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Marlborough Stirling

Directors' report and financial statements

Year ended 31st December 2002

[contents]

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[financial highlights]

	2001 £m	2002 £m
Turnover (including share of joint ventures)	**73.4**	**121.0**
Adjusted pre–tax profit*	**15.0**	**11.3**
Operating cash flow	**13.5**	**11.5**
Net cash	**7.5**	**9.1**

*Pre–tax profit before charges for goodwill amortisation and impairment, employee share options, reorganisation costs and amounts written off investments

[highlights of the year]

The year saw a significant number of highlights for Marlborough Stirling including major new contracts, significant contract extensions, successful product launches and key strategic initiatives

jan	**Canadian mortgage contract** MCAP Mortgage Corporation signs a licence for Marlborough Stirling's Omiga mortgage point-of-sale and application processing software
feb	
mar	
apr	**Officeweb contract** Licence of Officeweb software system to Thomson's Group agreed
may	**Strategic distribution initiative** A key initiative commences with a number of major UK life and pension companies to extend the capability of Exweb to embrace full electronic trading
jun	
jul	**Mortgage outsourcing contract** Marlborough Stirling Mortgage Services signs five year outsourcing contract with London Mortgage Company
aug	**Success for Genesis Life** Genesis Life, Marlborough Stirling's offshore portfolio bond management software system, implemented by Isle of Man Assurance
sep	***Officeweb contract*** Licence of Officeweb software system to The Tenet Group announced ***Omiga contract*** Implementation of latest version of Omiga software for Birmingham Midshires announced
oct	**Lamda implementation for AXA Sun Life** Major phase of Lamda software implementation for AXA Sun Life completed enabling the launch of group pension products
nov	**Outsourcing contract extension** Outsourcing contract with Sun Life Financial of Canada extended by two years
dec	**Completion of key migration phase** Migration of approximately 300,000 policies from Sun Life Financial of Canada's legacy systems onto Lamda completed **The Exchange** 18,270 subscribers 99 million annual quotations

Largest ever contract
Business process outsourcing contract signed with Sun Life Financial of Canada generating more than £95 million in turnover over five years

Outsourcing contract
Edinburgh Fund Managers selects Marlborough Stirling as its outsourcing partner for its Edinburgh Portfolio Pension plans

Launch of Officeweb
Marlborough Stirling launches Officeweb, its business administration software system for intermediaries

Lamda implementation for AXA Sun Life
Major phase of Lamda software implementation for AXA Sun Life completed enabling the launch of investment bonds

Success for Genesis Life
Genesis Life, Marlborough Stirling's offshore portfolio bond management software system, implemented by Prudential Europe Management Services

Outsourcing contract with GE Pensions
An £11 million contract is secured to administer pension related policies for GE Pensions Limited, part of the GE Life group

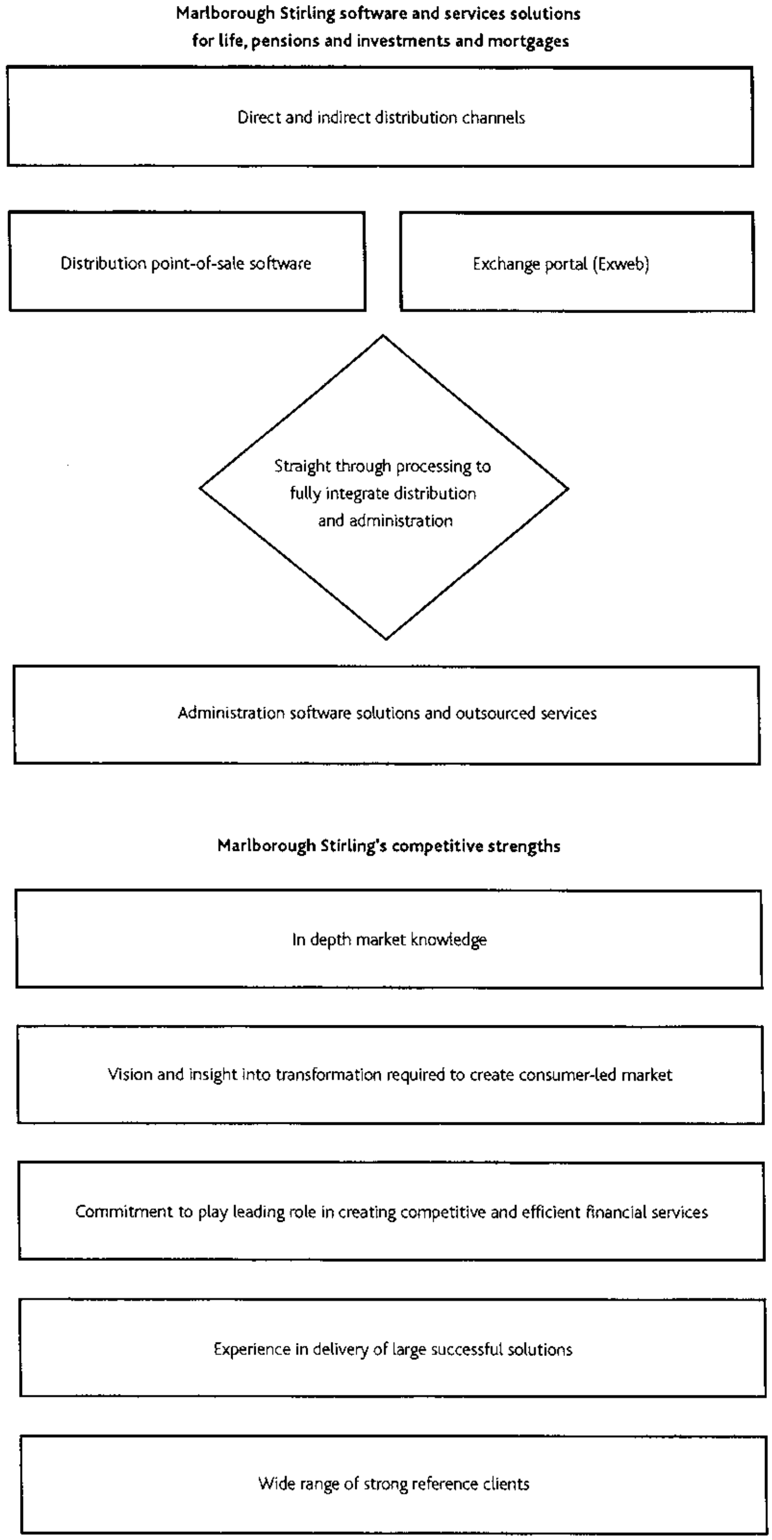
Point-of-sale contract extension
Friends Provident extends point-of-sale software contract

Mortgage outsourcing contract
Marlborough Stirling Mortgage Services signs five year outsourcing contract with Standard Life Bank

Strategic alliance with Bankhall
Strategic alliance agreed with Bankhall relating to electronic quotation and new business transactions, Officeweb and other services

[transforming financial services]

Marlborough Stirling plays a leading role in the transformation of financial services to a consumer-led, competitive and efficient market place



[products and services]

Life, pensions and investment software and consultancy
These activities are based on the delivery of software products such as Lamda and Genesis Life. Lamda is a highly strategic solution for the servicing of life, pension and investment products from submission of new business to claim or maturity including fulfilment of contribution and investment processing, commission rules and processing, administrative, account and management reporting and document production. Genesis Life is an integrated policy administration solution enabling the administration, investment management, accounting and reporting of offshore and international wealth management products

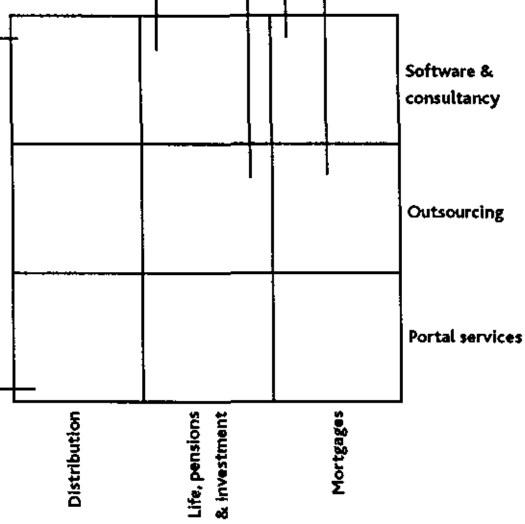
Distribution software and consultancy
Marlborough Stirling's distribution software and consultancy activities are based on the delivery of software products such as Omiga+ and Officeweb. Omiga+ is an integrated customer management, point-of-sale and application processing solution for a broad range of retail financial products. Combined with back office solutions, it can enable straight through processing of new business and fulfilment of traditional back office functions in the front office. Officeweb is a business administration system for IFAs and other intermediaries

Mortgage software and consultancy
These activities are based on the delivery of software products such as Omiga and Optimus. Omiga is an integrated customer management, point-of-sale and application processing solution for the mortgage industry. Optimus supports post-completion activities such as mortgage servicing, borrower retention management and securitisation. It also interfaces with various enterprise systems including general ledger and payment processing, document management, imaging and workflow, data warehouses and pricing systems

Life, pensions and investment outsourcing
Marlborough Stirling provides a range of outsourcing services to the life and pensions industry including business process re-engineering, change management, new business processing, customer service, past business reviews, finance and actuarial

Mortgage outsourcing
Marlborough Stirling Mortgage Services provides a range of outsourcing services to the mortgage industry including change management, new business processing, mortgage packaging and customer service

Exchange portal (Exweb)
Exweb is the UK's leading intermediary trading platform in the financial services market, providing connectivity supporting the provision of product quotation, illustration and information services. Exweb has over 18,000 subscribers and 99 million quotations were processed through the service during 2002



[client case studies]

Sun Life Financial of Canada

Sun Life Financial of Canada (SLFoC) is a leading international financial services organisation providing a diverse range of wealth accumulation and protection products and services to individuals and corporate customers.

SLFoC's UK operation has been a major client since 1999 when it decided to implement Lamda, Marlborough Stirling's life and pensions administration system, to help transform its business. Having already closed to new business, in 2002 SLFoC decided to extend this transformation by entering into a major business process outsourcing contract with Marlborough Stirling.

Using Lamda and outsourcing, Marlborough Stirling has reduced significantly SLFoC's costs particularly through decommissioning costly and disparate legacy systems, unifying the view of the business, enabling customer service personnel reductions, and implementing business process re–engineering disciplines.

"Marlborough Stirling has played a key role in the transformation of Sun Life Financial of Canada's UK operation. Lamda has proved a reliable and low cost alternative to our legacy mainframe systems, underpinning this transformation. Outsourcing has reduced our costs further and Marlborough Stirling has met our challenging expectations from the outset of the BPO contract. We have been able to transfer costs from a fixed to a variable basis which is in line with the gradual run down of our policy portfolio thereby giving much more certainty to the management of our business going forward."
David Davies, Chief Executive Officer of Sun Life Assurance Company of Canada (UK) Limited

MCAP Mortgage Corporation is a leading provider of residential, construction and commercial mortgages in Canada.

Marlborough Stirling's successful relationship with MCAP Mortgage Corporation has seen us deliver our Optimus mortgage back office servicing solution. Most recently, we implemented Omiga, our customer management, point-of-sale and application processing system for mortgage providers creating, for our client, an integrated end–to–end core IT infrastructure.

"Omiga is the best–of–breed mortgage solution that, combined with the Optimus back office solution, provides enhanced customer service, extensive multi–channel functionality and the cost benefits of full electronic straight through processing. We also expect Omiga to deliver significant productivity gains, particularly in the areas of underwriting and fulfilment, by eliminating manual processes and duplication of data entry."
Ron Swift, President and Chief Executive Officer of MCAP Mortgage Corporation

tenet
group

The Tenet Group is the largest privately owned IFA group in the UK, representing more than 2,250 financial advisers with a client base of over 1.5m.

