

Focusrite Audio Engineering Limited

Annual report and financial statements

31 August 2017

SATURDAY



A76R89UQ

A12

26/05/2018

#253

COMPANIES HOUSE

Company registered number: 02357989

Contents

Strategic report	2
Directors' report	9
Statement of directors' responsibilities	11
Independent auditor's report to the members of Focusrite Audio Engineering Limited	12
Statement of comprehensive income	14
Statement of financial position	15
Statement of changes in equity	16
Notes to the accounts	17

Strategic report

The directors present their annual report and the audited financial statements for the year ended 31 August 2017.

Business Overview

I am very pleased to report that FY17 has proved to be another successful year, exceeding our expectations for revenue, at £66.1million (+21.6%), profit and cash flow. The Company's products have continued to grow market share in our established and growth markets. Revenue and profits have been boosted by the strengthening of the Euro and US Dollar but, even on a constant currency basis, the Company has enjoyed excellent growth.

This is our first set of results with Tim Carroll as Chief Executive Officer, having joined the Company in January 2017. He has successfully established himself with the management team and the Company more broadly and is building on Focusrite's strong foundations. Tim enjoyed almost 20 years with Avid Technology Inc, a respected business in our marketplace, in global sales roles and latterly heading the audio division, as a result of which he has an unmatched experience of the markets that Focusrite seeks to serve, from the professional to amateur.

FY17 has seen continued development of our sales channels. I am particularly pleased with the progress of our e-commerce platform, only in its second year and which is now offering the Company's products globally. Sales in the Far East, notably China, continue to grow faster than most other regions of the world. In response to this demand, the Company has established a Hong Kong office to manage our third-party distributors and marketing in the Asia-Pacific region and to provide customer support to Asian customers. This office continues to grow and, importantly, enables us to provide support to customers who use our products all over the world, 24/7. Looking forward, new distribution initiatives in Japan promise to underpin growth prospects in this important but challenging market.

Last year, I reported on the launch of the second generation of Focusrite's Scarlett range of audio interfaces. Scarlett is the market-leading range globally and our results very much reflect the outstanding success and growth of this range, that provides musicians and the wider recording community with outstanding performance and reliability. Focusrite Clarett is a premium range of interfaces for those whose recordings are more likely to have commercial potential.

Our Novation brand of musical instruments comprising synthesisers, keyboard controllers and the Launchpad grid controller family enjoyed a 37.8% uplift in demand compared with a flat 2016. A new flagship synthesiser, Peak, was launched to much acclaim.

Focusrite continues to build demand for products designed for a professional audience and business enterprises, namely the RedNet and Red ranges. A Focusrite Pro team has been formed to develop the professional and commercial sales channels, as well as bringing better focus to product development and marketing to these specialist vertical markets that include broadcast, post-production, education and entertainment facilities. This market segment is seen as an exciting growth opportunity where our investment in this segment over recent years is expected to pay off handsomely.

I am delighted Focusrite has delivered another strong year of growth. Our foundations as a company that has a history at the leading edge of music technology innovation, with an established, global customer base for its market-leading brands and a strong culture, make us well placed for further growth. The Company has no debt, continues to be highly cash-generative and continues to consider acquisition opportunities that would complement the existing business.

I would like to take this opportunity to thank our employees, manufacturing partners, distribution partners and professional advisers for their contributions to our success.

Strategic and Operational Review

The Company's products are now sold in approximately 160 territories and countries all over the world. We utilise an effective mix of retailers – online and 'bricks and mortar' locations, distributors in areas where localisation is a factor, a hybrid approach in the USA utilising a distributor with our own demand generation team, and direct business to consumer with our own e-commerce store and in-app software purchases.

We sold approximately 800,000 physical products to end-users last year, and our music creation apps were downloaded 2.7 million times with around 700,000 in-app customer transactions. Our manufacturing partners are located in South China and we use third-party logistics support. We employ around 190 people in the UK, USA, Germany and Hong Kong.

This is a business of considerable scale with scope for further growth and our market position, products, people and customer base are the envy of many in the industry.

Strategic report (continued)

The market

The global audio production market continues to grow and we believe we remain well poised to increase our market share with existing products and also to exploit opportunities to expand into adjacent product categories that would make commercial sense and are a strategic fit for our existing business. This can be done organically and, when it makes commercial and economic sense, by acquisition.

For many personal and professional audio recording customers, Focusrite technology and solutions are a cornerstone of their set-ups and creative workflows. We know that puts us in a unique position to expand our offerings and participate in more of the economic value chain. Alongside that, we recognise the opportunity to continue to make audio recording technology easier to use and more accessible to a larger addressable market.

Operating review

This year has seen further operational progress and this has translated into financial success with careful management of our cost base and a focus on cash generation. Revenues grew by 21.6% to £66.1 million, delivering an operating profit of £9.6 million, representing year-on-year growth of 31.7%. These results were materially ahead of forecasts and represent a very pleasing outcome for the Company.

This positive performance has been driven by a number of factors, including a wider market acceptance and growth of share in many of our core products; along with a suite of new innovative offerings, giving us more depth to our portfolio and the opportunity to sell more to our customer base.

The Company continues to penetrate new market segments and price points with best-in-class, user-friendly products. Customer and sales channel satisfaction feedback remains strong on new and existing products and continued high levels of end-user satisfaction are illustrated by our top net promotor scores for individual products.

Focusrite

Within Focusrite, our Scarlett, Clarett and RedNet ranges all grew, leading to total segment revenue growth of 18.6%. In each category we increased market share and experienced growth beyond the industry norms.

Sales of our second generation Scarlett USB audio interface range, upgraded and launched in June last year, were particularly strong. The Scarlett family has earned the reputation as a best-in-class, premium solution at affordable pricing. This product line remains the number one selling audio interface product in the world.

The Clarett range continues to set new price/performance standards in our mid-range interface offerings and with an advanced set of features catered to creative professionals, we are very pleased to see that Clarett has been warmly received and enjoyed numerous accolades from the industry.

Our commercial and pro-audio range, led by RedNet, is gaining momentum as applications for its use and potential customers grow, especially in post-production, education and broadcast markets. This year we have witnessed some of the top production facilities in the world transition their entire infrastructure to RedNet and reap numerous benefits in efficiency, costs and productivity.

During the year we also launched the Focusrite Pro brand to support our growing Red/RedNet business and bring key sales talent and focus to this market. This additional investment will continue next year. We believe that our portfolio of professional AOIP solutions are well poised to become industry standards in post-production, broadcast, installed and live sound.

Novation

The Novation segment now consists of Novation and Ampify, the Company's own software brand.

Launchpad, Launchkey, and the synthesiser product categories all experienced accelerated sales growth, with overall growth in this business segment of 37.8%.

