

RARE LIMITED

Report and Financial Statements

52 weeks ended 30 June 2006



RARE LIMITED

REPORT AND FINANCIAL STATEMENTS 2006

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RARE LIMITED

REPORT AND FINANCIAL STATEMENTS 2006

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTOR

K R Dolliver

J A Seethoff (resigned 7 March 2006)

B O Orndorff (appointed 7 March 2006)

SECRETARY

RB Secretariat Limited

REGISTERED OFFICE

Beaufort House

Tenth Floor

15 St Botolph Street

London

EC3A 7EE

BANKERS

Lloyds TSB

1 Marlborough Square

Coalville

Leicestershire

LE67 3WD

SOLICITORS

Pinsent Masons

3 Colmore Circus

Birmingham

B4 6BH

Richards Butler

Beaufort House

15 St Boltoph Street

London

EC3A 7EE

Osborne Clarke

2 Temple Back East

Temple Quay

Bristol

BS1 6EG

AUDITORS

Deloitte & Touche LLP

Chartered Accountants

Reading

TAX ADVISERS

KPMG LLP

Theale

Berkshire

DIRECTORS' REPORT (CONTINUED)

Auditors

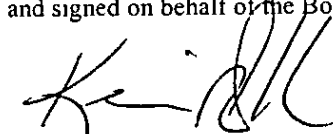
Each of the persons who is a director as at the date of approval of this report confirms that

- (1) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware, and
- (2) the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information

This confirmation is given and should be interpreted in accordance with provisions of s234ZA of the Companies Act 1985

Pursuant to s386 Companies Act 1985, an elective resolution has been passed dispensing with the requirement to appoint auditors annually Deloitte & Touche LLP have expressed their willingness to continue in office as auditors

Approved by the Board of Directors
and signed on behalf of the Board on 26 April 2007



K Dolliver
Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report including the financial statements. The directors have chosen to prepare the financial statements for the company in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

Company law requires the directors to prepare such financial statements for each financial year which give a true and fair view, in accordance with UK GAAP, of the state of affairs of the company and of the profit or loss of the company for that period and comply with UK GAAP and the Companies Act 1985. In preparing those financial statements, the directors are required to

- (a) select suitable accounting policies and then apply them consistently,
- (b) make judgements and estimates that are reasonable and prudent,
- (c) state whether applicable accounting standards have been followed, and
- (d) 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 the director to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF RARE LIMITED

We have audited the financial statements of Rare Limited for 52 weeks ended 30 June 2006 which comprise the profit and loss account, the balance sheet and the related notes 1 to 16. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' 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 and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

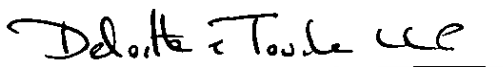
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the 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 company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as 30 June 2006 and of its profit for the 52 weeks then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.



Deloitte & Touche LLP
Chartered Accountants and Registered Auditors

Reading, United Kingdom

30 April 2007

RARE LIMITED

PROFIT AND LOSS ACCOUNT 52 weeks ended 30 June 2006

	Note	52 weeks ended 30 June 2006 £	52 weeks ended 1 July 2005 £
TURNOVER	2	24,439,875	21,180,528
Administrative expenses		(11,589,661)	(10,060,426)
OPERATING PROFIT	4	12,850,214	11,120,102
Interest receivable and similar income	5	1,178,957	1,443,837
Interest payable and similar charges	6	(1,188)	(152,532)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		14,027,983	12,411,407
Tax charge on profit on ordinary activities	7	(4,447,818)	(4,189,327)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		9,580,165	8,222,080
Dividends		(35,000,000)	-
(LOSS)/PROFIT FOR THE FINANCIAL PERIOD TRANSFERRED TO RESERVES	14	(25,419,835)	8,222,080

All the activities of the company are classed as continuing

There are no recognised gains and losses for the current period or prior period other than as stated in the profit and loss account. Accordingly, no statement of total recognised gains and losses is presented.

RARE LIMITED

BALANCE SHEET At 30 June 2006

	Note	30 June 2006 £	1 July 2005 £
FIXED ASSETS			
Tangible assets	8	3,491,612	4,382,780
CURRENT ASSETS			
Debtors	10	18,778,512	42,598,663
Cash at bank and in hand		97,054	77,001
		<u>18,875,566</u>	<u>42,675,664</u>
CREDITORS amounts falling due within one year	12	<u>(2,460,731)</u>	<u>(1,732,162)</u>
NET CURRENT ASSETS		<u>16,414,835</u>	<u>40,943,502</u>
NET ASSETS		<u>19,906,447</u>	<u>45,326,282</u>
CAPITAL AND RESERVES			
Called up share capital	13	14,767,000	14,767,000
Share premium account	14	8,303	8,303
Profit and loss account	14	<u>5,131,144</u>	<u>30,550,979</u>
SHAREHOLDERS' FUNDS	14	<u>19,906,447</u>	<u>45,326,282</u>

These financial statements were approved by the Board of Directors on 26 April 2007

Signed on behalf of the Board of Directors



Keith Dolliver
Director

NOTES TO THE ACCOUNTS

52 weeks ended 30 June 2006

1 ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted are described below. They have all been applied consistently throughout the current and preceding period.