During 2002 Tenet decided to integrate Officeweb, our new business administration system for intermediaries, with our Exweb portal to enable full electronic trading and straight through processing between its advisers and product providers. This integrated Officeweb/Exweb platform will provide its advisers with the business efficiencies and cost savings associated with online transactions and real time access to client and policy records.

"Together Exweb and Officeweb provide the most comprehensive solution available to meet Tenet's strategy of delivering high quality e–commerce services that will generate the efficiencies demanded by IFAs in today's competitive environment.

Exweb is the leading electronic trading platform in UK life and pensions providing well proven efficiencies in generating quotations and new business submission. Integration with Officeweb brings further benefits from seamless client and policy servicing as well as other savings to the intermediary office. Together we are convinced they will provide Tenet with sustainable competitive advantage."
Simon Hudson, Chief Executive Officer at The Tenet Group

FRIENDS PROVIDENT

Friends Provident is one of the UK's leading financial services groups and a member of the FTSE 100 Index.

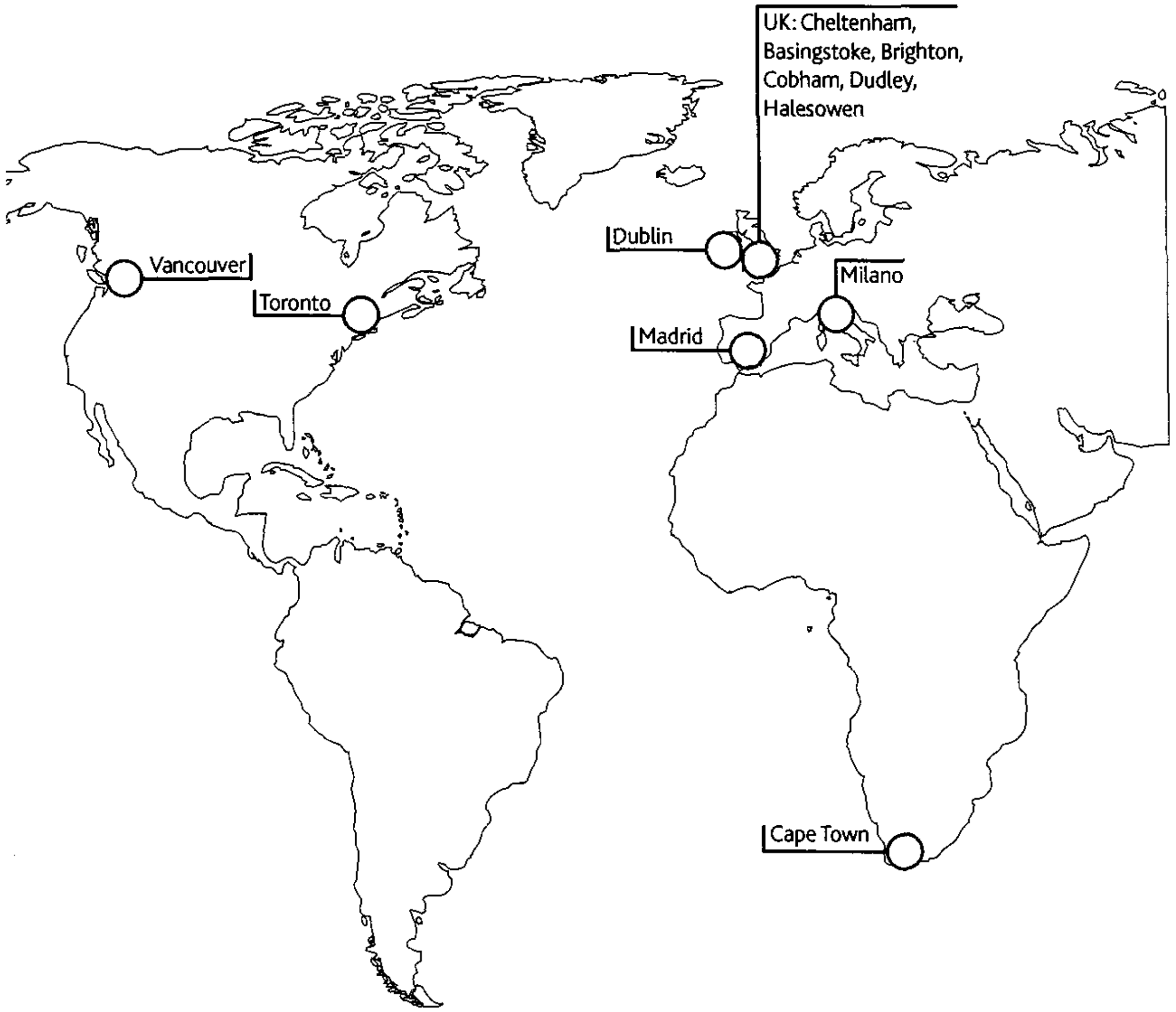
Marlborough Stirling is developing a Java based multi–channel point-of-sale software solution for Friends Provident. Once complete it is intended that the solution will be used by up to 800 people across its call centre, direct sales force and appointed representative channels and will provide a single view of client data, irrespective of the channel through which a consumer contacts the business.

The system will assist Friends Provident's advisers in guiding clients through the entire advice process, from lead generation, prospecting and initial contact through to electronic fact–find, needs analysis, illustrations and completion tracking. As part of a new customer service and sales strategy, the system development will eliminate duplication, improve quality and productivity and enhance client management and sales tracking.

"We needed a business partner that could build solutions to match our detailed requirements and to ensure our customers receive the best possible advice and service whichever way they decide to contact us. Marlborough Stirling's experience in integrated, multi–channel point-of-sale solutions is impressive and we are looking forward to benefiting from the returns on investment that we expect this strategic solution to deliver."
Jamie McIver, Director of Direct Business Operations at Friends Provident

[locations]

Marlborough Stirling is a global business with offices in the UK, Canada, Ireland, Italy, South Africa and Spain



[directors]

Huw Evans, Chairman

Huw Evans, aged 54, was one of the founders of Marlborough Stirling in 1987 and was Chief Executive of the Group from then until October 2000. He assumed his current position in January 2000. Prior to founding the Group he held a number of senior positions with software companies providing packaged software and specialist consultancy services to the financial services industry. He has responsibility for the effective operation of the Board, co-ordinating the strategic direction of the Group and leading the company's community relations.

Graham Coxell, Chief Executive

Graham Coxell, aged 33, joined Marlborough Stirling in 1994, was appointed to the Board in 1999 and assumed his current position in October 2000. Prior to becoming Chief Executive, he was Director of Sales and Software Development. In his early years with the Group he had primary responsibility for establishing the Omiga product in the UK mortgage market. Prior to joining the Group, he held a senior sales management position with Bristol and West Building Society. He has full responsibility for the Group's operations and the implementation of Group strategy.

Robert Beveridge, Finance Director

Robert Beveridge, aged 47, joined Marlborough Stirling in November 2002 and was appointed to the Board in February 2003. His previous experience includes being Finance Director of Cable & Wireless Communications plc prior to its demerger and sale in May 2000, spending 12 years with Mars Incorporated where he was ultimately European Financial Controller and four years with United Biscuits plc in a number of senior roles including Business Development Director. He is responsible for the Group's financial, corporate services and corporate development activities.

Andrew Fritchie, Legal and Commercial Director

Andrew Fritchie, aged 38, joined Marlborough Stirling in 1997 as Group Counsel and assumed the role of Company Secretary shortly thereafter. He was appointed to the Board in May 2002. He is responsible for all legal and risk management aspects of the Group's affairs. Prior to joining the Group, he was a member of the Chambers of Baroness Scotland QC, worked in the law firm of Gray Cary Ames and Frye in San Diego and as an in-house lawyer in Sydney. He was called to the bar in 1988.

David Gales, Group Development Director

David Gales, aged 50, was one of the founders of Marlborough Stirling in 1987. He became Group Development Director in November 2002 having previously been Finance Director since November 2000. Prior to founding the Group, he was Administration Director at Devonshire Life. He is involved in the Group's business development and marketing activities and also develops key strategic initiatives for the Group.

Anthony Klim, Executive Director Distribution

Anthony Klim, aged 44, joined Marlborough Stirling in 1998 and was appointed to the Board in 1999. Prior to joining the Group, he worked at Deluxe Data, a US financial systems company, where he was responsible for international marketing, and was a director of The Software Partnership Limited, a leading provider of direct electronic banking solutions. During the 1980s he worked as a consultant with Software Sciences Limited (now IBM Data Sciences) and Systems Designers Limited (now EDS). In 2003, he is responsible for managing Marlborough Stirling's distribution business unit.

David Power, Executive Director Life and Pensions

David Power, aged 43, joined Marlborough Stirling in 1994 and was appointed to the Board in 1999. Prior to joining the Group, he was client services manager at London Life Limited. He has over 20 years experience in the life and pensions industry, working in operational management and marketing management capacities. In 2002, he was responsible for the Group's outsourcing activities, including representing Marlborough Stirling on the board of Marlborough Stirling Mortgage Services. In 2003, he is responsible for managing Marlborough Stirling's life and pensions business unit.

Christopher Ryland, Group Development Director

Christopher Ryland, aged 54, was one of the founders of Marlborough Stirling. He has spent all his career in systems and programming, the last 29 years of which have been concerned exclusively with the life and pensions industry. He is involved in the Group's business development and marketing activities and also develops key strategic initiatives for the Group.

Gerald Whitmore, Group Business Development Director

Gerald Whitmore, aged 51, joined Marlborough Stirling and was appointed to the Board in November 2001. He resigned from the Board in January 2003. He was previously Chief Executive of Exchange FS Group plc. He was also Chief Executive Officer of Crisp Computing from its foundation in 1981. In 2002, he was responsible for the Group's business development activities.

Paul Fullagar, Non–Executive Director - Senior Independent Director

Paul Fullagar, aged 52, joined the Board of Marlborough Stirling in 2000. He is currently Non–Executive Deputy Chairman of Staffware plc. Prior to joining Staffware, he was Finance Director of Ellerman Lines plc during which time he organised a management buyout and subsequent sale of the company to Trafalgar House plc.

Geoffrey Harrison–Dees, Non–Executive Director

Geoffrey Harrison–Dees, aged 64, joined the Board of Marlborough Stirling in February 2002. He was previously a non–executive director of Exchange FS Group plc at various stages of its development including being Chairman between 1997 and 1998 and also between April 2001 and November 2001 when Exchange FS Group plc was acquired by Marlborough Stirling. He has also been Chairman of Origo and Director of Marketing and Sales at Sun Life Assurance Society plc.

Colin Hayfield, Non–Executive Director

Colin Hayfield, aged 47, joined the Board of Marlborough Stirling in 1996 having previously worked on a part time basis as Finance Director and Company Secretary. He is a qualified chartered accountant practising with Hardcastle Burton where he was responsible for the audit and taxation affairs of the Group between 1987 and 1994.

Paul Seymour, Non–Executive Director

Paul Seymour, aged 58, joined the Board of Marlborough Stirling in 1994. He is also a member of the Council of the Institute of Actuaries. He is Chairman of Barclays Global Investors Endowment Fund Limited and a non–executive director of other companies including Creechurch Underwriting Ltd and Gerling Global Life Reassurance Co (UK) Ltd. He was previously Chief Executive of Laurentian Financial Group plc and Group Director – Europe of Lloyds Abbey Life plc.

[chairman's statement]

Introduction

The markets in which Marlborough Stirling operates are undergoing a period of massive change. This change will transform totally the way in which the financial services industry operates within the next few years. This upheaval will undoubtedly present significant opportunities to the Group as well as challenges such as those we faced in 2002.