Wider market acceptance of grid-based controllers in the electronic music space, coupled with larger penetration from online distribution channels such as Amazon, has driven demand for Launchpad. This product range experienced significant worldwide uplift in demand with year-on-year sales volume growth of 39.0%.

Our Launchkey family of keyboard controllers also enjoyed significant uplift in worldwide demand, with its intuitive feature set and extensive integrated control features with top music-making software such as Ableton Live.

Our new flagship synthesiser, Peak, has seen widespread adoption within the professional music community and won numerous accolades from the industry as a true next-generation synthesiser; building off the legacy of the Novation brand and its many famous earlier synthesiser products.

Strategic report (continued)

During the year we rebranded our apps division to Ampify: a brand on which we will continue to develop powerful audio software tools for new customers and our existing customers alike. We are investing substantially in Ampify, as we aim to grow the Company's own software capability. This investment is starting to be rewarded with operational progress and we now have three music-making apps with around 550,000 active users. Revenues are still small when seen as a percentage of total Company revenue, but growing significantly year-on-year as we continue to increase our library of in-app purchases for these customers. Our apps consistently rank in the top ten for music creation tools on Apple's app store and are currently displayed in Apple stores worldwide. We recently launched Groovebox – 'a new beats and synth music studio' for iPad and iPhone – and to date it has had over 200,000 downloads and is growing fast.

Innovation

Innovation is key driver of growth and we continue to spend around 6% to 7% of revenue on research and development so as to provide a constant stream of new and relevant products for our various customer channels.

During the year we launched eight new hardware and two new software products, including: Red 8 Pre, Clarett OctoPre, Scarlett OctoPre, Scarlett OctoPre Dynamic, iTrack One Pre and Circuit Components update.

These new products are across different price segments and target customer markets, giving us further penetration and reach. Feedback from the consumer, retailer and distribution channels has been positive and acceptance so far has been pleasing.

We continue to enhance our offerings with improved drivers, new tool sets and capabilities that make our solutions easier to install and use, netting us industry-leading Net Promoter Scores and overall customer experience statistics.

Additionally, we have focused some of our development resources on the 'out-of-the-box' experience for new customers, as we believe that ensuring customers have a great first experience with our products is paramount to our overall success and growth strategy.

Geographic overview

I am pleased to report that our success this past year was truly global and sales in all major regions grew.

The USA finished with a 30.9% rise in revenue when compared with last year. Europe experienced 11.4% growth. Finally, the Rest of the World (incorporating Asia, Latin America and Canada) finished the year with 24.9% year-on-year growth.

The USA market, the largest market for our portfolio and currently 42% of total Company sales, remains a key focus for our sales efforts and we continue to expand the team in our Los Angeles office.

In Europe, where we saw increased competition between the major continental resellers, our growth was lower than our other regions but still ahead of industry averages in our segment.

Within the Rest of the World, Asia-Pacific sales were strong across most countries, especially in China, and our Hong Kong office is now fully functional and integrated with our Company systems. Additionally, we are investing in more sales talent to scale for what we believe is still a large opportunity in this region.

Finally, Latin America and Canada both had healthy growth and we will continue to invest in resources and tools to grow these regions into this next year and beyond.

Distribution and logistics initiatives

Focusrite's distribution of adjacent products, such as KRK monitors and sE Electronics microphones, remains a small overall proportion of Company revenue. It remains important to us as it offers add-on products within the music-making industry and provides us with invaluable market feedback, insight and knowledge.

e-commerce initiatives

The Company's e-commerce store, which launched in March last year, accounted for over 1% of the Company's revenue and this continues to improve. With a global presence but specific emphasis on markets where localised content, language support and swift delivery to end-users are key to success, we believe this segment will grow further.

Summary and outlook

We are focused on three core goals: growing our customer base; increasing the lifetime value of our customers; and expanding into new market segments both from a price and product perspective. To achieve this we will continue to innovate, disrupt, grow our audience and ultimately continue in our tradition of making the creative process of music creation and audio recording easier for our customers.

Strategic report (continued)

Although competitive pressures remain strong, changes in technology and new customer requirements can emerge quickly, and macroeconomic and political factors affect our end customers and distributors alike, we remain committed to keeping abreast of these risks in order to continue to deliver strong growth.

Since the year end, revenue and cash have both grown further. We continue to see strong market acceptance across our expanding portfolio and our new product pipeline continues to grow. Our solid momentum has continued into the current year and we continue to look forward with confidence.

Financial Review

Revenue

Revenue grew from £54.3 million to £66.1 million, a rise of 21.6%. Since 2009, when the Company revenue was £9.1 million, the Company has grown revenue every year at a growth rate of at least 10%.

The largest segment, Focusrite, grew by 18.6%, from £37.6 million to £44.6 million, as the second generation of the Scarlett range continued to gain market share following its launch in June 2016. Scarlett is approximately three-quarters of the Focusrite segment by revenue and the Company has developed related ranges of products such as Clarett and RedNet, which are diversifying the Focusrite segment as they also grow and establish themselves in their markets.

The Novation segment consists of Novation and Ampify, the Company's new software brand. The combined revenue was £18.9 million, up 37.8% on £13.7 million last year. The Novation segment is relatively diverse: the largest range is Launchpad, which is approximately half of the segment revenue and, for which, demand grew strongly. Approximately a quarter of segment revenue is the Launchkey range and the remainder is split between synthesisers, Circuit and the remaining products.

In the UK, the Company distributes products such as microphones and monitors manufactured by other organisations. Revenue was £2.6 million, down 13.6% from £3.1 million in 2016.

All regions grew. Regionally, the USA is the largest market in the music industry and the largest market for the Company's products. Revenue in the USA grew 30.9% (constant currency: 18%) to £28.0 million, Europe grew 11.4% (constant currency: 7%) to £25.2 million and the Rest of the World grew by 24.9% (constant currency: 13%) to £12.9 million. The primary drivers of growth in the USA were the further consolidation of the Scarlett range in the market and strong growth of Novation. In Europe, there was increased competition between the major continental resellers which held back growth. In the Rest of the World, the major portion of the revenue is in Asia, which continues to grow as the new regional sales office in Hong Kong becomes more established.

Exchange rates were important this year. In essence, in FY16 there were ten months 'pre-Brexit' and two months post. Therefore, there was a more pronounced effect this year of the stronger US Dollar and Euro. At constant currency, revenue grew by 13%.

Gross profit

Gross profit increased to £26.2 million, up from £20.7 million in FY16. This represented a gross margin of 39.7% (FY16: 38.2%). This growth in gross margin was driven by several factors: closer attention paid to the fluctuations of market prices and then management of discounts given to resellers; the stronger Euro; and a minor range mix impact.

