

RARE LIMITED

Report and Financial Statements

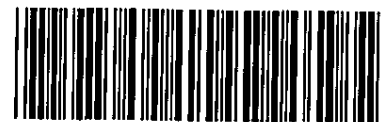
52 weeks ended 30 June 2007

Presenter

**REED SMITH
RICHARDS BUTLER LLP
BEAUFORT HOUSE
15 ST. BOTOLPH STREET
LONDON EC3A 7EE
SOLICITORS**

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RARE LIMITED

REPORT AND FINANCIAL STATEMENTS 2007

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RARE LIMITED

REPORT AND FINANCIAL STATEMENTS 2007

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTOR

K R Dolliver
B O Orndorff

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

Reed Smith Richards Butler LLP
Beaufort House
15 St Boltoph Street
London
EC3A 7EE

Osborne Clarke
2 Temple Back East
Temple Quay
Bristol
BS1 6EG

AUDITORS

Deloitte & Touche LLP
Reading

TAX ADVISERS

KPMG LLP
Theale
Berkshire

RARE LIMITED

DIRECTORS' REPORT

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report, for the period ended 30 June 2007

Principal activities

The principal activity of Rare Limited during the period was the writing and development of video games software

Business review

Revenue performance and outlook

The company's main source of revenue is derived from commission received from its ultimate parent undertaking on a cost plus mark up basis. As a result of royalty contracts expiring in the previous period, total revenue for the period fell by 4.4% from £24.4m to £23.3m.

The company continues to develop computer games software, primarily for its ultimate parent company, and the directors expect current activity levels to be maintained in the coming year. The company continues to maintain its high standing in the market place which has been established over two decades.

As games software is developed primarily for Rare's ultimate parent undertaking this minimises any risk related to changes in technology as the company does not directly market its product.

Recruitment in the market is highly competitive but the directors consider the risk of being unable to recruit suitable personnel is low due to the company's long standing reputation and high profile amongst the graduate population.

The company operates as a key strategic franchisee, developing product to requirements specified by its ultimate parent undertaking with the main aim of increasing market share and profitability for the group.

Key performance indicators are the abilities to fulfil this remit within pre-agreed financial budgets and timescales. To date the company has performed satisfactorily within these boundaries. The company is monitored by its ultimate parent undertaking by way of a three year rolling plan.

Results and dividends

The profit for the period, after taxation, amounted to £7,138,117 (2006: £9,580,165). During the period the directors paid an interim dividend of £5,000,000 (2006: £35,000,000).

Directors and their interests

The directors who held office during the period and to the date of signing were as follows:

K R Dolliver
B O Orndorff

None of the directors at the period end had any interest in the shares of the company at any point during the period.

Charitable contributions

Charitable contributions for the period amounted to £19,098 (2006: £3,163).

RARE LIMITED

DIRECTORS' REPORT (CONTINUED)

Auditors

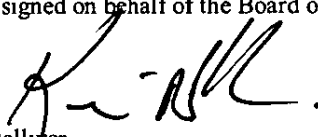
Each of the persons who is a director as at the date of approval of this report confirms that

- (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 29 April 2008



K Dollhyer
Director

RARE LIMITED

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 financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to 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 these 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 that 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 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF RARE LIMITED

We have audited the financial statements of Rare Limited for 52 weeks ended 30 June 2007 which comprise the profit and loss account, the balance sheet and the related notes 1 to 15. 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 2007 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

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

Reading, United Kingdom

9 May 2008

RARE LIMITED

PROFIT AND LOSS ACCOUNT 52 weeks ended 30 June 2007

	Note	52 weeks ended 30 June 2007 £	52 weeks ended 1 July 2006 £
TURNOVER	2	23,348,891	24,439,875
Administrative expenses		(13,596,533)	(11,589,661)
OPERATING PROFIT	4	9,752,358	12,850,214
Interest receivable and similar income	5	512,976	1,178,957
Interest payable and similar charges	6	(7,171)	(1,188)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		10,258,163	14,027,983
Tax charge on profit on ordinary activities	7	(3,120,046)	(4,447,818)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		7,138,117	9,580,165