Marlborough Stirling itself has undergone a significant transformation over the last 12 months. In our first full year as a public company, two key strategic initiatives were successfully completed:

- The integration of Exchange FS into our portfolio of services and strategy
- *Securing the Sun Life Financial of Canada (SLFoC) outsourcing contract*

These two developments build on Marlborough Stirling's established strength in life and pensions and mortgage point-of-sale and back office administration systems. The Group now possesses the UK's leading intermediary trading platform in the financial services market and is able to demonstrate large scale outsourcing expertise. Together they will play a key role in supporting our mission to be a key enabler of the transformation of financial services to a competitive, highly efficient, consumer-led industry.

Marlborough Stirling now has a complete range of point-of-sale (front office) and administration (back office) solutions, together with straight through processing capabilities for life insurance, pension and mortgage customers. Our transformed presence in distribution through the Exchange portal (Exweb) leaves us well placed to extend our capabilities into other financial services vertical markets.

The significant changes being implemented within our own business in 2002 coincided with a marked deterioration in market conditions in certain of the markets we serve. This was particularly the case for the UK life and pensions industry which was materially affected by falls in equity markets of over 30% during the year, ultimately to the lowest levels experienced in over six years. In the medium term, we believe these difficulties will bring positive momentum to our own business. However, in 2002, the unprecedented uncertainty for our customers led to deferrals and cancellations of commitments to suppliers, from which we were not immune. This in turn contributed to our financial performance for the year falling well below our initial expectations and the consequent need to reduce our cost base.

With great regret, we were forced to seek compulsory redundancies during the year beyond those implemented either as part of the SLFoC outsourcing contract or the integration of Exchange FS Group plc. Overall Group headcount (including that within our mortgage outsourcing joint venture) reduced from approximately 2,400 at its peak when we commenced the SLFoC contract in March 2002 to just under 1,900 at 31st December 2002.

For a company particularly dependent on its people this has been a difficult period and the board is acutely conscious of the efforts and contribution of all members of staff. However, we believe that as a result of this process we will emerge with a more focused business, better positioned to operate profitably in the ongoing demanding market conditions and to deliver growth in new areas and geographies as opportunities arise.

Results in brief

Total turnover, including Marlborough Stirling's share of turnover from joint ventures, for the year ended 31st December 2002 increased by 65% to £121.0m (2001: £73.4 m). Organic turnover growth was 38% relative to 2001.

The reported pre–tax loss for the year of £34.5m (2001: profit of £9.3m) reflects goodwill amortisation and impairment charges of £33.4m, amounts written off investments, taken against the carrying value of the company's shares held in employee related share trusts, of £9.1m and employee share option charges and reorganisation costs of £3.3m.

Underlying profit, namely operating profit, including the results of joint venture and before charges for goodwill amortisation and impairment, employee share options and reorganisation costs, amounted to £11.5m (2001: £14.8m). On this basis, in 2002 the operating margin was 9.5% (2001: 20.1%).

The basic loss per share for the year ended 31st December 2002 was 20.0 pence (2001: earnings of 3.6 pence). Basic and diluted earnings per share (before charges for goodwill amortisation and impairment, employee share options, reorganisation costs and amounts written off investments) for the period were 3.8 pence and 3.5 pence respectively (2001: 7.3 pence and 5.9 pence respectively).

The Board continues to support a progressive dividend policy, consistent with the cash generative nature of the business. However, the recent fall in the company's share price has led to a significant impairment in the carrying value of the company's shares held in employee related share trusts. Unfortunately, this has the effect of reducing distributable reserves to the extent that it would be imprudent for the Board to declare a dividend for 2002 despite the company's significant cash resources.

Board changes

During the year there were a number of changes to the Board.

In February 2002, Geoffrey Harrison–Dees joined the Group and the Board as a non–executive director. He was previously Chairman of Exchange FS Group plc, that was acquired by the Group in November 2001, as well as having been Chairman of Origo and a director of Sun Life Assurance Society plc earlier in his career.

In May 2002, Andrew Fritchie was appointed to the Board as Legal and Commercial Director. He joined Marlborough Stirling in 1997 as Group Counsel, becoming Company Secretary shortly thereafter. He is responsible for all legal and risk management aspects of the Group's affairs.

In November 2002, Robert Beveridge joined the Group replacing David Gales as Finance Director. He has significant financial and operational experience gained at a number of multinational companies including Cable & Wireless Communications plc where he was Finance Director prior to its demerger and sale in May 2000. Prior to this he spent 12 years with Mars Incorporated and four years with United Biscuits plc in a number of senior roles.

In December 2002, the resignation of Gerald Whitmore from the Board was announced which became effective on 31st January 2003.

Outlook

In recent months, certain areas of the business, particularly life and pensions and mortgage outsourcing, Officeweb and mortgage software in both the UK and Canada, have been experiencing encouraging levels of interest. However, our UK life and pensions software business continues to show weakness. Our visibility for 2003, in terms of contracted and recurring turnover, is currently approximately £90m, a satisfactory position at this stage in the year.

Marlborough Stirling's sales activities have always been characterised by long lead times. Further, some of the initiatives we are pursuing have significant strategic value but will only enhance our financial performance in the medium term. We expect to make good operational progress in 2003 whilst building the foundations for improving our future financial performance. This includes continuing to review our cost base to enable the Group to operate in 2003 with similar margins at lower turnover levels than achieved in 2002. In order to maximise synergies and efficiencies, we recently announced the proposed relocation of employees based in our Halesowen office. In addition, as a final stage in our recent reorganisation programme, we have restructured the Group into four business units, to facilitate greater focus and accountability. We expect these developments to result in additional employees leaving the Group during the first half of the year.

Marlborough Stirling retains a strong position in its markets. Our solutions deliver demonstrable business benefits and return on investment at a time when our customers need our solutions more than ever. Our infrastructure is at the core of our customers' operations and we have a broad range of strong reference clients. We have an unparalleled depth of understanding of our markets and are committed to being a key enabler of transformation in financial services. With our highly skilled employees, I am certain that the foundations are in place for us to exploit the substantial opportunities ahead.

[operating review]

Introduction

The last 12 months have been a very difficult period for most participants in and suppliers to the financial services industry as the consequences of substantial falls in equity markets in the middle of the year unfolded.

Whilst this made for a difficult operating environment for the Group, we achieved a step change in the development of our business as illustrated by the following major developments during the year:

- Largest ever outsourcing contract secured with Sun Life Financial of Canada (SLFoC), expected to generate over £125 million in turnover over seven years
- 600,000 of SLFoC's policies migrated onto Lamda whilst delivering improved customer service levels for SLFoC
- Further major outsourcing contract secured with GE Pensions
- Integration of over 1,000 employees that joined the Group as a result of the acquisition of Exchange FS Group plc and the outsourcing contracts with SLFoC and GE Pensions
- Important software implementations for AXA Sun Life, MCAP Mortgage Corporation and Birmingham Midshires
- Successful launch of Officeweb and initial contract wins
- Enhancing the market positioning of the Exchange portal (Exweb) through alliances with Bankhall and Tenet

Industry background

In the UK, the Group operates in the distribution, life, pensions and investment and mortgage sectors within the financial services industry.

Distribution in UK financial services

A clear process leading to significant change in the distribution market within UK financial services began in the period, catalysed particularly by proposed regulatory changes. Distribution is expected to continue to be a key area of change as financial services in the UK transforms to a competitive, highly efficient, consumer-led industry. As a result of this process, influence across the industry's value chain is likely to move substantially from product manufacturing to retailing or distribution.

Changes in the regulatory environment governing distribution of several financial products and achieving a significant reduction in distribution costs are the current key areas of focus.

Both the life, pensions and investment and mortgage sectors will be adapting to significant regulatory change in the near term driven particularly by the FSA's publication of:

- CP121: Reforming polarisation: Making the market work for consumers
- CP166: Reforming polarisation: Removing the barriers to choice
- CP98: The Draft Mortgage Sourcebook
- CP146: The FSA's approach to regulating mortgage sales

CP121 and CP166 relate to depolarisation of the market for financial advice from its current split between tied agents and independent advisers covering products from the whole market. Independent advisers dominate the financial advice market at present.

More complex distribution relationships are likely to arise from these proposals such as multi-tied partnerships where distributors offer products from small panels of product providers. Multi-ties could be developed by parties that are currently life and pensions companies, retail banks, mortgage lenders, IFAs or other distributors. It is likely that multi-tied organisations will rely on connectivity deployed across the closed user groups operating within each multi-tie environment. Exweb, with its extensive connectivity across the financial services industry, is well placed to satisfy their requirements.

CP98 and CP146 will result in the regulation of mortgage advice and lending for the first time. This change is expected to occur from 2004 and participants in the mortgage industry have begun to anticipate its effects. It is expected that increased use of technology will be adopted by both mortgage product providers and distributors at the point-of-sale to manage compliance with regulation as it is introduced.

The whole financial services industry is under substantial pressure to reduce costs in both administration and distribution. Within the distribution environment there is currently significant manual processing and duplication of data entry resulting in excessive cost. This is true both for product providers and distributors, such as IFAs and other intermediaries.

Significant steps are being taken to increase the use of e-commerce and electronic trading. For example, in life, pensions and investments, there is momentum to extend the use of electronic trading beyond its current focus on providing quotation and other product information. This is expected to involve initially supporting the provision of electronic new business processing and online product valuations, both high volume processes of great value to either product providers, IFAs or consumers where the scope to reduce costs is substantial.

Participants in financial services distribution can ensure compliance at the same time as reducing costs by deploying technology solutions to streamline their business administration, fully integrated with point-of-sale systems.

Both commercial pressures and regulatory changes, particularly the introduction of a formal regime in mortgages, are having an effect on the intermediary market. It is expected that there will be increased blurring of the current distinction between IFAs and mortgage brokers as the latter address the introduction of regulation and both aim to extend their sources of income.

UK life, pensions and investments industry

During 2002, the Group's key market, the UK life, pensions and investment industry, experienced its most turbulent period in recent history as a result of falls in stock markets that were even more severe than those of the previous two years. These harsh conditions resulted in various adverse developments including:

- Product providers closing down or scaling back new business activities
- Severe restraints even on budgeted investment as the year progressed
- Ongoing solvency of product providers being called into question
- Consumers hesitating to make new equity based investments

During the year there was also greater focus on the need to stimulate significantly increased savings by individuals, driven by the growing realisation of the combined effects of longer life expectancy, reduced state and employer support of retirement incomes and lower investment returns experienced in recent years. There were a number of regulatory and government sponsored contributions to the debate including the publication by the Financial Services Authority of CP121 aimed at reforming the distribution regime and the Sandler and Pickering reports.

Difficult market conditions made it extremely difficult for industry participants to respond to these challenges in the near term. However, we firmly believe that they have acted as a watershed which is likely to result in increased opportunities for the Group as the life, pensions and investment industry undergoes substantial restructuring and cost reduction across its whole value chain.

In the wake of the declines in equity markets there was widespread deferral or cancellation of investment decisions across the industry. However, in recent months one particularly strong theme has emerged. There has been a rapidly emerging demand for outsourcing from many of the largest UK life and pensions companies. This interest in outsourcing is expected to persist for the foreseeable future. Demand for outsourcing continues to be driven by its traditional role of reducing costs and making them vary more closely in relation to the size of the business. However, the current stimulus is also based on outsourcing's long term certainty of costs enabling the potential strengthening of solvency ratios through the release of embedded value from policy portfolios.

UK mortgage industry

The UK mortgage industry experienced a very different environment to the life and pensions market in the period with extremely buoyant conditions. House prices in the UK rose by 25.3% in 2002 (source: Nationwide house price index) and approximately 1.6 million properties changed hands during the year, the highest since 1988. In addition, gross mortgage lending amounted to £219bn (source: Council of Mortgage Lenders), the highest amount ever recorded. These benign conditions resulted from low unemployment and the lowest base rates for nearly 40 years, combining to sustain high levels of mortgage affordability.

A number of key themes are evident from recent activity in the market. Levels of re-mortgaging continue to increase with 38% of gross mortgage lending activity accounted for by this trend. This trend is placing additional pressure on mortgage lenders' systems and costs, boosting volumes whilst reducing the effective period in which a lender must generate a satisfactory return from its lending.