Administrative expenses

Administrative expenses consist of sales, marketing, operations, the uncapitalised element of research and development and central functions such as legal, finance and the Company Board. These expenses were £16.7 million, up from £12.9 million last year. Directionally, the greater growth was on sales and marketing as the Company invested, via the profit and loss account, in key initiatives such as the Asia office and e-commerce.

The Company buys product in US Dollars and approximately 60% of its revenue is in US Dollars so there is a natural hedge. Therefore, the US Dollar strengthening from \$1.45 to \$1.27 increased revenue but had little effect on gross profit. Approximately a quarter of revenue is in Euro but little cost. The Company enters into forward contracts to convert Euro to GBP. In FY16, approximately three-quarters of Euro flows were hedged at €1.39, thereby creating a blended exchange rate of approximately €1.37. In FY17, the equivalent hedging contracts were at €1.28 (a blended rate of approximately €1.26). For FY18, the equivalent rate for the forward contracts is €1.12. Hedge accounting is used, meaning that the hedging contracts have been matched to income flows and, providing the hedging contracts remain effective, movements in fair value are shown in a hedging reserve in the balance sheet, until the hedge transaction occurs.

Strategic report (continued)

Corporation tax

Corporation tax as a proportion of profit before tax was 9.7% (FY16: 12.4%). The effective tax rate is lower than the headline rate, largely due to enhanced tax relief on R&D, a small element of vesting share options and a lower than expected payment in the prior year. In addition, the UK headline tax rate has been reduced by 1 percentage point to 19% within the last year.

Non-current assets

The non-current assets comprise mainly capitalised R&D costs. Between 70% and 80% of R&D costs are capitalised and they are amortised over three years. The typical product life is three to six years. This policy is unchanged from last year.

Working capital

Working capital increased slightly from 16.5% of revenue to 18.3%. Two main factors have contributed to this change, the main driver of this was the reduction of amounts owed to Group undertakings. An opposite effect was the reduction of stock from £11.4 million to £8.3 million. The reduction in stock was achieved through lower levels of safety stock and the rising sales of new products, launched in FY15 and FY16, for which the Company had bought larger initial quantities to protect against possible 'stock-outs' should demand have risen more quickly than expected. As commented on in last year's Accounts, stock quantities have been reduced as the demand pattern for these products has become more predictable. There have been no significant changes in payment terms relating to either customers or suppliers.

Cash flow

Cash at the year end was £6.5 million, up from £5.3 at 31 August 2016, driven by the higher profit and lower working capital explained previously.

Going concern

As required, the Board have considered the ability of the Company to continue as a going concern. The Board reviewed the cash position, the management of working capital, the strategic plans, the forecast cash flow and the borrowing arrangements and capacity. The Board have concluded that the Company will remain as a going concern and that this Annual Report should be prepared on that basis.

Summary

The Company has had an excellent year. Revenue has grown by 21.6%, and the cash balance has increased from £5.3 million to £6.5 million. The Board remains focused on extending our track record of growth in future years.

Key performance indicators

In addition to reviewing individual Company business performance against annual budgets and quarterly reforecasts and monitoring cash flow management, the Board pays particular attention to identifying and monitoring Key Performance Indicators (KPIs). The principal KPIs monitored by the Board include:

- Revenue
- Adjusted EBITDA
- Underlying free cash flow
- NPI revenue as % of full year revenue
- Net promoter score
- Make easy (the proportion of people who own a Focusrite product and have no need to call our technical helpline)

Strategic report (continued)

Principal Risks and Uncertainties

The Company is required to give a description of the principal risks and uncertainties that it faces. The principal risks and uncertainties are detailed below. These risks should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. Other risks may arise of which the Board is not currently aware or which it deems immaterial.

Risk area	Description	Mitigation
Economic environment	The Group operates in the global economy and ultimately within a retail environment to consumer end-user musicians. Such operations are influenced by global and national economic factors.	The Group sells products in around 160 territories worldwide via two distinct product categories and so aims to avoid being unduly reliant on any single product or territory.
UK exit from the European Union	The impact of the decision to exit the European Union remains uncertain. There has already been foreign exchange volatility and it is possible that, in future, the UK may not be part of the European free trade zone or the customs union.	The Group has increased selling prices in the UK to correct the imbalance caused by the significant foreign exchange rate changes. The Group will continue to monitor other possible effects of Brexit and act accordingly as they become known.
Technological changes, innovation and competition	The market for the Group's products is characterised by continued evolution in technology, evolving industry standards, changes in customer needs and frequent new competitive product introductions. If the Group is unable to anticipate or respond to these challenges, or fails to develop and introduce successful products on a timely basis, it could have an adverse impact on the Group's business and prospects.	The Group invests significantly in its R&D and operates a rigorous, disciplined product introduction process to ensure that as far as possible the fast-changing needs of its target markets are met. In addition, the Board aims to operate an efficient, low-cost business.
Dependence on a small number of suppliers	The Group is dependent on a small number of suppliers, in particular its largest supplier, which supplies Focusrite interfaces. Failure or material delay by its suppliers to perform or failure by the Group to renew such arrangements could have a material adverse effect on the Group's business, operating results and financial position.	The Group aims to diversify its risk by using four major Chinese manufacturers for the production of its products. The Group maintains appropriate levels of insurance to mitigate the financial impacts of a failure of one of its suppliers. Relationships are long-lasting and strong. Typically, members of the operations department within Focusrite meet each supplier every quarter to review performance and costs.
Key resellers and distributors	In certain countries, the Group operates via a single distributor or has large individual reseller customers. In certain cases, a failure of or breakdown in the relationship with a key reseller or distributor, or even the failure of a major customer of that distributor, could significantly and adversely affect the Group's business.	In cases where there is a large distributor in a significant market (e.g. the USA distributor purchased £28 million of stock in FY17), the Group also maintains relationships with the major retailers. In addition, the Group carefully monitors customer credit limits and has credit insurance which typically covers the majority of the customer debts outstanding at any point in time.