Accounting convention

The financial statements have been prepared under the historical cost convention, modified to include the revaluation of certain fixed assets, and in accordance with applicable United Kingdom accounting standards.

Tangible fixed assets

Tangible fixed assets are stated at cost or valuation, net of depreciation and any provision for impairment. Depreciation is provided on cost less residual value in equal annual instalments over the estimated useful lives of the assets. The estimated useful economic lives are as follows:

Buildings	15 years
Computer equipment	2 years
Fixtures, fittings and vehicles	3 - 5 years

Land is not depreciated.

Leases

Rental costs under operating leases are charged to the profit and loss account in equal annual amounts over the period of the lease.

Stock

All work in progress is written off to the profit and loss account as it is incurred.

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Research and development expenditure

Expenditure on research and development is written off to the profit and loss account in the period in which it is incurred.

Pensions

The company operates a defined contribution pension scheme for certain employees. The assets of the scheme are held separately from those of the company. The contributions are charged to the profit and loss account as they become due and payable.

Foreign currencies

Transactions in foreign currencies during the year are recorded at the average rate ruling for the month of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the closing rate of exchange at the balance sheet date.

All exchange gains and losses are taken to the profit and loss account.

NOTES TO THE ACCOUNTS (continued)
52 weeks ended 30 June 2006

2. TURNOVER

Turnover represents royalty income receivable and amounts derived from the ultimate parent undertaking in the United States based on a mark-up on total costs incurred. In the 52 weeks to 30 June 2006, royalty income totalled £11,280,541 (2005 £12,039,686) and amounts derived from the mark-up on costs total £13,159,334 (2005 9,140,842) £1,289,161 (2005 £1,662,814) of total revenue derived from Japan. All other revenue derived from the United States.

3. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	52 weeks ended 30 June 2006	52 weeks ended 1 July 2005
The average number of employees during the period was	No.	No
Office and management staff	218	209
Staff costs:	£	£
Wages and salaries	8,303,342	7,413,039
Social security costs	918,556	820,819
Other pension costs	4,600	5,200
	<u>9,226,498</u>	<u>8,239,058</u>

The directors received remuneration paid by Microsoft Corporation in respect of their services to group companies for the periods ended 30 June 2006 and 1 July 2005. The portion of this that relates to the Company is £nil (2005 £nil).

4. OPERATING PROFIT

	52 weeks ended 30 June 2006	52 weeks ended 1 July 2005
	£	£
Operating profit is stated after charging/(crediting)		
Depreciation of tangible fixed assets – owned	390,102	379,494
Profit on disposal of fixed assets	(4,548)	(5,000)
Impairment of owned tangible fixed assets	923,627	-
Reversal of past impairment losses	(250,000)	-
Net loss on foreign exchange translation	267,193	32,733

Auditors' remuneration has been borne by the ultimate parent company in the current and preceding periods.

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2006

5 INTEREST RECEIVABLE AND SIMILAR INCOME

	52 weeks ended 30 June 2006 £	52 weeks ended 1 July 2005 £
Bank interest receivable	69,288	149,899
Interest receivable from group companies	1,109,669	1,293,938
	<u>1,178,957</u>	<u>1,443,837</u>

6. INTEREST PAYABLE AND SIMILAR CHARGES

	52 weeks ended 30 June 2006 £	52 weeks ended 1 July 2005 £
Bank interest payable	-	84
Interest payable on corporation tax	1,188	152,448
	<u>1,188</u>	<u>152,532</u>

NOTES TO THE ACCOUNTS (continued)
52 weeks ended 30 June 2006

7. TAX ON PROFIT ON ORDINARY ACTIVITIES

	52 weeks ended 30 June 2006 £	52 weeks ended 1 July 2005 £
UK corporation tax – current year	4,524,736	3,774,229
Double taxation relief	(125,336)	(114,367)
	<hr/>	<hr/>
Foreign tax for current period	4,399,400	3,659,862
	125,336	114,367
	<hr/>	<hr/>
	4,524,736	3,774,229
Adjustments in respect of prior periods		
- UK corporation tax	1,691	(25,138)
	<hr/>	<hr/>
Total current tax	4,526,427	3,749,091
Deferred tax – origination and reversal of timing differences	(74,804)	68,556
Adjustment in respect of prior periods	(3,805)	371,680
	<hr/>	<hr/>
Total deferred tax (credit)/charge for the period	(78,609)	440,236
	<hr/>	<hr/>
	4,447,818	4,189,327
	<hr/>	<hr/>

The standard rate of current tax for the period, based on the UK standard rate of corporation tax is 30%. The current tax charge for the period differs from 30% for the reasons set out in the following reconciliation