Increased competition, combined with low interest rates, has led providers to introduce simple low margin products, requiring highly efficient business processes. At the other end of the spectrum there is a growth in more sophisticated offerings such as buy-to-let mortgages, sub-prime mortgages and equity release mortgages. All these products bring additional credit risk burdens to the industry as well as putting a strain on lenders' infrastructure. These features are resulting in greater adoption of more automated processes in areas such as credit risk assessment as well as increased take-up of third party administration services to support activity in these newer market areas.

International financial services markets

Outside the UK, the Group operates in Canada, Ireland, Italy, South Africa and Spain. In addition, the Group supports the offshore life, pensions and investment industry through Marlborough Stirling WebTech based in the Isle of Man.

In Canada, the Group currently operates solely in the mortgage market, supplying both distribution and administration software applications. The Canadian mortgage industry experienced many of the same issues that applied to the UK mortgage market in the year. House prices rose and the number of housing starts were up nearly 30% in the first nine months of the year. This activity was underpinned by a combination of economic growth, rising disposable income and low interest rates. Re-mortgaging activity is even more prevalent than in the UK market. Against this background, mortgage lenders are increasingly looking to upgrade their front and back office technology platforms to manage the significant increases in volumes experienced in recent years.

In Ireland, the Group has an actuarial and management consultancy that provides advisory services to both local life and pensions companies and international life and pensions companies looking to establish operations in the country to take advantage of the attractive fiscal environment. The international companies typically then sell financial products back into their home markets and more broadly across Europe from Ireland. The local life and pensions industry was affected adversely by the turbulence in investment markets. At the same time significant activity was generated by government sponsored savings initiatives with substantial demand created by the phasing out of the SSIA savings scheme. The Irish equivalent of stakeholders pensions – Personal Retirement Savings Accounts – were launched and will increase cost pressures on product providers. The Irish based international life and pensions industry experienced a weak environment, reflecting general market conditions, with a reduction in the number of new companies establishing in the International Financial Services Centre.

The Italian and Spanish financial services markets are experiencing many of the developments that have already occurred in the UK market. There is increased adoption of unit linked products, increasing regulation of the sale of a broad range of financial services products, growing pressure to reduce costs and a pressing need for increased saving by an ageing population. In addition, there is a substantial need to modernise legacy systems. This provides an attractive environment for investment in both front and back office solutions based on low cost, modern technology. In addition, outsourcing is a developing market, albeit more slowly than in the UK.

The South African financial services industry was also affected by the poor returns from equity markets as well as increased bad debt write-offs from low income markets. The insurance sector is expected to place increased focus on improving operational efficiencies in response to poor asset management returns and a highly competitive market. The banking sector is likely to emphasise improvements in credit analysis and debt recovery.

Commercial strategy

Marlborough Stirling plays a leading role in the transformation of financial services to a consumer-led, competitive and efficient marketplace, by providing comprehensive software and service solutions for:

- Point-of-sale
- Back office administration of policies and mortgages at lowest cost
- Straight through processing which enables full integration of point-of-sale and back office administration systems

We achieve this by working with our customers who are both distributors and providers of financial products who choose to partner with us because of our:

- In depth knowledge of the market and the needs of both existing and prospective customers
- Vision and insight into the future consumer-led market and the transformation process necessary to get there
- Experience in delivery of large successful solutions to over 80 clients
- Commitment to play a leading role in the creation of a truly competitive and efficient financial services market

Uniquely in this marketplace our range of solutions now covers direct and indirect sales support, back office administration and the ability to join front and back office with seamless straight through processing. In addition to developing and implementing process and system solutions directly for our customers we offer either a partial or full outsourced service.

The current key areas of focus within our strategy are closely related to the key growth trends in the UK retail financial services industry, namely distribution, life and pensions (particularly via an outsourcing arrangement), and mortgages.

Business review – Distribution

Divisional highlights	2002	2001	Change
Software and consultancy turnover (£m)	15.5	2.9	+ 447%
Portal services turnover (£m)	15.8	2.9	+ 439%
Total turnover (£m)	31.3	5.8	+ 443%

Marlborough Stirling's distribution business comprises the Exchange portal (Exweb), which provides comparative product quotations and illustrations to intermediaries, and a software business targeting both UK financial intermediaries and product providers. Exweb is the leading intermediary trading platform in the UK financial services market. Our software solutions include Officeweb, an intermediary business administration system, and products for product providers such as Omiga+, a customer management, point-of-sale and product application processing solution.

The intermediary part of our distribution business enjoyed good levels of activity across both portal services and software in the year, but activity in the distribution software business targeting product providers was below our expectations.

Exweb continued to perform well, increasing subscriber numbers by 6% in the year to 18,270 at 31st December 2002 (2001: 17,254). Despite some slowdown in growth in the second half of the year, this increase is particularly encouraging given Exweb's already strong market position. The volume of quotations and illustrations generated through Exweb grew from 89 million in 2001 to 99 million in 2002.

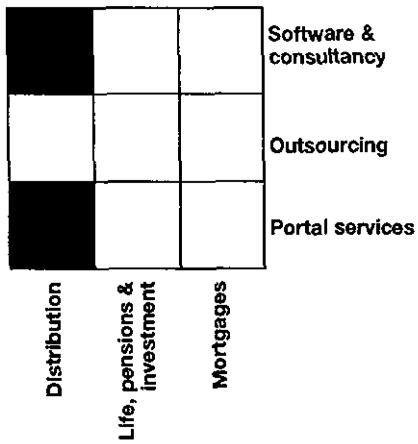
A number of key initiatives commenced to enhance further the market position of Exweb and its value to intermediaries, product providers and Marlborough Stirling. These included:

- A strategic alliance with Bankhall that will bring additional subscribers to and usage of Exweb as well as new services to the portal's subscribers
- A contract with The Tenet Group that involves Officeweb being integrated with the portal's quotation and new business functionality

The agreements with Bankhall and Tenet are particularly important as both organisations are amongst the largest providers of support and distribution services to the IFA market and they will align the IT strategy for their businesses with use of our infrastructure for the intermediary market.

However, our core strategic objective for Exweb is to make it a key enabler of electronic trading and straight through processing in financial services distribution. This has the potential to deliver substantial efficiencies, cost savings and competitive advantage to product providers, intermediaries and other distributors. It will also allow Exweb to participate actively in the complex distribution relationships likely to arise as a consequence of regulatory change. *These include new environments such as multi–tied partnerships, whether developed by parties that are* currently life and pensions companies, retail banks, mortgage lenders, IFAs or other current or potential distributors. Our relationship with parties such as Bankhall and Tenet are early examples of these types of arrangements. Exweb's substantial existing subscriber base and its extensive connectivity across financial services position the Group well to benefit from the expected significant increase in electronic trading revenues in financial services as these developments unfold.

We commenced implementation of this strategy during the period in conjunction with a number of major product providers. Exweb's electronic trading capabilities will be extended from the current focus on the provision of quotation and other product information. Initially this will involve developing infrastructure to support the provision of services such as electronic new business processing and online product valuations. Ultimately, it is expected to embrace more complex services such as customer data aggregation. It is expected that the first phase of these services will become operational in late 2003 and increasingly significant new transactional revenues will result from 2004 onwards.



Turning to the software element of our distribution business, in March 2002 we launched Officeweb, which manages all aspects of an intermediary's business administration and can be integrated seamlessly with Exweb. Increasing our involvement in infrastructure provision for the intermediary market is central to our strategy of maximising our presence in the distribution market. Officeweb is expected to play a key role in achieving this goal. Since Officeweb's development commenced, a number of contracts have been secured with clients such as Chase de Vere, The Tenet Group and Thomson's Group and we aim to further increase its market penetration.

New business activity in our distribution software business targeting product providers was disappointing, reflecting the difficult market conditions. However, we continued work on a number of implementations for clients such as Wesleyan, Royal London and Friends Provident. We are currently undertaking the first implementation of Omiga with full point-of-sale functionality for the life and pensions market, representing a strategic extension from its previous role in the mortgage market.

Business review – Life, pensions and investment

Divisional highlights	2002	2001	Change
Software and consultancy turnover (£m)	32.3	44.9	– 28%
Outsourcing turnover (£m)	43.2	10.4	+ 317%
Total turnover (£m)	75.5	55.3	+ 37%

Marlborough Stirling's life, pensions and investment business supplies life insurance companies and providers of pensions and other investment products with a range of software, related services and outsourcing. The main software application in this market is Lamda, a comprehensive back office administration platform for many types of life, pension and investment products. Other software applications include Genesis Life targeted at the offshore wealth management market and a range of niche applications for the UK market. The life and pensions outsourcing business provides a range of services on behalf of financial services companies to transform their administration functions. These services include business process re–engineering, change management, new business processing, customer service, past business reviews, finance and actuarial. The Group has nine life, pensions and investment outsourcing clients.

The challenging market conditions had a marked impact on the life, pensions and investment business with substantial increases in activity relating to outsourcing helping to offset weakness in software sales.

Significant developments during the year included the major outsourcing contracts for Sun Life Financial of Canada (SLFoC) and GE Pensions and continuation of the Lamda software implementation for AXA Sun Life.

Substantial progress was made in increasing our presence in the outsourcing market, a key part of the Group's strategy. In particular, the scale of our life and pensions outsourcing activities was completely transformed by securing an outsourcing contract with SLFoC involving the administration of around 800,000 policies. Despite delays in completing the migration of SLFoC's policies from its legacy mainframe systems onto Lamda, 600,000 policies had been migrated by the end of 2002 and the overall programme is expected to be completed by the third quarter of 2003. The penultimate portfolio migration of around 50,000 policies should occur by the end of March 2003.

We have begun to realise efficiencies under the SLFoC contract enabling us to implement planned reductions in headcount. Permanent headcount reduced by approximately 100 between commencement of the contract and 31st December 2002. In addition, SLFoC endorsed the strength of our performance late in the year by extending the outsourcing contract from five years to seven years, giving it an expected value of over £125 million in turnover over its life. Significant cost transformation has been achieved for SLFoC's operations and it is already acting as a strong reference site for potential clients to the Group. We have developed the operation into a showcase for the industry in terms of achieving high customer service at significantly reduced cost.

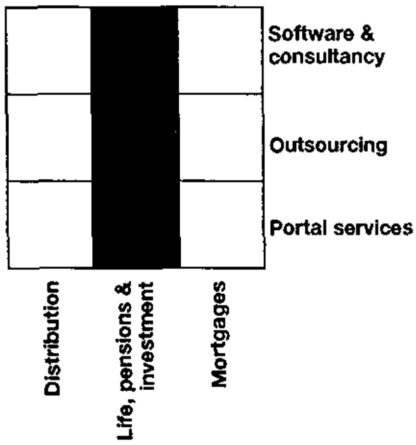
During the year the Group secured a further major outsourcing contract with GE Pensions with a value of £11 million over five years. Part of this contract is being administered out of the same offices in Basingstoke as the SLFoC contract.

The most significant project for the life, pensions and investment software business in 2002 was our Lamda implementation for AXA Sun Life, on which substantial progress was made. In May, the first phase of the implementation went live enabling the launch of investment bonds. The second phase then went live in October, enabling AXA Sun Life to launch a number of products into the group pensions market.

We are in the early stages of managing the migration of policies from AXA Sun Life's Tandem and IBM legacy systems onto Lamda which is expected to continue throughout 2003.

Elsewhere, Marlborough Stirling WebTech, based on the Isle of Man, has continued the good progress apparent since its acquisition in August 2000. It has either completed or is in the process of implementing projects to install Genesis Life, the Group's solution for offshore portfolio bond management, for Prudential Europe Management Services, Isle of Man Assurance and a new entrant to the offshore market based in the Isle of Man and Ireland.