Strategic report (continued)

Risk area	Description	Mitigation
Development of the channels to market	Significant change in the methods by which end-users wish to buy Focusrite products could significantly affect the Group's business.	The Group or its distributors sell to both 'bricks and mortar' and e-commerce retailers so that the Group can satisfy customer demand via both methods.
Currency risks	The Group is exposed to currency and exchange rate fluctuations, which may affect the Group's revenue and costs when reported in Sterling.	There is a largely effective natural hedge for US Dollar transactions in as much as the Group uses its generation of US Dollars to buy product in US Dollars. In addition, the Group mitigates its Euro exposure by entering into forward foreign exchange hedging contracts for the conversion of Euros to Sterling.
Scarcity of experienced technical personnel	The nature of the Group's business requires its employees in the technical and development teams to be highly skilled and experienced in their respective fields. The Group is dependent for its continued success on being able to hire and retain such individuals.	The Group is a leading music industry company in the UK and so attracts high-quality technical personnel. The Group also attracts graduates from music technology courses at local universities. The Group has wide-ranging share ownership incentives and other employment benefits to aid retention.
Intellectual property and data protection	The intellectual property and data developed by the Group is valuable and the Group could be harmed by infringement or loss.	The Group has data and information technology controls which are reviewed by the Group Board. Additionally, the Group includes data protection provisions in the contracts of all Group employees. The Group also aims to protect its intellectual property and pursues infringements.
Information security	Information security and cyber threats are currently a priority across all industries and remain a key Government agenda item.	The Group has carried out a detailed review of IT systems to identify elements requiring upgrade. There has already been a widespread upgrade of core IT functionality and the improvement of backup and disaster recovery processes. The Group has moved core ERP systems to cloud with robust SLAs in place to ensure data availability and security. There is an improving business continuity framework and a dedicated internal IT support team aided by external support providers.

By order of the board



Jeremy Wilson

Chief Financial Officer

24 May 2018

Directors' report

The Directors present their report together with the audited financial statements for the year ended 31 August 2017.

Financial results and dividends

The audited accounts for the Company for the year ended 31 August 2017 are set out on pages 14 to 34. The Company profit for the year after taxation from continuing operations was £8.7 million (FY16: £6.3 million).

Directors and directors' interests

The directors who held office during the year and to the date of this report were as follows:

T Carroll (appointed 1 January 2017)
T J Dingley
P S Dudderidge
D R Foker (resigned 31 December 2016)
D R Hawley
R D Jenkins (resigned 31 December 2017)
G R Orford
P R Wagner (resigned 1 June 2017)
M F G Warriner (resigned 1 December 2017)
J M C Wilson

Dividends

During the year the directors assessed the appropriateness of the company declaring a dividend and recommended that a dividend of £4,646,000 should be paid. Consequently dividends of £4,646,000 (FY16: £2,903,750) were paid in respect of Ordinary Shares during the financial year to which this report relates.

Directors' and officers' liability insurance

At no time during the year did any Director hold a material interest in any contract of significance with the Group or any of its subsidiary undertakings other than an indemnity provision between each Director and the Group and employment contracts between each Executive Director and the Group. The Group has purchased and maintained throughout the year Directors' and Officers' liability insurance in respect of all Group companies.

Future business developments

The strategy of the Group is explained in the Strategic Report section of this Annual Report and Accounts which, as noted in the preamble to the Directors' Report, is incorporated into this Report by reference.

R&D

The Group continues to invest in its research and development activities, as explained in the Chairman's Statement and the Chief Executive's Statement.

Health and safety

The Group is committed to providing a safe and healthy working environment for all staff and contractors. The Group's health and safety standard sets out the range of policies, procedures and systems required to manage risks and promote wellbeing. The General Counsel has overall accountability for health and safety across the organisation.

Going concern

The Company's business activities, together with risk factors which potentially affect its future development, performance or position can be found in the Strategic Report on pages 2 to 8.

After making reasonable enquiries, the Board has an expectation that the Group and the Company have adequate financial resources together with a strong business model to ensure they continue to operate for the foreseeable future. The Company is a cash-generative business that, when required, has access to borrowing facilities to meet the Group's future cash requirements. Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Directors' report (continued)

Disclosure of information to the auditor

As required by Section 418 of the Companies Act 2006, each Director serving at the date of approval of the financial statements confirms that:

- to the best of his knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each Director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information. Words and phrases used in this confirmation should be interpreted in accordance with Section 418 of the Companies Act 2006.

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

By order of the Board



Jeremy Wilson

Director

Windsor house
Turnpike Road,
High Wycombe
Buckinghamshire
HP12 3FX
24 May 2018

Statement of Directors' Responsibilities in respect of the Strategic report, the Directors' report and the financial statements

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

Under company law the directors must not approve the financial statements unless they are satisfied that they 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:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and 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 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Independent Auditor's Report to the Members of Focusrite Audio Engineering Limited

Opinion

We have audited the financial statements of Focusrite Audio Engineering Limited ("the company") for the year ended 31 August 2017 which comprise the Statement of comprehensive income, Statement of financial position, Statement of changes in equity and related notes, including the accounting policies in note 2.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 August 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

Strategic report and directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.; We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 11, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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.



Peter Meehan (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
One Snowhill
Snow hill Queensway
Birmingham
B4 6GH

24 May 2018

Statement of comprehensive income

For the year ended 31 August 2017

		2017	2016
	Note	£'000	£'000
Revenue	4	66,055	54,301
Cost of sales		(39,837)	(33,562)
Gross profit		26,218	20,739
Administrative expenses		(16,653)	(12,942)
Exceptional legal and professional costs		-	(537)
Operating profit		9,565	7,260
Finance income	8	86	320
Finance costs	9	(44)	(339)
Profit before tax		9,607	7,241
Income tax expense	11	(930)	(901)
Profit for the year	6	8,677	6,340
Other comprehensive income, net of income tax			
<i>Items that may be reclassified subsequently to the income statement</i>			
Gain/(loss) on forward foreign exchange contracts designated and effective as a hedging instrument		525	(914)
Total comprehensive income for the period		9,202	5,426
Profit attributable to:			
Owners of the Company		9,202	5,426
		9,202	5,426

The result has been derived from continuing operations.

Notes 1 to 25 form part of the financial statements.

Statement of financial position

As at 31 August 2017

	Note	2017 £'000	2016 £'000
Non-current assets			
Goodwill	13	419	419
Other intangible assets	14	4,544	4,373
Property, plant and equipment	15	1,306	1,515
Investments	16	13	13
Total non-current assets		6,282	6,320
Current assets			
Inventories	17	8,344	11,361
Trade and other receivables	18	12,829	11,151
Cash and cash equivalents		6,547	5,322
Total current assets		27,720	27,834
Total assets		34,002	34,154
Current liabilities			
Trade and other payables	21	9,053	13,568
Current tax liabilities		527	696
Derivative financial instruments		484	1,143
Total current liabilities		10,064	15,407
Net current assets		17,656	12,427
Total assets less current liabilities		23,938	18,747
Non-current liabilities			
Deferred tax	19	245	282
Total liabilities		10,309	15,689
Net assets		23,693	18,465
Capital and reserves			
Share capital	22	58	58
Share premium		332	332
Deferred tax reserve		447	333
Hedging reserve		(389)	(914)
Capital redemption reserve		1,116	1,116
Retained earnings		22,129	17,540
Total shareholder's funds		23,693	18,465

