ARTHUR ANDERSEN

STC Submarine Systems Limited

Financial statements 31 December 1996
together with the directors' and auditors' reports

Registered number: 1750343

Contents

Directors' report

For the year ended 31 December 1996

The directors present their annual report on the affairs of the company and the audited financial statements for the year ended 31 December 1996.

Principal activities, research and development

The company's principal activity during the year was the development and supply of submarine telecommunication systems including equipment, software and services. These activities are supported by extensive research and development.

Results and dividends

The loss for the financial year was £57.7 million (1995 - £5.0 million). The directors do not propose to pay a dividend (1995 - £nil) and the loss for the year has been transferred to reserves.

The anticipated market recovery has materialised and the company foresees significantly improved financial results in 1997.

Restructuring of the business

The decline in the submarine telecommunications market and the need to integrate the Alcatel Submarine Networks businesses resulted in the company making the decision to close the Southampton cable factory. As a result an additional charge of £6.9 million was made to the restructuring provision established in 1995. During 1996 £15.1 million of this provision was utilised. The remaining provision of £1.0 million will be utilised in 1997.

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those 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 company will continue in business.

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

Directors' report (continued)

Directors and their interests

The following served as directors of the company during the year:

D. Cross	
N. Horne	(resigned 12 March 1996)
J. Leclercq	
P. Radley	
F. Vincent	
C. Matthews	(appointed 12 March 1996)

The directors in office at 31 December 1996 do not have any interests required to be disclosed under Schedule 7 of the Companies Act 1985.

Donations

During the year, the company made charitable donations totalling £625 (1995 - £2,250).

Employment

The company is an equal opportunities employer and ensures that employees or job applicants are assessed on their merits and suitability. No employee or candidate receives less favourable treatment than others on the grounds of sex, race, colour, nationality, ethnic or national origin, marital status, disability or religion.

The company places considerable value on the involvement of its employees in the conduct of the business and participation is encouraged by means of team briefings, house magazines and newspapers.

Policy on payment of suppliers

The company adheres to the CBI Prompt Payers Code whereby the policy is to settle the terms of payment with suppliers when agreeing the terms of each transaction, and to ensure that suppliers are made aware of the terms of payment and abide by the terms of payment.

Christchurch Way
Greenwich
London SE10 0AG

By order of the Board,

~~D. Cross~~

Director

23 October 1997

Auditors' report

London

To the Shareholders of STC Submarine Systems Limited:

We have audited the financial statements on pages 4 to 16 which have been prepared under the historical cost convention and the accounting policies set out on pages 6 to 8.

Respective responsibilities of directors and auditors

As described on page 1 the company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 December 1996 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

Arthur Andersen
Chartered Accountants and Registered Auditors

1 Surrey Street
London WC2R 2PS

23 October 1997

Profit and loss account

For the year ended 31 December 1996

	Notes	1996 £m	1996 £m	1995 £m	1995 £m
Turnover	2		39.8		212.6
Cost of sales			(47.9)		(148.3)
Gross (loss)/ profit			(8.1)		64.3
Marketing, selling and distribution expenses		(2.4)		(3.3)	
Administration expenses		(3.7)		(5.6)	
Research and development expenses		(11.9)		(12.9)	
Goodwill amortisation and write-down		(4.9)		(7.2)	
Restructuring costs	3	(6.9)		(12.3)	
Other operating expenses		(21.3)		(25.2)	
			(51.1)		(66.5)
Operating loss			(59.2)		(2.2)
Net interest receivable	4		0.3		0.1
Loss on ordinary activities before taxation			(58.9)		(2.1)
Tax on loss on ordinary activities	6		1.2		(2.9)
Loss for the financial year			(57.7)		(5.0)

A statement of movements on reserves is given in note 17.

Statement of total recognised gains and losses

For the year ended 31 December 1996

There are no recognised gains and losses other than the loss for the year ended 31 December 1996 of £57.7 million and loss for the year ended 31 December 1995 of £5.0 million.

The accompanying notes are an integral part of these financial statements.

Balance sheet

31 December 1996

	Notes	1996 £m	1996 £m	1995 £m	1995 £m
Fixed assets					
Intangible assets	9	83.4		88.3	
Tangible assets	10	10.6		21.5	
			94.0		109.8
Current assets					
Stocks	11	4.8		6.9	
Debtors	12	123.0		149.0	
Cash at bank and in hand		3.5		12.7	
		131.3		168.6	
Creditors: Amounts falling due within one year	14	(82.0)		(78.2)	
Net current assets			49.3		90.4
Total assets less current liabilities			143.3		200.2
Provisions for liabilities and charges	15		(29.9)		(29.1)
Net assets			113.4		171.1
Capital and reserves					
Called-up share capital	16		528.2		528.2
Profit and loss account	17		(414.8)		(357.1)
Shareholders' Funds	18		113.4		171.1

Signed on behalf of the Board

Derek Cross Director

23 October 1997

The accompanying notes are an integral part of this balance sheet.