Life Strategies, our actuarial and management consultancy based in Ireland, performed satisfactorily in the period and, through the contacts it has developed in recent years assisting life companies setting up cross-border operations in Dublin, it has played a key role in developing interest in Lamda and life and pensions outsourcing in other European markets.



Business review – Mortgages

Divisional highlights	2002	2001	Change
Software and consultancy turnover (£m)	10.0	8.9	+ 12%
Outsourcing turnover (£m)	4.2	3.4	+ 23%
Total turnover (£m)	14.2	12.3	+ 15%

Marlborough Stirling's mortgage business consists of mortgage software businesses in the UK and Canada and the UK outsourcing joint venture with Egg, Marlborough Stirling Mortgage Services (MSMS). Software applications for the mortgage market include Omiga, a customer management, point-of-sale and application processing solution and Optimus, a back office administration system. MSMS provides a range of services on behalf of mortgage lenders to transform their lending operations. These include change management, new business processing, mortgage packaging and customer service. MSMS currently has five clients.

Activity in the UK mortgage software business remained at a satisfactory level with work on a number of implementations of Omiga for clients such as Northern Rock and Birmingham Midshires, part of HBOS plc. The scope of our ongoing support for Northern Rock was significantly extended in terms of both scope of services provided and contracted duration of work. We also completed implementation of the latest version of our Omiga mortgage new business processing solution for Birmingham Midshires.

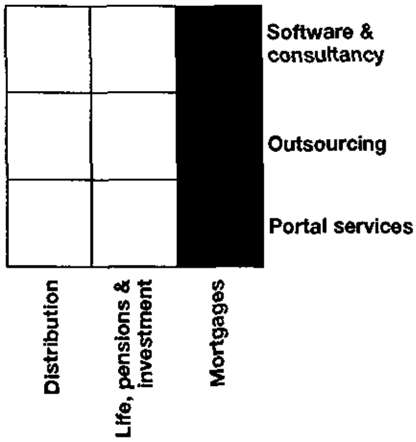
The Group's Canadian operation made strong progress in the year, with work concluding successfully on the first Canadian implementation of Omiga for MCAP Mortgage Corporation. There was also ongoing work for a number of established clients of the Optimus mortgage administration software. Furthermore, a new server gateway application developed for Optimus, to enable straight through processing with Omiga, was well received in the market.

Interest in Omiga has continued to strengthen in Canada reflecting the imperative for many mortgage lenders in this market to upgrade technology in both front and back office given the rapid rise in mortgage volumes that has occurred in recent years. Omiga's strong new business application processing functionality and scalability is well suited to many lenders' requirements in this environment. The success of the MCAP Mortgage Corporation implementation has provided additional credibility to both Omiga and our delivery capabilities in Canada.

The Group's mortgage outsourcing joint venture with Egg, Marlborough Stirling Mortgage Services (MSMS), continued to make steady progress following its establishment in 2001. Whilst new business activity was subdued during most of the year, the quality of services MSMS provides to its clients was endorsed by existing clients significantly extending the short term contracts initially entered into with MSMS when it commenced operations.

Its contract with London Mortgage Company expanded from being worth around £1m in turnover over three years to being worth in excess of £5m over five years. Its contract with Standard Life Bank was extended from a one year duration to a five year maturity. MSMS is now in a strong position with a number of medium term contracts in place. Sales activity was at a good level as the period ended and progress in securing both new clients and additional services from existing clients is envisaged during 2003.

The advent of mortgage regulation, the proliferation of new mortgage products (such as buy-to-let, equity release and sub-prime) and increasing competition and transparency provides an ideal environment for the Group to capitalise on the increased scope of its solutions for the mortgage industry.



Products and technology

Product and infrastructure development

We have continued our strong commitment to product and infrastructure development, particularly in areas aligned to our key strategic objectives. Consequently, during 2002 our research and development activities focused particularly on enhancing our competitive differentiation in providing straight through processing (STP) solutions that integrate financial services point-of-sale and administration capabilities. Opportunities are expected to arise in this area, driven by a proliferation of distribution channels with increasingly complex infrastructure requirements and by the significant business efficiencies and cost savings that STP can deliver.

Specific product and infrastructure development initiatives supporting this vision included the development of a new end-to-end solution for life and protection products, message enabling our Lamda and Optimus back office solutions, the extension of Omiga to include further sales automation capability across multiple financial products and delivery channels, completion of Officeweb, our business administration system for intermediaries, and extending Exweb's electronic trading capabilities to support deeper coverage of the distribution value chain.

The Group developed a new end-to-end solution for life and protection products which can be deployed in an extranet or portal environment to provide an internet front end to existing legacy systems. This should facilitate more rapid adoption across the market of electronic new business processing and other STP services. In addition, our back office administration systems, Lamda for life, pensions and investments and Optimus for mortgages, were enhanced during 2002 to support more open access by internet based distribution systems. This was achieved by providing XML messaging interfaces to the core functionality of these systems and enabling more flexible deployment in a web environment.

Omiga, our customer management, point-of-sale and application processing solution for both life, pensions and investments and mortgages, was enhanced to provide a fully integrated sales process for multiple distribution channels and work was completed to integrate Omiga with Exweb for the provision of product quotes and new business processing. This integration will position the product well for the regulatory changes occurring in the market.

Since Officeweb's launch in March 2002, development has focused on integrating this product with Exweb and enhancing its functionality to manage the administration of major IFA groups with several thousand individual IFA members.

We have made good progress with our broad strategic initiative to extend Exweb's electronic trading capabilities to support deeper coverage of the distribution value chain through the provision of services such as electronic new business processing, a common industry security model, single data entry, online product valuations and customer data aggregation.

Development operations

We are taking a number of steps to enhance operational aspects of our product development activities. We are placing significantly increased emphasis on improving the quality and efficiency of our software development processes. In addition, as part of our overall focus on reducing costs we are planning to develop our existing presence in South Africa into a significant product development base for the Group. This low cost offshore development resource should enable us to continue to invest in product development at a considerable saving.

Technology evolution

Marlborough Stirling continues to adopt an evolutionary approach to migrating the technologies on which its products are based in response to our vision of the adoption of key new technologies and client requirements.

The internet boom has resulted in the emergence of a number of technologies, such as .NET, Java, web services and XML, that are now maturing and being deployed in mainstream products. These technologies will result in considerable flexibility in the deployment of new applications and should enable the Group to take advantage of a number of new business opportunities.

There are already several examples of these technologies at work across the Group.

Marlborough Stirling was one of only five organisations world-wide to work as launch partners with Microsoft on the Visual Studio for Applications early adopter program, a technology closely coupled to Microsoft's .NET technical architecture. The Group is actively utilising .NET technologies in support of web services on Exweb.

Reference has already been made above to the adoption of XML technology to enhance the STP capabilities of our Lamda and Optimus administration systems.

[financial review]

The statutory accounts for the year disclose the turnover and operating results relating to the outsourcing contract with Sun Life Financial of Canada (SLFoC) as arising from an acquisition as the contract was effected through the acquisition of an existing services company previously owned by SLFoC. From a management perspective, this contract is viewed as organic growth and treated as such in the commentary below.

Turnover

Total turnover, including Marlborough Stirling's share of turnover from joint ventures, for the year ended 31st December 2002 increased by 65% to £121.0m (2001: £73.4m). Organic turnover growth was 38% relative to 2001.

Organic turnover growth

	First half	Second half	Total
	£m	£m	£m
Reported total turnover for 2002	60.7	60.3	121.0
Less growth due to acquisition of Exchange FS Group	13.4	12.8	26.2
	47.3	47.5	94.8
Reported total turnover for 2001	33.7	39.7	73.4
Less growth due to acquisition of Exchange FS Group	–	4.8	4.8
	33.7	34.9	68.6
Organic growth 2002 v 2001	13.6	12.6	26.2
Organic growth % 2002 v 2001	**40%**	**36%**	**38%**

In the period, Marlborough Stirling's revenue mix changed substantially as a result of the acquisition of Exchange FS and the SLFoC outsourcing contract. Total turnover in the period comprised 48% from software and consultancy, 39% from outsourcing and 13% from portal services. In 2001, software and consultancy accounted for 77% of total turnover.

Software and consultancy turnover increased by 2% to £57.8m (2001: £56.6m) although, excluding turnover attributable to the acquisition of Exchange FS, it declined by 14%. This performance is due to a number of factors including the difficult environment for technology investment and current demand for life and pensions back office solutions being focused more towards outsourcing. However, there were some notable positive performances within the software and consultancy business from the mortgage software business and our operations based in the Isle of Man, Ireland and Canada.

Outsourcing turnover increased to £47.4m (2001: £13.8m). This strong growth was due to the commencement of the major outsourcing contract with SLFoC.

Our portal services business (excluding the portal services joint venture in Germany that was disposed of in the period) generated turnover of £15.7m (2001: £2.7m) reflecting a full year contribution from the Exweb portal acquired in November 2001. Turnover in the latter part of the year was impacted by a reduction in income from quotations, primarily relating to pension and other investment products, reflecting particularly difficult equity market conditions.

In 2002, the Group's distribution activities accounted for 26% of total turnover, up from 8% in 2001 primarily due to a full year contribution from the acquisition of Exchange FS Group plc. This sector is expected to become increasingly important in the next few years. The life, pensions and investment market remained the most important to the Group, contributing £75.5m or 62% of total turnover. The mortgage sector contributed 12% to total turnover.

The geographic breakdown of turnover in the period shows 93% of total turnover (2001: 87%) coming from the UK market. This reflects the greater UK revenue concentration of Exchange FS, the SLFoC outsourcing contract and reduced turnover from our activities in South Africa. Turnover from the remainder of our international operations increased by 34% in 2002 relative to 2001 reflecting encouraging progress for our activities in Canada and Ireland.

Cost of sales

Cost of sales increased by 93% to £57.9m (2001: £29.9m), resulting in a gross margin of 50.4% (2001: 57.1%) on turnover in the period (excluding joint ventures) of £116.7m (2001: £69.7m). The reduced gross margin relative to 2001 was due to a number of factors such as the increased contribution of outsourcing, which tends to have lower gross margins, reduced margins resulting from the extended migration period under our project for SLFoC, utilisation within the software business being affected by reduced turnover on a like–for–like basis relative to 2001 and low margins on a number of software contracts inherited from Exchange FS Group plc.

Operating costs

Operating costs (excluding charges for depreciation, goodwill amortisation and impairment, employee share options and reorganisation costs) increased by 94% to £42.7m (2001: £22.0m). Such operating costs as a proportion of turnover (excluding joint ventures) were 36.6% (2001: 31.5%) reflecting particularly the operating costs within the SLFoC outsourcing contract and the costs of establishing our new operations in Italy and Spain.

Research and development expenditure was around £5m, in line with last year, and the deliverables included the development of a new end–to–end solution for life and protection products (which is already attracting significant interest), the extension of Omiga to include further sales automation capability across multiple financial products and delivery channels, completion of Officeweb and message enabling our back office solutions. In 2003 we will incur research and development expenditure particularly in completing the full electronic trading capability of Exweb.

Goodwill

The Group has undertaken a review of the value of goodwill being carried in relation to previous acquisitions. The review was undertaken in accordance with FRS 11 "Impairment of fixed assets and goodwill". It concluded that, given the current performance of the former Crisp Computing business (that formed part of the acquisition of Exchange FS Group plc) and changes in valuations of similar businesses since the acquisition of Exchange FS in November 2001, a non–cash goodwill impairment charge of £23.6m should be included in the 2002 results relating to this business.

The review also confirmed the value of goodwill being carried in relation to the Exweb portal element of this acquisition which amounted to £46.4m at 31st December 2002. Exweb has brought significant strategic benefits and it is expected to play a key role in the transformation of financial services distribution in the UK. We expect to build further on the tangible successes achieved by Exweb since its acquisition and that it will have a significant influence on the Group's future development.