The financial statements were approved by the Board of Directors and authorised for issue on 24 May 2018. They were signed on its behalf by:



Jeremy Wilson
Director

Company registered number: 02357989

Statement of changes in equity

For the year ended 31 August 2017

	Share capital £'000	Share premium £'000	Deferred tax reserve £'000	Hedging reserve £'000	Capital redemption reserve £'000	Retained earnings £'000	Total £'000
Balance at 1 September 2015	58	332	-	-	1,116	14,003	15,509
Profit for the period	-	-	-	-	-	6,340	6,340
Other comprehensive income for the period	-	-	-	(914)	-	-	(914)
Total comprehensive income for the period	-	-	-	(914)	-	6,340	5,426
Transactions with owners of the Company:							
Recharged share-based payment expense	-	-	-	-	-	(262)	(262)
Share-based payment deferred tax deduction in excess of remuneration expense	-	-	333	-	-	-	333
Share-based payment current tax deduction in excess of remuneration expense	-	-	-	-	-	363	363
Dividends	-	-	-	-	-	(2,904)	(2,904)
Balance at 1 September 2016	58	332	333	(914)	1,116	17,540	18,465
Profit for the period	-	-	-	-	-	8,677	8,677
Other comprehensive income for the period	-	-	-	525	-	-	525
Total comprehensive income for the period	-	-	-	525	-	8,677	9,202
Transactions with owners of the Company:							
Share-based payment deferred tax deduction in excess of remuneration expense	-	-	114	-	-	-	114
Share-based payment current tax deduction in excess of remuneration expense	-	-	-	-	-	558	558
Dividends	-	-	-	-	-	(4,646)	(4,646)
Balance at 31 August 2017	58	332	447	(389)	1,116	22,129	23,693

Notes to the financial statements

for the year ended 31 August 2017

1 General information

Focusrite Audio Engineering Limited (the "Company"), is a company incorporated and domiciled in the United Kingdom.

Basis of preparation

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare group financial statements. Accordingly, these financial statements present information about the Company as an individual undertaking and not about its group.

The Company has applied IFRS 1 whilst ensuring that its assets and liabilities are measured in accordance with FRS 101.

The Company's parent undertaking, Focusrite Plc, includes the Company in its consolidated financial statements. The consolidated financial statements of Focusrite Plc are prepared in accordance with International Financial Reporting Standards and are available to the public and may be obtained from the Company's registered office.

In these financial statements, the company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- Cash Flow Statement and related notes;
- Disclosures in respect of transactions with wholly owned subsidiaries;
- Disclosures in respect of capital management;
- The effects of new but not yet effective IFRSs;

As the consolidated financial statements of Focusrite Plc include the equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of the following disclosures:

- IFRS 2 Share Based Payments in respect of group settled share based payments;
- Certain disclosures required by IAS 36 Impairment of assets in respect of the impairment of goodwill and indefinite life intangible assets;
- Certain disclosures required by IFRS 13 Fair Value Measurement and the disclosures required by IFRS 7 Financial Instrument Disclosures; and
- The disclosures required by IFRS 7 and IFRS 13 regarding financial instrument disclosures have not been provided apart from those which are relevant for the financial instruments which are held at fair value and are not either held as part of trading portfolio or derivatives.

2 Accounting policies

Going concern

The Company's business activities and position in the market are described in the Strategic Report. The Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertainties within the global economy. The Company and its immediate parent have considerable financial resources, recurring revenue streams and a broad spread of customers. As a consequence of these factors and having reviewed the forecasts for the coming year, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus, they continue to adopt the going concern basis of accounting in preparing the annual Financial Statements. Further detail is contained in the Strategic Report on pages 2 to 8.

Investments

Investments in subsidiaries are stated at cost less any provision for impairment.

Goodwill

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, after reassessment, the Company's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Company's cash-generating units expected to benefit from synergies arising from the combination. Cash-generating units to which goodwill has been attributed under IFRS 3 Business Combinations are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in determining profit or loss on disposal.

Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown net of sales taxes and discounts.

The Company recognises revenue when all the following conditions are satisfied:

- the Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue recognised in the income statement but not yet invoiced is held on the balance sheet within 'Trade and other receivables'. Revenue invoiced but not yet recognised in the income statement is held on the balance sheet within 'Deferred revenue'.

Revenue is classified as follows:

Sales of goods

Revenue from the supply of goods is recognised as soon as all substantial risks and rewards relating to the title of the goods have been transferred to the customer.

Sale of apps

Revenue from the download of apps is recognised upon confirmation from the app store provider.

2 Accounting policies (continued)

Leasing

The Company's leases are currently all operating leases (leases in which a significant portion of the risks and rewards of ownership are retained by the lessor). Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease (net of any incentive received from the lessor).

Foreign currencies

Transactions in foreign currencies are translated to the Company's functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences arising on translation are recognised in the profit and loss account.

Exchange differences are recognised in profit or loss in the period in which they arise except for:

- exchange differences on transactions entered into to hedge certain foreign currency risks (see below under financial instruments / hedge accounting); and
- exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal or partial disposal of the net investment.

Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Company's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the Financial Information and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are only recognised for taxable temporary differences arising on investments in subsidiaries, where the Company is unable to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered in the foreseeable future.

2 Accounting policies (continued)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited in other comprehensive income, in which case the deferred tax is also dealt with in other comprehensive income.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Tangible and intangible assets

Property, plant and equipment

The Company has held no land and buildings for the period covered by the financial statements.

Other items of property, plant and equipment are stated at cost less accumulated depreciation and any recognised impairment loss.

Depreciation is recognised so as to write off the cost or valuation of assets less residual value over their useful lives, using the straight-line method, on the following bases:

Plant, equipment and tooling	3-5 years
Computer equipment	2 years
Fixtures and fittings	5 years
Leasehold improvements	5-8 years
Customer demonstration units	2 years

The gain or loss arising on the disposal of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income on the transfer of the risks and rewards of ownership.

The Company has no class of tangible fixed asset that has been revalued. On transition to FRS 101 the net book values recorded at 1 September 2013 have been applied and these are based on historic cost or fair value recognised at the date of acquisition.

Internally-generated intangible assets – research and development expenditure

Intangible assets are amortised over the following periods on a straight-line basis:

Development expenditure	3 years
Purchased intellectual property	2 years
Licences	2-5 years
Computer software	2 years

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from the Company's development of new and enhanced products is recognised only if all of the following conditions are met:

- an asset is created that can be identified (such as product designs and new processes);
- it is probable that the asset created will generate future economic benefits; and
- the costs of developing this asset can be measured reliably.

Where no internally-generated intangible asset can be recognised, the expenditure is recognised as an expense in the period in which it is incurred.