Notes to financial statements

31 December 1996

1 Accounting policies

A summary of the principal accounting policies, all of which have been applied consistently throughout the year and the preceding year, is set out below.

a) Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

b) Turnover

Turnover represents the value (net of value added tax) of goods shipped, services rendered and equipment rentals. Turnover and cost of sales are adjusted so as to record profit on a percentage of completion basis of accounting for long-term contracts.

Data processing equipment and services are included in turnover when the initial contractual commitments to the customers have been fulfilled.

c) Leases

The company has entered into operating leases as described in note 19.

Rents due under operating leases are charged to the profit and loss account over the lease term.

d) Research and development

Research and development expenditure, other than costs which are customer-funded, is charged to the profit and loss account as incurred.

e) Taxation

Corporation tax payable is provided on taxable profits at the current rate.

Deferred taxation is provided using the liability method in respect of the taxation effect of timing differences to the extent that it is probable that liabilities will crystallise in the future. Deferred taxation is not provided on timing differences which in the opinion of the directors will not reverse. Any deferred taxation, both provided and unprovided, is shown in the notes to the financial statements.

1 Accounting policies (continued)

f) Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation.

Depreciation is provided primarily by the straight-line method, based on the cost and estimated useful lives of the various classes of tangible fixed assets over the following periods:

Freehold buildings	20 or 40 years
Leasehold buildings	the shorter of 20 or 40 years and the life of the lease
Plant and machinery	3 to 10 years

No depreciation is charged on construction in progress.

g) Goodwill

Goodwill at cost represents the excess of the cost attributed to investments in the business over the fair value of the underlying net assets at the date of their acquisition. Goodwill is amortised over the estimated useful economic life of the intangible fixed asset. With effect from 1 January 1994, the company has reassessed the remaining useful economic life to be approximately 20 years.

h) Stocks

Stocks are stated at the lower of cost (first-in, first-out) and net realisable value. Cost represents all direct costs incurred in bringing stocks to their present state and location, including an appropriate proportion of manufacturing overheads.

i) Long-term contracts

Long-term contract balances represent costs incurred on specific contracts, net of amounts transferred to cost of sales in respect of work recorded as turnover. Contract work-in-progress is recorded as turnover by reference to the value of work carried out to date. No profit is recognised until the contract has advanced to a stage where the total profit can be assessed with reasonable certainty. Provision is made for the full amount of foreseeable losses. Cash received on account of contracts is deducted from the amounts recoverable on contracts. Such amounts which have been received and exceed amounts recoverable are included in creditors.

j) Warranties and contract losses

Provision is made for any anticipated losses on incomplete contracts. Amounts provided for such anticipated losses and for residual costs on completed contracts and warranties are included in provisions for liabilities and charges.

k) Translation of foreign currencies

Transactions in foreign currencies arising from normal trading activities are recorded in pounds sterling at current or contracted exchange rates. Foreign currency gains and losses are credited or charged to the profit and loss account as they arise.

Notes to financial statements (continued)

1 Accounting policies (continued)

l) Pension costs

In accordance with the provisions of SSAP 24, 'Accounting for Pension Costs', pension costs are charged to the profit and loss account against profits on a systematic basis over the service lives of the employees in the scheme. The charges are calculated in accordance with the advice of a qualified actuary.

The regular pension cost, that is the consistent ongoing cost, is calculated as a level percentage of gross pensionable payroll. Variations from the regular cost are allocated over the average remaining service lives of the employees in the scheme.

Any difference between the amounts charged in the profit and loss account and the amounts paid over to the fund are dealt with as provisions or prepayments as appropriate.

m) Cash flow statement

Under the provisions of Financial Reporting Standard Number 1 (as revised in October 1996), the company has not presented a cashflow statement because it is a wholly owned subsidiary within the Alcatel Alsthom group. Alcatel Alsthom is registered in France, an EC country, and has prepared consolidated accounts which include the results of this company and which contain a cash flow statement.