As a result, total intangible assets carried on the balance sheet at 31st December 2002 were £51.3m and it is expected that annualised amortisation from 2003 to 2005 will be in excess of £7m.

Reorganisation costs

During 2002, substantial work was undertaken to complete the integration of the operations of Exchange FS Group with the remainder of the Group. This integration programme included reduction in headcount particularly in central and administrative functions. The integration also involved rationalising investments previously made by Exchange FS, including the disposal of a 25.5% interest in Financial Express Prestel Limited and a 50% interest in the joint venture, eXtrahyp.de, in Germany. The disposal programme resulted in a modest net gain which led to an adjustment to the goodwill arising on the acquisition of Exchange FS.

In the latter part of 2002, the Group embarked on a reorganisation programme necessitated by the difficult trading conditions experienced by the UK software business. This resulted in significant reductions in headcount. The integration of Exchange FS, combined with the reorganisation programme, resulted in total reorganisation charges, principally relating to severance costs associated with headcount reductions and property rationalisation costs, of £4.1m in the period.

The integration of Exchange FS and the reorganisation programme have realised ongoing annualised savings of around £4m and £6m respectively, consistent with previous announcements. It should be noted that these cost reductions will be partially offset by higher business taxes in the UK, modest increases in employee costs and other minor increases in non–people based costs.

Since the end of 2002, we have announced the proposed relocation of employees based in our Halesowen office. In addition, as a final stage in our recent reorganisation programme, we have restructured the Group into four business units, each with greater focus and accountability. These units are the three UK markets we serve – distribution, life, pension and investments and mortgages – and our international activities. We expect these developments will result in a total of up to 100 employees leaving the Group during the first half of 2003. This is expected to result in a restructuring charge to be incurred in the first half of 2003 of around £2m and annualised savings of over £3m from the middle of 2003.

Results

The reported pre–tax loss for the year of £34.5m (2001: profit of £9.3m) reflects goodwill amortisation and impairment charges of £33.4m, amounts written off investments, taken against the carrying value of the company's shares held in employee related share trusts, of £9.1m and employee share option charges and reorganisation costs of £3.3m.

Underlying profit, namely operating profit, including the results of joint ventures and before charges for goodwill amortisation and impairment, employee share options and reorganisation costs, amounted to £11.5m (2001: £14.8m). On this basis, in 2002 the operating margin was 9.5% (2001: 20.1%). The reasons for the reduced margin in 2002 relative to 2001 are set out above in the sections entitled 'Cost of sales' and 'Operating costs'.

Taxation

The underlying taxation rate, based on pre–tax profit, including the results of joint ventures but after adding back goodwill amortisation and impairment and amounts written off investments, was 38.0% (2001: 32.3%). The principal factors causing the rate of tax to exceed the UK statutory rate of 30% were overseas losses for which no benefit can currently be assumed and non–deductible expenses.

Earnings per share

The basic loss per share for the year ended 31st December 2002 was 20.0 pence (2001: earnings of 3.6 pence). Basic and diluted earnings per share (before charges for goodwill amortisation and impairment, employee share options, reorganisation costs and amounts written off investments) for the period were 3.8 pence and 3.5 pence respectively (2001: 7.3 pence and 5.9 pence respectively).

Adjusted diluted earnings per share

	2002 pence	2001 pence
Diluted earnings per share	(20.0)	2.9
Goodwill amortisation	4.7	1.9
Goodwill impairment	11.3	–
Amounts written off investments	4.3	–
Employee share option (credit)/charges	(0.3)	0.6
Reorganisation costs	1.4	0.5
Adjustment for dilutive effect of options	2.1	–
Adjusted diluted earnings per share	3.5	5.9

Dividend

The Board continues to support a progressive dividend policy, consistent with the cash generative nature of the business. However, the recent fall in the company's share price has led to a significant impairment in the carrying value of the company's shares held in employee related share trusts. Unfortunately, this has the effect of reducing distributable reserves to the extent that it would be imprudent for the Board to declare a dividend for 2002 despite the company's significant cash resources.

Cash flow and borrowings

Operating cash flow was £11.5m (2001: £13.5m), representing 100% of Group operating profit before charges for goodwill amortisation and impairment, employee share options and reorganisation costs.

Operating cash flow relative to underlying operating profit was strong in the year given that there were some specific adverse non–recurring movements relating to the acquisition of Exchange FS Group plc, the reorganisation programme undertaken by the Group and the SLFoC outsourcing contract. This strong performance is attributable particularly to good cash inflows during the second half of the year when the level of trade and other debtors was reduced substantially.

This positive influence was offset by cash outflows in the period of £4.2m related to reorganisation costs charged in both 2001 and 2002 as well as cash movements linked to fair value provisions established since the acquisition of Exchange FS Group plc. The reorganisation costs relate to the integration of Exchange FS as well as the reorganisation programme undertaken by the Group in the second half of the year.

The adverse operating cash flow movements relating to the SLFoC outsourcing contract were linked to redundancy costs. These costs were not charged in the period as provisions had been established at the time that we acquired Sun Life of Canada (UK) Group Services Limited (SLOCGSL) as part of the contract arrangements. However, this adverse movement was offset in large part by the receipt of a substantial receivable from the SLFoC group towards the end of the year, which contributed to the strong cash collection referred to above.

During 2002, non–operating cash movements included payments of £4.9m of acquisition costs and related professional fees in connection with the acquisition of Exchange FS and the consideration for the acquisition of SLOCGSL (offset by £3.5m held on SLOCGSL's balance *sheet) and £10.3m relating to capital expenditure, dividends and tax. These payments were offset by the receipt of £1.3m on the exercise of* share options and £0.3m on disposal of the Group's shareholding in Financial Express Prestel Limited.

Overall, reflecting principally the above factors, during 2002 Marlborough Stirling moved from an opening net cash position of £7.5m to a closing net cash position of £9.1m. The Group also maintains significant available bank facilities amounting to £20m which were all undrawn at 31st December 2002.

[report on corporate governance]

Statement of compliance

The Combined Code on Corporate Governance published in June 1998 contains 14 Principles of Good Governance and a Code of Best Practice with 45 detailed provisions applicable to listed companies. This statement explains how the Board has set out to ensure that the Group has an effective system of corporate governance and provides details of the procedures the Board has established to apply the principles set out in the Combined Code.

Board of directors

The Board meets monthly throughout the year and deals with important aspects of the Group's affairs including setting and monitoring strategy, analysing risk, reviewing performance, ensuring that the Group has adequate financial resources and reporting to shareholders. These meetings are scheduled well in advance and all attendees are provided with sufficient and timely information to enable them to discharge their duties. A schedule of matters reserved for decision by the Board is in place.

All directors have access to the advice and services of the company secretary, who is responsible to the Board for ensuring compliance with Board procedures. If required, the directors are entitled to take independent professional advice at the expense of the company provided that the potential cost of such advice has been notified beforehand.

At the beginning of 2002 the Board comprised three non-executive directors and seven executive directors. On 18th February 2002 Geoffrey Harrison-Dees was appointed as an additional non-executive director; Andrew Fritchie was appointed as an additional executive director on 29th May 2002. Robert Beveridge joined the Group as Finance Director on 18th November 2002 and was appointed to the Board on 6th February 2003. At the end of 2002, the Board consisted of four non-executive directors and eight executive directors. The non-executive directors (Paul Fullagar, Geoffrey Harrison-Dees, Colin Hayfield and Paul Seymour) are regarded as a strong and autonomous element of the Board by their fellow directors. The Senior Independent Director is Paul Fullagar. The company has a chairman, Huw Evans, and a chief executive, Graham Coxell. The chairman and chief executive have separate responsibilities.

The chairman is responsible for the effective operation of the Board, co-ordinating the strategic direction of the Group and leading the company's community relations. The chief executive is responsible for implementing the Group's strategy and all operational aspects of the business. Each executive director has assigned responsibilities and (other than the chairman) is accountable to the chief executive and to the Board at large for the performance of those duties.

Throughout 2002 the chief executive chaired an operational board which comprised the executive directors (other than the chairman) and senior management. The operational board met twice monthly and was responsible to the Board for the effective day to day running of the Group's operations and trading performance. Since the beginning of 2003, the Group's UK business has been restructured into three core business units, focusing on (i) life and pensions, (ii) mortgages and banking and (iii) distribution. The operational board has been replaced by a senior management team which now has responsibility for day to day management of key commercial, operational and financial issues. The team is chaired by the chief executive, meets weekly and comprises the heads of the three UK business units, the managing director of the Group's International Business Unit, the Group's finance director and the Group's commercial director.

Board committees

The Board delegates responsibility for specific matters to Board committees, as described below. Each Board committee has formal written terms of reference. The company secretary is the secretary to each committee and provides advice as appropriate.

(i) Audit Committee

The Audit Committee monitors and reviews the financial and internal control of the Group (working with the Risk Committee in relation to the latter). It also reviews and approves the directors' report and financial statements and half year interim statement prior to submission to the Board for approval. The Committee is chaired by Paul Seymour and includes Paul Fullagar, Geoffrey Harrison-Dees and Colin Hayfield. It meets, together with the finance director, at least four times each year and more frequently if required. The Group's external auditors are also invited to attend meetings of the Committee from time to time. The Committee monitors the level of non-audit work carried out by, and the independence of, the Group's external auditors.

(ii) **Remuneration Committee**

The Remuneration Committee determines the terms of service and remuneration of the executive directors. It also considers the grant and exercise of options under the Group's share option schemes. The Committee is chaired by Paul Fullagar and includes Geoffrey Harrison-Dees, Colin Hayfield and Paul Seymour. Huw Evans was also a member of this Committee until 25th September 2002.

(iii) **Nominations Committee**

The Nominations Committee has responsibility for nominating candidates to fill board vacancies and makes recommendations to the Board on board composition and balance. The Committee is chaired by Colin Hayfield and includes Paul Fullagar, Geoffrey Harrison-Dees, Paul Seymour and Huw Evans.

(iv) **Risk Committee**

The Risk Committee was constituted by the Board in 2002 and is responsible for monitoring and managing risk across the Group. The Committee meets monthly and is chaired by Andrew Fritchie, includes David Power, David Gales and Paul Seymour and is assisted in its day-to-day operation by the group risk manager who leads the Group Risk Management Team. Further details of the Group's risk management policies and processes are set out below under the heading 'Internal control'.

Accountability

The Board is aware of its responsibility to present a clear and balanced assessment of the Group's financial position and prospects. This assessment is provided in the chairman's statement, the operating review and the financial review.

Shareholder relations/communication

The Board is committed to developing long-term relationships with both existing and potential investors in the company through a comprehensive and proactive investor communications programme. The main objective of this programme is to inform, educate and build long-term investor relationships based on trust and a sound understanding of the strategy of the business, its competitive advantages, value drivers and track record of delivering shareholder value.

The company has actively pursued the development of an annual investor relations programme since flotation. The programme was broadened during 2002 and, on an ongoing basis, is expected to include:

- Organised schedules of institutional investor and analyst meetings after the publication of annual and interim results and other significant announcements relating to the Group
- Involvement in other more ad hoc meetings with investors and analysts
- Hosting investor and analyst open days at the company's offices and other appropriate locations
- Participating in forums and conferences run by investment houses on the financial software and more general technology sectors
- Making available appropriate business and financial information via the company's website (www.marlborough-stirling.com)
- The Annual General Meeting (AGM)
- Maintaining a dialogue with a number of leading investment analysts.

Around 10 analysts currently produce dedicated research reports and/or financial forecasts on the Group.

In its annual and interim reports, results presentations and market announcements generally, the Group endeavours to present an accurate, balanced and objective picture.

Shareholders are encouraged to participate in the AGM where, in addition to the formal business, current business activity is discussed and questions are invited either during the meeting or in supplemental meetings with the directors and other senior management after the formal proceedings have ended.