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired. Capitalised development costs are calculated by reference to the Company's product development department and will therefore be tested for impairment at cash generating unit level.

2 Accounting policies (continued)

Recoverable amount is the higher of: (i) fair value less costs to sell and (ii) value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease to the extent that the revaluation balance is greater than the impairment loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years for the asset (or cash-generating unit). A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using either the First-In-First-Out method or, for fast moving items, the average cost method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount. Provision for impairment is made through profit or loss when there is objective evidence that the Company will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

Financial instruments

Financial assets and financial liabilities are recognised in the Company's balance sheet when the Company becomes a party to the contractual provisions of the instrument.

Financial Assets

All financial assets are normally recognised and derecognised on a trade date basis where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value. On derecognition however, where a specific transaction is entered into with a counterparty that is judged to carry a high credit or liquidity risk, then management may determine that derecognition of the financial asset shall be based on settlement date rather than trade date, with any realised gain or loss taken to profit and loss on date of settlement.

Financial assets are classified into the following specified categories: financial assets at 'fair value through profit or loss' ("FVTPL"), 'held-to-maturity' investments, 'available-for-sale' ("AFS") financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments other than those financial assets classified as at FVTPL.

2 Accounting policies (continued)

Classes of financial asset

Financial assets at FVTPL

Financial assets are classified as at FVTPL when the financial asset is either held for trading or is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near term; or
- on initial recognition it is a part of a portfolio of identified financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a Company of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Company's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the 'other gains and losses' line item in the income statement.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For listed and unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, including finance lease receivables, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment is the differences between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

2 Accounting policies (continued)

Financial liabilities

Financial liabilities are classified as either financial liabilities 'at FVTPL' or 'other financial liabilities'.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- it has been incurred principally for the purpose of repurchasing it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Company's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability and is included in the 'other gains and losses' line item in the income statement.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Company derecognises financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire.

Derivative financial instruments

The Company is able to enter into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risk, including foreign exchange forward contracts, interest rate swaps and cross currency swaps.

Hedge accounting

For the year ended 31 August 2016 and subsequent years, the Company adopted hedge accounting for qualifying transactions. Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Company designates certain derivatives as hedges of highly probable forecast transactions or hedges of foreign currency risk of firm commitments (cash flow hedges).

2 Accounting policies (continued)

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the hedging reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

For cash flow hedges, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

3 Critical judgements and estimations in applying the Company's accounting policies

The following are the important judgements and estimations that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial information.

Judgements

Revenue recognition

In making its judgement, management considered the detailed criteria for the recognition of revenue set out in IAS 18. Management is satisfied that the significant risks and rewards of ownership are transferred and that the recognition of revenue upon despatch is appropriate.

Inventory valuation

Judgement is required to determine the level of inventory at the year end that may become obsolete due to changes in consumer habits or technology and therefore the level of provision against it. The Group has an inventory provisioning policy that reflects the fact that there are strong physical controls carried out by the independent service provider which manages the Group's inventory resulting in low inventory loss or damage.

Estimates

Revenue recognition

The Group has contractual terms with certain customers that require estimation of the rebate payable at the year end because the amount payable is based on future sales to the end user.

Recoverability of internally-generated intangible asset

Management reconsidered the recoverability of its internally-generated intangible asset for development costs which is included in the balance sheet at 31 August 2017 at £4,066,000 (2016: £4,172,000). These projects continue to progress in a satisfactory manner, and customer reaction has reconfirmed management's previous estimates of anticipated revenues from the project.

Management is confident that the carrying amount of the asset will be recovered in full. This situation will be closely monitored, and adjustments made in future periods if future market activity indicates that such adjustments are appropriate.

Allowance for doubtful debts

Management undertakes a review of all new customers and a periodic review of existing customers to determine whether specific risks of default exist. A substantial proportion of the Group's trade receivables ledger is covered by credit insurance. Beyond identification of specific risks, management undertakes periodic reviews into the calculation of allowances for doubtful debts to ensure historic trends continue to provide a basis for determining a reliable estimate for them.

3 Critical judgements and estimations in applying the Company's accounting policies (continued)

Share option schemes

The Group has established several share option schemes. The fair value of the options issued under these schemes is derived by the Company using the Black-Scholes model and the resultant values are allocated to the income statement over the period of vesting. In arriving at the fair value using this model, the Company calculates a number of inputs to the model, including estimated share price volatility.

Further details regarding the option schemes are set out in note 24.

4 Revenue

	Year ended 31 August	
	2017	2016
	£'000	£'000
Continuing operations		
USA	27,990	21,382
Europe, Middle East and Africa	25,153	22,582
Rest of World	12,912	10,337
Revenue	66,055	54,301

5 Business Segments

Products and services from which reportable segments derive their revenues

Information reported to the Company's Chief Executive (who has been determined to be the Company's Chief Operating Decision Maker) for the purposes of resource allocation and assessment of segment performance is focused on the main product groups which Focusrite sells. The Company's reportable segments under FRS 101 are therefore as follows:

Focusrite	-	Sales of Focusrite branded products
Novation	-	Sales of Novation branded products
Distribution	-	Distribution of third party brands including KRK speakers, Ableton, Stanton, Cerwin Vega, Cakewalk and sE Electronics

Segment revenues and results

	Year ended 31 August	
	2017	2016
	£'000	£'000
Revenue from external customers		
Focusrite	44,552	37,563
Novation	18,862	13,683
Distribution	2,641	3,055
Total	66,055	54,301
Segment profit		
Focusrite	20,221	17,159
Novation	9,198	6,743
Distribution	711	917
	30,130	24,819
Central distribution costs and administrative expenses before non-underlying items	(20,565)	(17,559)
Operating profit	9,565	7,260
Finance income	86	320
Finance costs	(44)	(339)
Profit before tax	9,607	7,241
Tax	(930)	(901)
Profit after tax	8,677	6,340

5 Business Segments (continued)

The accounting policies of the reportable segments are the same as the Company's accounting policies described in note 2. Segment profit represents the profit earned by each segment without allocation of the share of central administration costs including Directors' salaries, investment revenue and finance costs, and income tax expense. This is the measure reported to the Company's Chief Executive for the purpose of resource allocation and assessment of segment performance.

Central administration costs comprise principally the employment related costs and other overheads incurred by Focusrite and its US subsidiary, net of inter-company commission income. Also included within central administration costs is the re-charged amount relating to the share option scheme (note 24) of £145,000 for the year ended 31 August 2017 (2016: £120,000).

Management does not make use of segmental data relating to net assets and other balance sheet information for the purposes of monitoring segment performance and allocating resources between segments. Accordingly, other than the analysis of the Company's non-current assets by geographical location shown below, this information is not available for disclosure in the financial information.

