TREASURY STOCK				
At January 1, 2003	698	638	698	638
Issued in satisfaction of options exercised during the year	(6)	-	(6)	-
Purchase during the year	110	60	110	60
At December 31, 2003	802	698	802	698

The Company purchased 750,000 (for £461,000) of its own shares of common stock during 1998 and 180,000, 50,000 and 100,000 of its own shares of preferred stock during 2001, 2002 and 2003 respectively. As a US company, it is permitted to hold these shares as treasury stock, without cancelling them, and to reissue them. On October 23, 2003 the Company issued 2,000 shares of common stock in satisfaction of the exercise of 2,000 options at 68.5p per share and, on December 2, 2003 the Company issued 8,000 shares of common stock in satisfaction of the exercise of 5,000 options at 68.5p per share and 3,000 options at 111.5p per share. Prior to December 2003, companies were 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 £802,000. (2002: £698,000). Following a change to UK company law in December 2003, it is now permissable for a UK company to purchase and own its own shares. The true and fair override as described above will no longer apply to shares purchased and held as treasury stock after December 1, 2003.

Notes to the Financial Statements

17 RESERVES

	GROUP		
	PAID IN SURPLUS	REVALUATION RESERVE	PROFIT AND LOSS ACCOUNT
	£000	£000	£000
At beginning of the year	23,891	988	(22,135)
On shares issued during the year	2	-	-
Retained profit for the year	-	-	2,351
Difference on translation of net assets and profit and loss accounts of non-UK companies	-	-	16
Transfers	-	(10)	10
At the end of year	23,893	978	(19,758)
Analysed as follows:			
Profit and loss account			4,956
Goodwill previously written off to reserves			(24,714)
			(19,758)

	COMPANY	
	PAID IN SURPLUS	PROFIT AND LOSS ACCOUNT
	£000	£000
At beginning of year	23,891	(11,263)
On shares issued during the year	2	-
Profit for the year	-	(1,458)
At the end of year	23,893	(12,721)

18 FINANCIAL COMMITMENTS

	GROUP			
	LAND AND BUILDINGS 2003	OTHER 2003	LAND AND BUILDINGS 2002	OTHER 2002
	£000	£000	£000	£000
At December 31, 2003, the Group had annual commitments to make payments under operating leases during the next year as follows for leases expiring:				
Within one year	447	14	392	4
Between two and five years	600	119	626	112
	1,047	133	1,018	116

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 £28,000 (2002: *£nil*).

Notes to the Financial Statements

19 CONTINGENT COMMITMENTS AND LIABILITIES

The Group 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, 2003, there was a potential liability, based on Book Sales Inc's financial statements, of approximately US $1,857,000. No provision has been made because the minority shareholder has not exercised his option. At December 31, 2003 the minority interest relating to Book Sales Inc in the consolidated financial statements of The Quarto Group, Inc was US$1,564,000.

The Quarto Group, Inc. has issued guarantees in respect of £35,000 of overdrafts of subsidiaries [2002: £2,013,000] and bank loans of £28,551,000 [2002: £28,722,000]. The Group has also issued guarantees in respect of £1,275,000 of hire purchase creditors of subsidiaries [2002: £276,000]. 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	GROUP 2003 £000	GROUP 2002 £000
RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOWS FROM OPERATING ACTIVITIES		
Operating profit	5,765	6,031
Depreciation and amortisation charge	1,162	1,165
Loss (Profit) on sale of fixed assets	8	(7)
(Increase) Decrease in stocks and work in progress	(148)	26
Increase in creditors	1,214	498
(Increase) Decrease in debtors	(36)	683
Net cash inflow from operating activities	7,965	8,396

	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	7,323	480	(340)	-	7,463
Bank overdrafts < 1 year	(2,013)	2,080	(102)	-	(35)
	5,310	2,560	(442)	-	7,428
HP creditors	(276)	632	-	(1,631)	(1,275)
Current loan instalments < 1 year	(71)	(73)	-	-	(144)
Bank loans > 1 year	(28,722)	(1,161)	2,607	-	(27,276)
Mortgages	(16)	(1,131)	-	-	(1,147)
	(29,085)	(1,733)	2,607	(1,631)	(29,842)
Liquid resources	3,992	1,593	(558)	-	5,027
Net Debt	(19,783)	2,420	1,607	(1,631)	(17,387)

21 RELATED PARTY TRANSACTIONS

During the year R. J. Morley maintained a current account with the Group. The debit balance on this account was less than £5,000 throughout the year. The balance at the year end was £3,600. During the year L. F. Orbach loaned money to the Group and has earned an arm's length return of 2.5%. The total amount of interest earned during the year was £16,000 (2002: £2,000). The balance outstanding at the beginning of the year, which was also the highest amount outstanding, was £779,000 and the balance at the end of the year was £327,000.

Historical cost five-year summary

	GROUP				
	1999 £000	2000 £000	2001 £000	2002 £000	2003 £000
PROFIT AND LOSS ACCOUNT					
Turnover	76,456	73,564	73,620	74,735	74,623
Operating profit	5,813	5,573	4,923	6,031	5,765
Net interest	(1,716)	(2,023)	(1,733)	(1,151)	(892)
Profit before loss on closure of operations and taxation	4,097	3,550	3,190	4,880	4,873
LOSS ON CLOSURE OF OPERATIONS	(5,230)	-	-	-	-
PROFIT (LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	(1,133)	3,550	3,190	4,880	4,873
Taxation	(390)	(314)	(300)	(497)	(750)
PROFIT (LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION	(1,523)	3,236	2,890	4,383	4,123
Minority interests	(440)	(413)	(352)	(343)	(314)
PROFIT (LOSS) FOR THE FINANCIAL YEAR	(1,963)	2,823	2,538	4,040	3,809
Dividends	(1,262)	(1,262)	(1,295)	(1,379)	(1,458)
RETAINED PROFIT (LOSS)	(3,225)	1,561	1,243	2,661	2,351
EARNINGS PER SHARE					
Underlying	15.8p	16.1p	18.8p	21.1p	22.3p
Basic	(13.5p)	13.2p	11.7p	20.1p	18.9p
DIVIDENDS PER SHARE	4.5p	4.5p	4.73p	5.25p	5.75p
BALANCE SHEET					
Fixed assets	7,133	7,342	7,662	9,251	12,246
Other net assets	16,208	18,721	20,026	16,425	13,229
	23,341	26,063	27,688	25,676	25,475
NET BORROWINGS	(20,894)	(22,998)	(23,637)	(19,783)	(17,387)
NET ASSETS	2,447	3,065	4,051	5,893	8,088
CASH FLOW					
Net cash inflow from operating activities	8,259	6,409	5,746	8,396	7,965
Return on investment and servicing of finance	(2,191)	(2,478)	(2,786)	(2,335)	(1,422)
Taxation	(594)	(627)	(348)	(504)	(371)
Capital expenditure and financial investment	(465)	(450)	(648)	(599)	(2,502)
Acquisition and disposals	(67)	(1,471)	(544)	(1,767)	(179)
Equity dividends paid	(928)	(877)	(807)	(875)	(969)
Other	(1,090)	(2,610)	(1,252)	1,538	(126)
Movement in (debt) funds for year	2,924	(2,104)	(639)	3,854	2,396
Net debt at beginning of year	(23,818)	(20,894)	(22,998)	(23,637)	(19,783)
Net debt at end of year	(20,894)	(22,998)	(23,637)	(19,783)	(17,387)