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 2007

	Note	30 June 2007 £	1 July 2006 £
FIXED ASSETS			
Tangible assets	8	3,474,947	3,491,612
CURRENT ASSETS			
Debtors	9	21,705,877	18,778,512
Cash at bank and in hand		3,746	97,054
		21,709,623	18,875,566
CREDITORS: amounts falling due within one year	11	(3,140,006)	(2,460,731)
NET CURRENT ASSETS		18,569,617	16,414,835
NET ASSETS		22,044,564	19,906,447
CAPITAL AND RESERVES			
Called up share capital	12	14,767,000	14,767,000
Share premium account	13	8,303	8,303
Profit and loss account	13	7,269,261	5,131,144
SHAREHOLDERS' FUNDS	13	22,044,564	19,906,447

These financial statements were approved by the Board of Directors on 29/42008

Signed on behalf of the Board of Directors


Keith Dolliver
Director

RARE LIMITED

NOTES TO THE ACCOUNTS **52 weeks ended 30 June 2007**

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 period 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.

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2007

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 2007, royalty income totalled £2,101,751 (2006 £11,280,541) and amounts derived from the mark-up on costs total £21,247,140 (2006 13,159,334). £2,101,751 (2006 £1,289,161) 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 2007	52 weeks ended 1 July 2006
The average number of employees during the period was:	No	No.
Office and management staff	206	218
Staff costs:	£	£
Wages and salaries	9,580,772	8,303,342
Social security costs	1,100,922	918,556
Other pension costs	2,600	4,600
	<u>10,684,294</u>	<u>9,226,498</u>

The directors received remuneration paid by Microsoft Corporation in respect of their services to group companies for the 52 week periods ended 30 June 2006 and 1 July 2005. The portion of this that relates to the Company is £nil (2006 £nil).

4. OPERATING PROFIT

	52 weeks ended 30 June 2007	52 weeks ended 1 July 2006
	£	£
Operating profit is stated after charging/(crediting):		
Depreciation of tangible fixed assets – owned	386,983	390,102
Profit on disposal of fixed assets	(9,000)	(4,548)
Impairment of owned tangible fixed assets	-	923,627
Reversal of past impairment losses	-	(250,000)
Net loss/(gain) on foreign exchange translation	<u>885,910</u>	<u>(267,193)</u>

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 2007

5 INTEREST RECEIVABLE AND SIMILAR INCOME

	52 weeks ended 30 June 2007 £	52 weeks ended 1 July 2006 £
Bank interest receivable	42,341	69,288
Interest receivable from group companies	465,715	1,109,669
Corporation tax interest	4,920	-
	<u>512,976</u>	<u>1,178,957</u>

6. INTEREST PAYABLE AND SIMILAR CHARGES

	52 weeks ended 30 June 2007 £	52 weeks ended 1 July 2006 £
Bank interest payable	6	-
Interest payable on corporation tax	7,165	1,188
	<u>7,171</u>	<u>1,188</u>

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2007

7. TAX ON PROFIT ON ORDINARY ACTIVITIES

	52 weeks ended 30 June 2007 £	52 weeks ended 1 July 2006 £
UK corporation tax – current period	3,087,436	4,524,736
Double taxation relief	(2,143)	(125,336)
	<u>3,085,293</u>	<u>4,399,400</u>
Foreign tax for current period	2,143	125,336
	<u>3,087,436</u>	<u>4,524,736</u>
Adjustments in respect of prior periods		
- UK corporation tax	(22,459)	1,691
	<u>3,064,977</u>	<u>4,526,427</u>
Total current tax		
Deferred tax – origination and reversal of timing differences	45,013	(74,804)
Adjustment in respect of prior periods	10,056	(3,805)
	<u>55,069</u>	<u>(78,609)</u>
Total deferred tax charge/(credit) for the period (Note 10)		
	<u>3,120,046</u>	<u>4,447,818</u>