The Company's non-current assets, analysed by Geographical location were as follows:

	2017 £'000	2016 £'000
Non-current assets		
USA	13	13
Europe, Middle East and Africa	5,665	5,602
Rest of World	604	705
Total non-current assets	6,282	6,320

Information about major customers

Included in revenues shown for 2017 is £28.0 million (2016 £21.4 million) attributed to the Company's largest customer. Amounts owed at end of year is £6.8 million (2016: £5.2 million).

6 Profit for the year

Profit for the year has been arrived at after charging/(crediting):

		Year ended 31 August	
	Note	2017 £000	2016 £000
Net foreign exchange gains	8,9	(84)	(92)
Research and development costs		1,120	779
Exceptional costs		-	537
Depreciation and impairment of property, plant and equipment	15	625	435
Loss on disposal of property, plant and equipment		7	-
Amortisation of intangibles	14	2,950	2,051
Operating lease rental expense	20	181	183
Cost of inventories recognised as an expense		35,493	27,955
Staff costs	10	7,481	6,608
Impairment loss recognised on trade receivables	18	(3)	4
Change in fair value of financial instruments		-	223
Share based payments charge to profit and loss		145	120

7 Auditor's remuneration

	Year ended 31 August	
	2017	2016
	£000	£000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	43	38
Fees payable to the company's auditor and its associates for other services:		
Audit-related assurance services	10	2
Tax compliance services	3	4
Other assurance services	5	30
	61	74

8 Finance Income

	Year ended 31 August	
	2017	2016
	£000	£000
Bank deposit interest	2	5
Exchange gain	84	315
Finance income	86	320

9 Finance costs

	Year ended 31 August	
	2017	2016
	£000	£000
Bank charges	44	116
Exchange loss	-	223
Finance costs	44	339

10 Staff costs and directors' remuneration**a) Staff costs**

	Year ended 31 August	
	2017	2016
	£000	£000
Wages and salaries	6,657	5,872
Social security costs	539	562
Other pension costs	285	174
	7,481	6,608

The average number of persons, including executive directors, employed by the Company during the year was as follows:

	2017	2016
	Number	Number
Research and development	63	57
Sales and marketing	24	45
Operations	43	39
Administration and central	15	18
	145	159

10 Staff costs and directors' remuneration (continued)

b) Directors' remuneration

	Year ended 31 August	
	2017	2016
	£000	£000
Management remuneration and fees	688	718
Pension contributions	193	142
Benefits	9	7
	890	867
In respect of the highest paid director:		
Management remuneration and fees	167	163
Pension contributions	9	10
Benefits	2	2
	178	175

11 Tax

	Year ended 31 August	
	2017	2016
	£'000	£'000
Corporation tax charges:		
Overprovision in prior year	(13)	(231)
Current year	1,000	1,031
	987	800
Deferred taxation		
Current year	(57)	101
	930	901

Corporation tax is calculated at 19.58% (2016: 20.00%) of the estimated taxable profit for the year.

The tax charge for each year can be reconciled to the profit per the income statement as follows:

	Year ended 31 August	
	2017	2016
	£'000	£'000
Current taxation		
Profit before tax on continuing operations	9,607	7,241
Tax at the UK corporation tax rate of 19.58% (2016: 20.00%)	1,881	1,448
Effects of:		
Expenses not deductible for tax purposes	(28)	480
Income not taxable for tax purposes	-	(1)
R&D tax credit	(773)	(706)
Prior period adjustment - current tax	(113)	(231)
Prior period adjustment - deferred tax	(18)	(12)
Effect of change in standard rate of deferred tax	(19)	-
Share options expense deductible - current tax	-	(25)
Share options expense deductible - deferred tax	-	(52)
Total tax charge for period	930	901

The Finance Act 2016, which included legislation reducing the main rate of corporation tax from 20% to 19% from 1st April 2017 and to 17% from 1st April 2020, was enacted on 15th September 2016. The deferred tax liability at 31 August 2017 has been calculated based on these rates.

12 Dividends

The following equity dividends have been declared:

	Year to 31 August 2017	Year to 31 August 2016
Dividend per qualifying ordinary share	8.0p	5.0p

During the year, the Company paid an interim dividend in respect of the year ended 31 August 2017 of 8 pence per share (2016: 5 pence per share).

The Directors recommended a final dividend of nil pence per share (2016: nil pence per share), making a total of 8 pence per share for the year (2016: 5 pence per share).

13 Goodwill

	£'000
Cost	
At 31 August 2015	419
At 31 August 2016	419
At 31 August 2017	419
Carrying amount	
At 31 August 2015	419
At 31 August 2016	419
At 31 August 2017	419

No impairment losses have been required on goodwill amounts recognised in the Company to date.

Goodwill arose as a result of a transfer on 31 August 2006 of the assets and liabilities of Novation Digital Music Systems Limited for a consideration of £711,000. Accordingly, the whole of the value of goodwill is attributable to the Novation cash generating unit ('CGU').

14 Other Intangible assets

	Intellectual property £'000	Development costs £'000	Licences £'000	Trademark £'000	Computer software £'000	Total £'000
Cost						
At 1 September 2015	72	9,904	211	-	107	10,294
Additions	133	2,716	-	-	53	2,902
At 31 August 2016	205	12,620	211	-	160	13,196
Additions	-	2,721	-	127	273	3,121
Disposals	-	-	(124)	-	(10)	(134)
At 31 August 2017	205	15,341	87	127	423	16,183
Depreciation						
At 1 September 2015	30	6,485	165	-	92	6,772
Charge for the year	42	1,963	32	-	14	2,051
At 31 August 2016	72	8,448	197	-	106	8,823
Charge for the year	72	2,822	9	14	33	2,950
Eliminated on disposal	-	-	(124)	-	(10)	(134)
At 31 August 2017	144	11,270	82	14	129	11,639
Carrying amount						
At 31 August 2017	61	4,071	5	113	294	4,544
At 31 August 2016	133	4,172	14	-	54	4,373
At 31 August 2015	42	3,419	46	-	15	3,522

15 Property, plant and equipment

	Plant, tooling equipment and machinery £'000	Fixtures, fittings & leasehold improvements £'000	Computer equipment £'000	Customer demonstration units £'000	Total £'000
Cost					
At 1 September 2015	2,807	983	709	-	4,499
Additions	402	6	152	101	661
At 31 August 2016	3,209	989	861	101	5,160
Additions	279	20	130	18	447
Disposals	(905)	(114)	(539)	(26)	(1,584)
At 31 August 2017	2,583	895	452	93	4,023
Accumulated depreciation and impairment					
At 1 September 2015	2,124	473	613	-	3,210
Charge for the year	275	71	89	-	435
At 31 August 2016	2,399	544	702	-	3,645
Charge for the year	397	84	129	15	625
Eliminated on disposal	(903)	(112)	(538)	-	(1,553)
At 31 August 2017	1,893	516	293	15	2,717
Carrying amount					
At 31 August 2017	690	379	159	78	1,306
At 31 August 2016	810	445	159	101	1,515
At 31 August 2015	683	510	96	-	1,289

16 Investments

	Shares in group undertakings £'000
Cost and net book value	
At 31 August 2017	13
At 31 August 2016	13
At 31 August 2015	13

The investment of £13,000 represents the entire issued share capital of Focusrite Novation Inc. The Company's principal subsidiary undertaking for the period is set out below, including the name, country of incorporation, and proportion of ownership, and controlling, interest.