	2006 £	2005 £
Profit on ordinary activities before tax	14,027,983	12,411,407
	<hr/>	<hr/>
Tax charge on ordinary activities at 30%	4,208,395	3,723,422
Permanent adjustments	241,537	119,363
Timing differences – origination and reversal	74,804	(68,556)
Prior period adjustment in respect of corporation tax	1,691	(25,138)
	<hr/>	<hr/>
Current tax charge for the period	4,526,427	3,749,091
	<hr/>	<hr/>

NOTES TO THE ACCOUNTS (continued)
52 weeks ended 30 June 2006

8. TANGIBLE FIXED ASSETS

	Land £	Buildings £	Computer equipment £	Fixtures, fittings and vehicles £	Total £
Cost					
At 2 July 2005	1,130,000	11,782,538	1,523,188	638,012	15,073,738
Additions	-	5,787	42,290	124,484	172,561
Disposals	-	-	(828,222)	(54,655)	(882,877)
At 30 June 2006	1,130,000	11,788,325	737,256	707,841	14,363,422
Accumulated depreciation					
At 2 July 2005	380,000	8,298,204	1,456,619	556,135	10,690,958
Charge for the period	-	284,281	46,928	58,893	390,102
Disposals	-	-	(828,222)	(54,655)	(882,877)
Impairment losses	-	923,627	-	-	923,627
Reversal of past impairment losses	(250,000)	-	-	-	(250,000)
At 30 June 2006	130,000	9,506,112	675,325	560,373	10,871,810
Net book value					
At 30 June 2006	1,000,000	2,282,213	61,931	147,468	3,491,612
At 1 July 2005	750,000	3,484,334	66,569	81,877	4,382,780

9 REVALUATION OF ASSETS

Freehold land and buildings were professionally valued during the year by Jones Lang LaSalle, Chartered Surveyors, on the basis of open market value at 5 June 2006 at a combined value of £3 3m, which the directors also believe to be the value as at 30 June 2006. If the valuation had not occurred the freehold land and buildings would be held in the books at £673,627 more. The revaluation loss has been recognised in the profit and loss account during the period ended 30 June 2006.

10 DEBTORS

	30 June 2006 £	1 July 2005 £
Amounts owed by group undertakings	18,286,887	42,149,286
Deferred tax (see note 11)	249,630	171,021
Prepayments and accrued income	241,995	278,356
	<u>18,778,512</u>	<u>42,598,663</u>

NOTES TO THE ACCOUNTS (continued)
52 weeks ended 30 June 2006

11 DEFERRED TAX ASSET

	£
At 2 July 2005	171,021
Credited to profit and loss account in the period	78,609
At 30 June 2006	<u>249,630</u>

Deferred tax is provided as follows	30 June 2006 £	1 July 2005 £
Timing differences in respect of capital allowances	247,350	169,521
Other timing differences	2,280	1,500
Provision for deferred tax	<u>249,630</u>	<u>171,021</u>

12 CREDITORS. AMOUNTS FALLING DUE WITHIN ONE YEAR

	30 June 2006 £	1 July 2005 £
Trade creditors	16,662	198,664
Corporation tax payable	2,150,966	1,225,775
Taxation and social security	226,133	236,906
Accruals and deferred income	66,970	70,817
	<u>2,460,731</u>	<u>1,732,162</u>

13. CALLED UP SHARE CAPITAL

	30 June 2006 £	1 July 2005 £
Authorised 14,767,000 ordinary shares of £1 each	<u>14,767,000</u>	<u>14,767,000</u>
Called up, allotted and fully paid 14,767,000 £1 ordinary shares	<u>14,767,000</u>	<u>14,767,000</u>

NOTES TO THE ACCOUNTS (continued)
52 weeks ended 30 June 2006

14. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Called up capital share £	Share premium account £	Profit and loss account £	2006 Total £	2005 Total £
At start of period	14,767,000	8,303	30,550,979	45,326,282	37,104,202
Profit for the period	-	-	9,580,165	9,580,165	8,222,080
Dividend for the period	-	-	(35,000,000)	(35,000,000)	-
At end of period	<u>14,767,000</u>	<u>8,303</u>	<u>5,131,144</u>	<u>19,906,447</u>	<u>45,326,282</u>

15. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The company is a 52% owned subsidiary of Rareware Limited, a company incorporated in England. Copies of the group financial statements of Rareware Limited are available from Companies House, Crown Way, Cardiff, CF14 3UZ. Rareware Limited is the smallest group that consolidates the results of the company.

The ultimate parent undertaking of the company, which is also the controlling undertaking, is Microsoft Corporation, a company incorporated in the United States of America. This is the largest group into which the results are consolidated. Copies of Microsoft Corporation's annual report are available on written request from the Investor Relations Department, Microsoft Corporation, One Microsoft Way, Redmond, WA 98052-6399, United States of America.

16. RELATED PARTY TRANSACTIONS

In accordance with Financial Reporting Standard No 8 "Related Party Disclosures", transactions with other group undertakings within the Microsoft group have not been disclosed in these financial statements.