2 Turnover

	1996 £m	1995 £m
Class of business		
Submarine telecommunication systems	39.8	212.6

Geographical analysis

	1996 £m	1995 £m
UK	1.1	11.2
Continental Europe	9.4	64.6
Total Europe	10.5	75.8
The Americas	3.6	72.1
Africa	1.1	-
Asia and Australasia	24.6	64.7
	39.8	212.6

3 Restructuring costs

The decline in the submarine telecommunications market and the need to integrate the Alcatel Submarine Networks businesses resulted in the company making the decision to close the Southampton cable factory. As a result an additional charge of £6.9 million was made to the restructuring provision in 1995. During 1996 £15.1 million of this provision was utilised. The remaining provision of £1.0 million will be utilised in 1997.

Notes to financial statements (continued)

4 Net interest receivable (payable)

	1996 £m	1995 £m
Bank loans and overdrafts repayable within five years	(0.1)	(0.8)
Interest receivable	0.4	0.9
	0.3	0.1

5 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging:

	1996 £m	1995 £m
Depreciation		
- owned tangible fixed assets	5.2	5.8
Amortisation		
- intangible fixed assets	4.9	5.0
Operating leases		
- plant and machinery	0.8	1.2
- other	0.9	1.2
Auditors' remuneration		
- audit	0.1	0.1
- other	0.2	0.1
Staff costs (note 7)	18.3	29.0

6 Tax on loss on ordinary activities

	1996 £m	1995 £m
Tax loss carried back	(1.1)	-
Tax on profit for the year		
- UK corporation tax charged on profits at 33%	-	4.9
Adjustment of current taxation in respect of prior years	(0.1)	(2.0)
	(1.2)	2.9

The tax losses have been carried back against taxable profits for the year ended 31 December 1994.

Notes to financial statements (continued)

7 Staff costs

Employee costs during the year amounted to:

	1996 £m	1995 £m
Wages and salaries	15.4	25.3
Social security costs	1.4	1.7
Other pension costs	1.5	2.0
	18.3	29.0

Average weekly number of persons employed by the company:

	1996 Number	1995 Number
Submarine telecommunication systems	497	880

8 Directors' emoluments

The directors received no remuneration in respect of their services to the company as directors (1995 - £nil).

As executives:

	1996 £'000	1995 £'000
Other emoluments	65	-

Aggregate emoluments excluding pension contributions include amounts paid to:

	1996 £'000	1995 £'000
The chairman	-	-
The highest paid director	65	-

The range of directors' emoluments was as follows:

	1996 Number	1995 Number
Less than £5,000	5	7
£60,001–£65,000	1	-

Notes to financial statements (continued)

9 Intangible fixed assets

	£m
Cost	
At 31 December 1995	104.7
Write down	-
At 31 December 1996	104.7
Amortisation	
At 31 December 1995	16.4
Charge for the year	4.9
At 31 December 1996	21.3
Net book value	
At 31 December 1995	88.3
At 31 December 1996	83.4

10 Tangible fixed assets

	Land and buildings £m	Plant and machinery £m	Construction in progress £m	Total £m
Cost				
At 31 December 1995	4.7	68.1	0.1	72.9
Additions	-	-	-	-
Disposals	(0.1)	(11.3)	-	(11.4)
Transfers	-	0.1	(0.1)	-
At 31 December 1996	4.6	56.9	-	61.5
Accumulated depreciation				
At 31 December 1995	4.2	47.2	-	51.4
Charge for year	0.1	5.1	-	5.2
Write down of Southampton factory assets	0.3	3.5	-	3.8
Disposals	-	(9.5)	-	(9.5)
At 31 December 1996	4.6	46.3	-	50.9
Net book value				
At 31 December 1995	0.5	20.9	0.1	21.5
At 31 December 1996	-	10.6	-	10.6

	1996 £m	1995 £m
Land and buildings at net book value comprises:		
Short leaseholds	-	0.4

Notes to financial statements (continued)

11 Stocks

	1996 £m	1995 £m
Raw material and consumables	3.5	4.8
Work-in-progress	1.3	1.7
Finished goods and goods for resale	-	0.4
	4.8	6.9

The replacement cost of stocks is not considered to be materially different from the balance sheet value.