Name	Country of registration or incorporation	Address	Principal activity	Class of shares	2017 %	2016 %
Focusrite Novation Inc	USA	840 Apollo St, El Segundo, CA, 90245, USA	Marketing services	Ordinary	100	100
Focusrite Novation Asia Limited	Hong Kong	2316, 23/F Hong Kong Plaza, 181- 191 Connaught Road West, Shek Tong Tsui, Hong Kong	Marketing services	Ordinary	100	100

17 Inventories

	2017 £'000	2016 £'000
Raw materials	61	95
Finished goods	8,283	11,266
	8,344	11,361

No inventories have been pledged as security against borrowings (2016: £nil). Stock days recorded against cost of sales amounted to 76 days in 2017 (2016: 124 days).

18 Trade and other receivables

	2017 £'000	2016 £'000
Amount receivable for the sale of goods	11,223	9,643
Allowance for doubtful debts	(20)	(40)
	11,203	9,603
Other debtors	1,141	1,407
Prepayments	485	141
	12,829	11,151

Trade receivables

Trade receivables disclosed above are classified as loans and receivables and are measured at amortised cost.

The average credit period offered on sales of goods during 2017 was 56 days (2016: 57 days). The average days sales outstanding ("DSO") in 2017 was 60 days (2016: 63 days).

The Company has not charged interest for late payment of invoices in 2016 or 2017.

Allowances against doubtful debts are recognised against overdue trade receivables based on estimated irrecoverable amounts determined by reference to past default experience. Specific counterparty risk is also considered where an analysis of the counterparty's current financial position indicates a change in credit risk.

Before accepting any significant new customer, the Company uses a variety of credit scoring systems to assess the potential customer's credit quality and to define credit limits for each customer. Limits and scoring attributed to customers are reviewed regularly. A single major distributor accounted for 60% of the total balance of trade receivables net of allowances for doubtful debts on 31 August 2017 (2016: 53%). No other single customer accounted for more than 10% of the total balance of trade receivables net of allowances for doubtful debts during the period under review.

Trade receivables disclosed above include amounts which are past due at the year-end but against which the Company has not recognised an allowance for doubtful receivables. There has not been a significant change in credit quality and the amounts are still considered recoverable.

19 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Company:

	Accelerated tax depreciation £'000	Share based payments £'000	Hedging instrument £'000	Total £'000
Cost				
At 1 September 2015	743	-	-	743
Credit to profit or loss	153	(52)	-	101
Debit to equity	-	(333)	(229)	(562)
At 31 August 2016	896	(385)	(229)	282
Credit to profit or loss	(40)	(17)	134	77
Debit to equity	-	(114)	-	(114)
At 31 August 2017	856	(516)	(95)	245

There is no net off of tax assets/liabilities included within the above categories. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2017 £000	2016 £000
Deferred tax liabilities	856	896
Deferred tax assets	(611)	(614)
	245	282

20 Operating lease arrangements

	Minimum lease payments	
	2017	2016
	£'000	£'000
Minimum lease payments under operating leases recognised as an expense during the year	181	183

At the balance sheet date the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	Present value of minimum lease payments	
	2017	2016
	£'000	£'000
Within one year	233	164
In the second to fifth years inclusive	725	650
After five years	54	216
	1,012	1,030

Operating lease payments typically represent rentals payable by the Company for its office properties and office equipment. Rent reviews and break clauses apply to leased property agreements.

21 Trade and other payables

	2017	2016
	£'000	£'000
Trade payables	4,303	6,374
Accrued expenses	3,481	2,328
Amounts owed to Group undertakings	1,269	4,866
	9,053	13,568

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases was 37 days (2016: 68 days). No interest costs have been incurred in relation to trade payables. The Company policy is to ensure that payables are paid within the pre-agreed credit terms and to avoid incurring penalties and/or interest on late payments. Other creditors include sales taxes, property taxes, social security and employment taxes due to local tax authorities.

The directors consider that the carrying amount of trade payables approximates their fair value.

The amounts owed to Group undertakings are interest free and repayable on demand.

22 Share capital

The Company has one class of ordinary shares which carry no right to fixed income.

	2017	2016
	Number	Number
Issued and fully paid:		
Ordinary shares of £0.001 each	58,075,000	58,075,000
	2017	2016
	£	£
Issued and fully paid:		
Ordinary shares of £0.001 each	58,075	58,075
	58,075	58,075

23 Retirement benefit scheme

The Company operates a stakeholder retirement benefit scheme which is open to all employees.

Other than amounts that are deducted from employees' remuneration and accrued pending payment to the pension fund, no further obligations fall on the Company as the assets of these arrangements are held and managed by third parties entirely separate from the Company.

The pension charge for the period represents contributions payable to the fund and amounted to £285,000 for the year ended 31 August 2017 (2016: £174,000). Contributions totalling £16,448 (2016: £20,000) were payable to the fund at the balance sheet date and are included in trade and other payables.

24 Share option scheme

The Company operated three options scheme, the 2012 EMI Scheme, the 2014 EMI Scheme and an unapproved option scheme ("Share option Scheme").

Prior to Focusrite Plc's incorporation, the Company operated Share Option Schemes and granted options over its share capital ("Old Options"), under which 8,143 share options were outstanding at the beginning of the period. Following Admission, the Old Options had been rolled over into options over shares in Focusrite Plc and Focusrite Plc took over the operation of the Share Option Scheme. As a result, the number of exercisable at end reporting period is Nil.

25 Related party transactions

Transactions between the Company and related parties, which are not wholly owned subsidiaries, are disclosed below.

During the year, the Company continued a commercial lease agreement in Lincoln Road, High Wycombe. Mr P Dudderidge, a Director of Focusrite Audio Engineering Limited and shareholder of Focusrite plc, is the landlord of the property in Lincoln Road, High Wycombe. The annual rental is £19,750 (2016: £19,750).