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

	2007 £	2006 £
Profit on ordinary activities before tax	10,258,163	14,027,983
Tax charge on ordinary activities at 30%	3,077,449	4,208,395
Permanent adjustments	41,103	241,537
Timing differences – origination and reversal	(31,116)	74,804
Prior period adjustment in respect of corporation tax	(22,459)	1,691
	<u>3,064,977</u>	<u>4,526,427</u>
Current tax charge for the period		

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2007

8. TANGIBLE FIXED ASSETS

	Land £	Buildings £	Computer equipment £	Fixtures, fittings and vehicles £	Total £
Cost					
At 2 July 2006	1,130,000	11,788,325	737,256	707,841	14,363,422
Additions	-	-	144,937	225,381	370,318
Disposals	-	-	(132,984)	(117,548)	(250,532)
At 30 June 2007	1,130,000	11,788,325	749,209	815,674	14,483,208
Accumulated depreciation					
At 2 July 2006	130,000	9,506,112	675,325	560,373	10,871,810
Charge for the period	-	202,835	88,458	95,690	386,983
Disposals	-	-	(132,984)	(117,548)	(250,532)
At 30 June 2007	130,000	9,708,947	630,799	538,515	11,008,261
Net book value					
At 30 June 2007	1,000,000	2,079,378	118,410	277,159	3,474,947
At 1 July 2006	1,000,000	2,282,213	61,931	147,468	3,491,612

9. DEBTORS

	30 June 2007 £	1 July 2006 £
Trade debtors	525,009	-
Amounts owed by group undertakings	20,687,994	18,286,887
Deferred tax (see note 11)	194,561	249,630
Prepayments and accrued income	276,919	225,721
Other debtors	21,394	16,274
	<u>21,705,877</u>	<u>18,778,512</u>

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2007

10. DEFERRED TAX ASSET

	£
At 2 July 2006	249,630
Deferred tax charge for the period	(41,172)
Effect of change in corporation tax (28% from 1 April 2008)	(13,897)
At 30 June 2007	<u>194,561</u>

Deferred tax is provided as follows	30 June 2007 £	1 July 2006 £
Timing differences in respect of capital allowances	194,561	247,350
Other timing differences	-	2,280
Provision for deferred tax	<u>194,561</u>	<u>249,630</u>

Following substantive enactment of the Finance Bill in June 2007, legislation is being introduced that would reduce the corporation tax rate to 28% with effect from 1 April 2008. As the Finance Act 2007 was enacted before the balance sheet date, deferred tax balances expected to unwind after 1 April 2008 have been valued at 28%.

11. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	30 June 2007 £	1 July 2006 £
Trade creditors	18,611	16,662
Corporation tax payable	2,014,179	2,150,966
Taxation and social security	451,494	226,133
Accruals and deferred income	655,722	66,970
	<u>3,140,006</u>	<u>2,460,731</u>

12. CALLED UP SHARE CAPITAL

	30 June 2007 £	1 July 2006 £
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>

RARE LIMITED

NOTES TO THE ACCOUNTS (continued) 52 weeks ended 30 June 2007

13. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Called up capital share £	Share premium account £	Profit and loss account £	2007 Total £	2006 Total £
At start of period	14,767,000	8,303	5,131,144	19,906,447	45,326,282
Profit for the period	-	-	7,138,117	7,138,117	9,580,165
Dividend for the period	-	-	(5,000,000)	(5,000,000)	(35,000,000)
At end of period	<u>14,767,000</u>	<u>8,303</u>	<u>7,269,261</u>	<u>22,044,564</u>	<u>19,906,447</u>

14. 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.

15. 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.