Whilst the nature of the company's share ownership dictates that the focus of dialogue should be with institutions, care is exercised to ensure that any price sensitive information is released at the same time to all shareholders, the market and the media.

Internal control

The Board has reviewed the effectiveness of the systems of internal control and risk management during the period. In carrying out this review the Board undertook a self-certification process with senior operational managers to confirm adherence to these controls. The Board has in place an organisational structure with clearly defined lines of responsibility, delegation of authority, segregation of duties and staff of the necessary calibre to fulfil each role. Together with clear and established management and control procedures, this structure is designed to ensure that all decisions are taken at an appropriate level. In this context, the Board's own functions include the following:

- Considering and developing Group strategy and formulating and adopting an annual budget based on that strategy and resulting medium-term projections. Core to this process is the regular review by the Audit and Risk Committees of risks facing and opportunities open to the Group

- Regular review of the Group's operational performance and updated current business and financial forecasts in accordance with specific procedures

- Primary responsibility for acquisition and divestment policy, investment appraisal, the approval of major capital expenditure and financing arrangements. The approval of capital expenditure, significant contracts, investments, acquisitions and divestments is carried out strictly in accordance with specific procedures

- Overview and supervision of environmental, social, ethical and health and safety matters as they relate to the Group's operations on the basis of reports from and with the support of the Group's senior management

- Overview and supervision of the effective operation of the Group's internal systems of control and risk management on the basis of reports from and with the support of the Group's Audit Committee and Risk Committee.

During the period the Board was supported by the operational and various subsidiary boards. The operational board reviewed and reported on key operational issues, including financial performance. As described above, this aspect of the Group's management structure has been reviewed since the end of the period and a new structure adopted since the beginning of 2003.

In fulfilment of its responsibility for effective management of risk across the Group, the Board ensures the continued development and improvement of the Group's system of internal controls. Whilst the Board acknowledges that such controls do not eliminate risk altogether, the Board remains committed to designing and implementing systems and structures intended to provide reasonable reassurance against the possibility of material misstatement or loss.

During 2002 the Board established the Risk Committee and the new Group Risk Management Team (led by the group risk manager reporting to Andrew Fritchie). The Group Risk Management Team is responsible for the day to day assessment and mitigation of risk across the Group, reporting at least monthly to the Risk Committee. In turn the Risk Committee directly informs the Audit Committee and the Board on risk matters.

The Risk Committee constantly monitors a risk register and is directly and actively involved in formulating and overseeing the implementation of mitigating action and risk planning. The risk register is itself constructed as the result of processes designed to identify, analyse, review and escalate the management of risks on a day to day basis. The Group has identified certain key areas in relation to which risk assessment and management is particularly important, comprising project and service delivery, personnel (including health and safety and training), finance, infrastructure (including property and technology, physical and information security), corporate governance (including compliance with law and regulation, business continuity and systems and control), electronic communication, the setting of vision and strategy and mergers and acquisitions.

In its trading statement of 5th September 2002 the Group noted that the data migration element of a software implementation project for Sun Life Financial of Canada would not be completed as quickly as expected and that certain additional costs would be incurred as a result of this delay. The Group undertook a specific and detailed review and revision of its internal controls relevant to this client engagement and project implementation. As a result of this review, it has taken active steps to refine and improve such controls across all its client engagement and project implementation activities. Actions taken include strengthening the planning, reporting and control mechanisms at both project and programme level and increased involvement of the Group Risk Management Team in planning and project reviews. It is the Group's intention that the internal audit activity commenced in 2002 in relation to the Sun Life Financial of Canada project will be broadened to the wider Group in 2003.

The Board has continued to focus on attaining and maintaining certificated standards of excellence, including ISO9001-2000 (Quality Management Systems Requirements Standards), FAST Accreditation (software management) and FSA approvals and best practice relevant to the Group's business. The Group also applies the principles of ISO17799 (Standard for Information Security Management).

Going concern

The Board has reviewed the Group's trading position and its projected cashflow and believes that it has adequate resources to continue operations, including planned major project expenditure, for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing the financial statements.

Compliance statement

The company is required to report on its compliance with the detailed provisions of the Combined Code throughout the year ended 31st December 2002.

The company has complied with the provisions of the Combined Code throughout the year ended 31st December 2002, other than the limited exceptions stated below.

A.3.1 Prior to the appointment of Geoffrey Harrison-Dees as a non-executive director on 18th February 2002, the non-executive directors did not comprise at least one third of the Board. As Robert Beveridge was not appointed to the Board until February 2003 the Board complied with this component of the Code for the remainder of the period.

B.2.2 Certain of the non-executive directors were granted share options pre-flotation but, from the implementation of revised share option schemes on 16th March 2001, they have no longer been eligible to participate in new grants of share options.

B.2.2 Huw Evans served as a member of the Remuneration Committee until 25th September 2002.

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the Group and of the profit and loss of the Group for that period. In preparing those financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently

- Make judgements and estimates that are reasonable and prudent

- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

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

The maintenance and integrity of the Marlborough Stirling plc website is the responsibility of the directors. The work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

BY ORDER OF THE BOARD

Andrew Fritchie, Company Secretary
3rd March 2003

[report of the remuneration committee]

Statement of compliance

The Committee operates in accordance with the principles of the Combined Code on Corporate Governance issued by the Greenbury Committee. It complies with Section A and has given full consideration to Section B of the best practice provisions annexed to the United Kingdom Listing Authority's Listing Rules, except as stated in the Report on Corporate Governance.

The Remuneration Committee

The Committee is chaired by Paul Fullagar and includes Geoffrey Harrison–Dees, Colin Hayfield and Paul Seymour.

During the period the Committee appointed New Bridge Street Consultants to assist and advise on matters relating to the company's policy on the remuneration of directors. New Bridge Street Consultants provided a full and detailed report on the company's policy following a comprehensive review. The Committee have given the report careful consideration and acted on the results of the review.

In addition to specific advice from expert consultants, the Committee maintains a high level of awareness of current thinking in relation to directors' remuneration policy as part of its ongoing commitment to ensure that the remuneration of the Group's directors remains effective and appropriate.

Remuneration of executive directors

The Committee aims to ensure that remuneration packages offered are competitive and designed to attract, retain and motivate executive directors and senior executives of the right calibre. The main components, in order of importance, are a basic salary, annual bonus, pension contributions and share options.

(i) **Basic salary** is determined taking into account the responsibilities and performance of the individual, information from independent sources, expert advice from external consultants and rates of salary for similar jobs in a selected group of comparative companies. Basic salaries are normally reviewed annually.

(ii) **Annual bonus** is based upon the achievement of corporate and personal objectives. The Committee believes that directors' remuneration should comprise a performance related bonus element of up to approximately 50% of basic salary. Superior performance is encouraged by setting challenging performance goals which must be achieved before the maximum bonus becomes payable. The corporate objectives are linked to the interests of shareholders and the key measures are profitability and the growth and development of the Group. The company's policy in relation to bonuses is as recommended by external advisers and the Committee regards the current policy as being in line with normal market practice. Bonus payments are non–pensionable and bonuses are not payable to non–executive directors.

No bonuses are due to any directors in respect of the period.

(iii) ***Pension contributions*** *are made to defined contribution schemes and the contributions are a percentage of basic salary.*

(iv) **Share options** are designed to strengthen the links between the personal interests of the executive directors and management and those of shareholders. Since flotation the company has complied with the ABI Guidelines in respect of the issue of share options.

With the exception of the options issued to Robert Beveridge and Gerald Whitmore, all options referred to in the table below were granted under the terms of the company's 1997 Approved and Unapproved Schemes. These Schemes were adopted prior to flotation of the company in April 2001 in order to incentivise employees, including directors, through to flotation and for the medium term beyond. All options granted pursuant to these Schemes are therefore subject to vesting criteria which reflect these aims, although no additional performance criteria apply. Since its flotation, the company has not and will not issue any further options pursuant to these Schemes. As in the case of the options granted to Robert Beveridge and Gerald Whitmore, it is the company's policy that grants of options following flotation (currently pursuant to the terms of the company's 2001 Approved and Unapproved Schemes) are subject to both vesting and performance criteria. The vesting criteria are designed to encourage medium to long-term commitment from employees and performance criteria focus on the creation of shareholder value and return by imposing a pre-condition to the exercise of any such options that the company achieves a compound annual growth in earnings per share equal to or in excess of 5% above the 'All Items' series of the Retail Prices Index for the relevant period.

The exercise of options by all staff, including directors, is regulated in accordance with the Group's Share Dealing Code. Directors may not exercise options without the permission of the Board who ensure that, amongst other things, all vesting and performance criteria have been satisfied in full before permission is given.

Details of directors' share options are set out in the table below.

Directors' interests in share options

The interests of the directors of the company at 31st December 2002 in options over ordinary shares held under the company's share option schemes were as follows:

Director/ issue date	No. of options at 1st January 2002 (i)	Granted in year	Exercised in year (ii)	No. of options at 31st December 2002	Exercise price	Exercisable from/to (iii)
R J Beveridge (appointed to the Board on 6th February 2003)						
23/12/02	–	273,333	–	273,333	£0.375	23rd December 2005/2006/2007 to 23rd December 2012 (iv)(v)
	–	**273,333**	**–**	**273,333**		
G P Coxell						
30/05/97	787,500	–	–	787,500	£0.14	Immediately to 30th May 2007
01/08/97	2,278,120	–	922,420 (vi)	1,355,700	£0.14	Immediately (vii)
25/11/98	315,000	–	–	315,000	£0.37	9th April 2003 to 25th November 2005 (iv)
28/02/00	1,260,000	–	–	1,260,000	£0.73	9th April 2003/2004 to 28th February 2007 (iv)
16/01/01	2,738,740	–	–	2,738,740	£0.90	Immediately/9th April 2003/2004 to 16th January 2008 (iv)
	7,379,360	**–**	**922,420**	**6,456,940**		
A P Fritchie (appointed to the Board on 29th May 2002)						
23/02/98	181,770	–	–	181,770	£0.19	9th April 2003 to 23rd February 2005 (iv)
25/11/98	333,620	–	–	333,620	£0.255	9th April 2003 to 25th November 2005 (iv)
05/04/00	420,000	–	–	420,000	£1.10	9th April 2003/2004 to 5th April 2007 (iv)
16/01/01	250,000	–	–	250,000	£2.00	Immediately/9th April 2003/2004 to 16th January 2008 (iv)
	1,185,390	**–**	**–**	**1,185,390**		
A B Klim						
25/11/98	1,009,640	–	–	1,009,640	£0.37	9th April 2004 to 25th February 2005 (iv)
28/02/00	1,560,000	–	300,000	1,260,000	£0.73	9th April 2003/2004 to 28th February 2007 (iv)
	2,569,640	**–**	**300,000**	**2,269,640**		

Director/ issue date	No. of options at 1st January 2002 (i)	Granted in year	Exercised in year (ii)	No. of options at 31st December 2002	Exercise price	Exercisable from/to (iii)
D Power						
30/05/97	315,000	–	–	315,000	£0.14	Immediately to 30th May 2007 (iv)
30/09/97	161,700	–	–	161,700	£0.19	9th April 2003/2004 to 30th September 2004 (iv)
25/11/98	212,900	–	–	212,900	£0.14	9th April 2003 to 25th November 2005 (iv)
25/11/98	320,040	–	–	320,040	£0.255	9th April 2003 to 25th November 2005 (iv)
28/02/00	1,584,240	–	324,240	1,260,000	£0.73	9th April 2003/2004 to 28th February 2007 (iv)
	2,593,880	**–**	**324,240**	**2,269,640**		
G M Whitmore (resigned from the board on 31st January 2003)						
09/11/01	164,740	–	–	164,740	£1.73	1st October 2004/2005/2006 to 9th November 2011 (iv) (v)
	164,740	–	–	**164,740**		
P G Fullagar						
12/01/01	60,000	–	–	60,000	£1.351	Immediately/9th July 2003/2004 to 12th January 2008 (iv)
	60,000	–	–	**60,000**		
G Harrison–Dees (appointed to the board on 18th February 2002)						
	–	–	–	–	–	–
	–	–	–	–		
C J Hayfield						
01/10/97	205,800	–	–	205,800	£0.19	9th April 2003 to 1st October 2007 (iv)
	205,800	–	–	**205,800**		
P A C Seymour						
12/01/01	42,000	–	–	42,000	£1.351	9th April 2003/2004 to 12th January 2008 (iv)
	42,000	–	–	**42,000**		

The market price of the ordinary shares at 31st December 2002 was £0.355. The range of market prices during the year ended 31st December 2002 was £0.20 to £2.385.