12 Debtors

	1996 £m	1995 £m
Amounts falling due within one year:		
Trade debtors	22.3	2.9
Amounts owed by group undertakings	90.2	82.1
Amounts recoverable on contracts	4.5	62.4
Corporation tax recoverable	1.1	-
Prepayments and accrued income	3.8	1.0
Social security and other taxes	1.1	0.6
	123.0	149.0

13 Deferred taxation

The amount of deferred tax asset recognised in the financial statements and the potential amount not recognised are:

	Provided		Unprovided	
	1996 £m	1995 £m	1996 £m	1995 £m
Depreciation in excess of capital allowances	-	-	2.9	0.5
Other timing differences	-	-	11.4	9.7
Net deferred tax asset	-	-	14.3	10.2

Notes to financial statements (continued)

14 Creditors: Amounts falling due within one year

	1996 £m	1995 £m
Bank loans	3.7	-
Payments received on account	1.2	1.2
Trade creditors	2.2	5.4
Amounts owed to parent company and fellow subsidiaries	32.2	32.2
Amounts owed to related companies	24.0	0.3
Other creditors including taxation and social security	0.5	0.8
Accruals and deferred income	18.2	38.1
Corporation tax	-	0.2
	82.0	78.2

15 Provisions for liabilities and charges

	1996 £m	1995 £m
Comprising		
- warranty and penalty provisions	28.9	19.9
- restructuring provision	1.0	9.2
	29.9	29.1

The movement in provisions was as follows:

	Restructuring provision £m	Warranty & penalty provision £m	Total £m
At 31 December 1995	9.2	19.9	29.1
Addition	6.9	11.5	18.4
Released during year	-	(1.5)	(1.5)
Utilisation	(15.1)	(1.0)	(16.1)
At 31 December 1996	1.0	28.9	29.9

Notes to financial statements (continued)

16 Called-up share capital

	1996 £m	1995 £m
Authorised		
780,000,000 ordinary shares of £1 each		
(1995 - 780,000,000 ordinary shares of £1 each)	780.0	780.0
Allotted, called-up and fully paid		
528,190,475 ordinary shares of £1 each		
(1995 - 528,190,475 ordinary shares of £1 each)	528.2	528.2

17 Reserves

	Profit and loss account £m
At 1 January 1996	(357.1)
Loss for the financial year	(57.7)
At 31 December 1996	(414.8)

18 Reconciliation of movements in shareholders' funds

	1996 £m	1995 £m
Opening shareholders' funds	171.1	176.1
Loss for the financial year	(57.7)	(5.0)
Closing shareholders' funds	113.4	171.1

19 Operating leases

The minimum annual rentals payable under operating leases are as follows:

	Land and buildings £m	Other £m	Total £m
Expiring			
- within one year	-	0.4	0.4
- within two to five years	-	0.2	0.2
- after five years	0.1	-	0.1
	0.1	0.6	0.7

Notes to financial statements (continued)

20 Contingent liabilities
The claim made against the company and one of its subsidiaries in respect of a business that was disposed of in 1991 has been settled by Nortel Limited (formerly Northern Telecom Europe Limited) in accordance with the indemnity provided by them to the company's parent company, Alcatel Limited (formerly Alcatel Submarine Systems UK Limited).

The company also has commitments and claims arising in the normal course of business under contracts affecting 1996 and prior years. In the opinion of the directors, adequate provision has been made where appropriate for these contingencies at 31 December 1996.

21 Pension arrangements
The company participates in certain group pension schemes covering substantially all employees. The main plan for UK employees up until 1 April 1997 was a defined benefit scheme called the STC Submarine Systems Pension Plan which was administered by trustees and was independent of the company's finances. With effect from 1 April 1997 the assets and liabilities of the STC Submarine Systems Pension Plan were transferred to a defined benefit scheme called the Alcatel Pension Scheme. All members of the STC Submarine Systems Pension Plan transferred to the Alcatel Pension Scheme with effect from 1 April 1997.

Valuations by independent professionally qualified actuaries are carried out at least once every three years and updated by formal reviews when required. Funding policy is determined following actuarial recommendations. A valuation of the STC Submarine Systems Pension Plan was completed as at 1 January 1996.

The principal assumptions used in the valuations of the liabilities were that total Plan assets are re-invested in the FT-All Share Index with a dividend growth of 4.0% pa, pension increases at 4.0% pa and a rate of interest of 8.5% pa.

The estimated market value of the assets of the Plan was £38.8 million which was sufficient to cover 100% of the liabilities for benefits that had accrued to members.

The pension cost for the defined benefit plan amounted to £2.2 million in 1996 (1995 - £2.4 million).

22 Ultimate parent company
The company's immediate parent company is STC Limited, incorporated in Great Britain.

The ultimate holding company is Alcatel Alsthom, a company incorporated in France.

Both the largest and smallest group in which the results of STC Submarine Systems Limited are consolidated is that headed by Alcatel Alsthom.

The consolidated accounts of this group are available to the public and may be obtained from 54, Rue La Boétie, 75382 Paris, France.