Notes

(i) If the director was appointed to the board after 1st January 2002, the number of options is at the date of appointment.

(ii) Options exercised during the period were exercised at the relevant exercise prices and the resulting shares sold at £1.80 per share.

(iii) This column sets out the exercise period for options held at 31st December 2002.

(iv) All options to be exercised within 10 years of date of grant and may be exercised in full in the event of a sale although for the majority of these options, in the event of a sale, the Board has the discretion to direct that they be converted into options in the acquiring company.

(v) Exercise of these options is also subject to the fulfilment of a performance condition based on the growth in earnings per share achieved by the company in the period between the grant and exercise of options.

(vi) No options lapsed or were surrendered during the year, except as described under 'Gains made by directors on exercise of share options' on page 41.

(vii) These options are intended to be exercisable in the same proportions as the founder shareholders realise their investment in the company.

Total shareholder return

Following the company's flotation in April 2001 its share price initially performed strongly but, over the course of most of 2002, it underperformed the FTSE Software and Computer Services index. Over the full period since flotation, the company's shares have marginally underperformed this index giving a total shareholder return of –74.5% compared to –71.1% for the index.

In the opinion of the directors, the FTSE Software and Computer Services index is the most appropriate index against which the total shareholder return from investing in Marlborough Stirling's shares should be measured as it consists of companies which, like Marlborough Stirling, operate in the software sub–sector of the technology industry.

Remuneration of the non–executive directors

The remuneration of the non–executive directors is in respect of Board and committee meetings and additional services. Certain of the non–executive directors were granted share options pre–flotation but, from the implementation of revised share option schemes on 16th March 2001, they have no longer been eligible to receive share options. Details of the share options held by the non–executive directors are set out in the table on page 38.

Directors' emoluments

a) Total emoluments of the directors

	31st December 2002	31st December 2001
	£000	£000
Salary, fees and benefits in kind	1,579	1,230
Bonuses	–	249
Sums paid to third parties for directors' services (see below)	23	48
Company contributions to defined contribution pension schemes	155	126
Payments to funded unapproved retirement benefit schemes	102	101
Total	**1,859**	**1,754**

Payments to third parties for directors' services represent £23,433 for the year ended 31st December 2002 (2001: £47,933) paid to Paul Seymour Limited a company owned by Paul Seymour for the provision of his services.

b) Emoluments of individual directors

Details of each individual director's emoluments are set out in the table below:

	Salaries and fees £000	Bonuses £000	Benefits in kind £000	Total 2002 £000	Total 2001 £000	Pension contributions 2002 £000	Pension contributions 2001 £000
Executive directors							
H D Evans	240	–	5	245	334	72	72
G P Coxell	250	–	4	254	288	25	23
R J Beveridge	27	–	1	28	–	–	–
A P Fritchie	71	–	4	75	–	7	–
D R Gales	190	–	23	213	262	48	49
A B Klim	121	–	11	132	142	12	11
D Power	121	–	10	131	144	12	11
C H Ryland	190	–	17	207	201	57	57
G M Whitmore	190	–	22	212	50	24	4
Non–executive directors							
P G Fullagar	20	–	–	20	25	–	–
G Harrison–Dees	17	–	–	17	–	–	–
C J Hayfield	20	–	–	20	20	–	–
P A C Seymour	48	–	–	48	61	–	–
Total	**1,505**	**–**	**97**	**1,602**	**1,527**	**257**	**227**

The table above includes the amounts payable to Andrew Fritchie and Geoffrey Harrison–Dees following their appointments to the board on 29th May 2002 and 18th February 2002 respectively. The table above also includes the amounts payable to Robert Beveridge from 18th November 2002 when he joined the Group although he was only appointed to the Board on 6th February 2003.

Emoluments for Gerald Whitmore in 2001 include amounts payable following his appointment to the Board on 1st November 2001 to 31st December 2001.

Benefits in kind include the provision of a company car (or car allowance), fuel, private medical insurance and life assurance for every director. In addition, Huw Evans and David Gales had the use of a driver during 2002.

Pension contributions detailed above comprise amounts payable to defined contribution pension plans and, in respect of Huw Evans, Graham Coxell, David Gales and Christopher Ryland, additional contributions accrued relating to funded unapproved retirement benefit schemes of £42,975 (2001: £43,650), £8,064 (2001: £2,981), £23,311 (2001: £25,371) and £27,975 (2001: £28,650) respectively.

c) Highest paid director

	G P Coxell	H D Evans
	2002	2001
	£000	£000
Aggregate emoluments	254	334

Gains made by directors on exercise of share options

The table below shows gains made by individual directors from the exercise of share options during the year. The gains are calculated on the difference between the share option exercise price and the price at which shares resulting from the exercise of options were sold.

Gains on share options exercised

	2002	2001
	£000	£000
Executive directors		
G P Coxell (i)	1,531	1,803
A B Klim	321	531
D Power	347	630
Non–executive directors		
C J Hayfield	–	62
P A C Seymour	–	1
	2,199	3,027

Notes

(i) Graham Coxell did not exercise any options but surrendered options over 922,420 shares in consideration of the grant of options of an equivalent economic value over shares in a newly incorporated company, the sole shareholder of which is Abacus Corporate Trustee Limited ('Abacus'), the trustee of The Marlborough Stirling plc Employee Share Ownership Trust No. 2 (the 'Second ESOT'). Abacus sold 922,420 shares held by the Second ESOT in order to fund a subscription of shares in the newly incorporated company.

Company pensions policy regarding executive directors

The company contributes to group personal pension schemes, defined contribution schemes and funded unapproved retirement benefit schemes set up by the company as set out in the emoluments table above. These contributions are based on a percentage of the basic salary of the executive directors.

Directors' service agreements and terms of engagement

It is the company's policy and practice to require all executive directors to enter into service agreements on broadly standard terms which, without exception, provide for a rolling term of employment which is in no case terminable by more than 12 months' notice by either party. No director is entitled to any form of predetermined retirement or termination payment (whether upon early termination or retirement or otherwise). The provisions of all service agreements with executive directors and the terms of engagement for non–executive directors have been formulated and adopted with the assistance of external expert advice and in keeping with best practice. All such terms and arrangements are periodically reviewed to ensure continued compliance with developing best practice, remuneration policy as amended from time to time and market conditions.

With the exception of Robert Beveridge (whose service agreement took effect on 18th November 2002 and who can be dismissed on six months' notice) and Andrew Fritchie (whose service agreement is dated 18th April 2001), all executive directors are engaged on contracts dated 19th March 2001 and can be dismissed on 12 months' notice. Each of the non–executive director's terms of engagement entitle the company to terminate the arrangement on three months' notice and provide that the arrangement will automatically terminate on the non–executive director reaching the age of 65.

Huw Evans, Graham Coxell, Christopher Ryland and Colin Hayfield will be retiring as directors and standing for re–election at the company's 2003 Annual General Meeting in accordance with Article 87 of the company's Articles of Association (Retirement by Rotation).

[directors' report]

The directors present their annual report and the financial statements of the company and the Group for the year ended 31st December 2002.

Principal activities, business review and future developments

The principal activity of the Group is the provision of software and services to the distribution, life, pensions and investment and mortgage markets in the financial services industry.

Marlborough Stirling's distribution business comprises the Exchange portal (Exweb), which provides comparative product quotations and illustrations to intermediaries, and a software business targeting both UK financial intermediaries and product providers. Exweb is the leading intermediary trading platform in the UK financial services market. Our software solutions include Officeweb, an intermediary business administration system, and products for product providers such as Omiga+, a customer management, point-of-sale and product application processing solution.

Marlborough Stirling's life, pensions and investment business supplies life insurance companies and providers of pensions and other investment products with a range of software, related services and outsourcing. The main software application in this market is Lamda, a comprehensive back office administration platform for many types of life, pension and investment products. Other software applications include Genesis Life targeted at the offshore wealth management market and a range of niche applications for the UK market. The life and pensions outsourcing business provides a range of services on behalf of financial services companies to transform their administration functions. These services include business process re-engineering, change management, new business processing, customer service, past business reviews, finance and actuarial. The Group has nine life, pensions and investment outsourcing clients.

Marlborough Stirling's mortgage business consists of mortgage software businesses in the UK and Canada and the UK outsourcing joint venture with Egg, Marlborough Stirling Mortgage Services (MSMS). Software applications for the mortgage market include Omiga, a customer management, point-of-sale and application processing solution and Optimus, a back office administration system. MSMS provides a range of services on behalf of mortgage lenders to transform their lending operations. These include change management, new business processing, mortgage packaging and customer service. MSMS currently has five clients.

Business reviews and future developments are given in the chairman's statement and chief executive's operating review.

Results and dividends

The results for the year are set out in the profit and loss account on page 48. The directors do not recommend the payment of a dividend. Details of dividends are shown in note 9 of the financial statements.

Research and development

The development of computer software is an integral part of the Group's business and the Group continues to develop in response to user demand and changes in software technology. All such costs are written off to the profit and loss account as incurred.

Fixed assets

Movements in tangible fixed assets are shown in note 13 of the financial statements.

Share capital

Details of movements in share capital are set out in note 23 of the financial statements.

Directors and their interests

The directors who held office during the year are disclosed on pages 10 and 11.

The beneficial and non-beneficial interests of the directors in the share capital of the company at 31st December 2001 and 31st December 2002 were as follows:

	31st December 2002		31st December 2001 or date of appointment	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Director	Ordinary shares	Ordinary shares	Ordinary shares	Ordinary shares
Executives				
H D Evans	17,395,710	4,588,162	20,465,541	6,922,970
D R Gales	17,395,710	7,223,132	20,465,541	9,557,940
A B Klim	24,348	-	24,348	-
C H Ryland	17,395,710	2,634,970	20,465,540	2,634,970
G M Whitmore	2,569,773	-	3,622,132	-
Non-executives				
G Harrison-Dees	14,500	-	14,500	-
C J Hayfield	25,000	-	29,400	-
P A C Seymour	18,000	-	18,000	-

Notes

(i) Details of the options over ordinary shares held by the directors are set out in the report of the remuneration committee. They are not included in the table above.

(ii) The beneficial and non-beneficial interests of the directors do not include any interest which they have in ordinary shares held by the trustees of ESOT 1, the trustees of ESOT 2 and the Colm Fagan Discretionary Trust.

(iii) The holding of CH Ryland set out above includes 4,588,162 ordinary shares which were transferred to UBS Warburg on 9th April 2001 pursuant to a stock lending agreement under which he remains interested in an equivalent number of shares.

The shareholdings of those who were directors at 31st December 2002 have not changed between the year end and the date of this report.

Paul Fullagar, Geoffrey Harrison-Dees, Colin Hayfield and Paul Seymour are non-executive directors. Biographies of the non-executive directors are shown on page 11.

The Group maintains insurance against certain liabilities which could arise from a negligent act or breach of duty by any director or officer in the discharge of his duty.

Shareholders

The number of ordinary shares allotted at 31st December 2002 was 225,716,013 (2001: 225,472,528). The company has been notified of the following shareholders with interests in the company's ordinary shares of 3% or more, other than the directors, as at 26th February 2003.

ESOT 2	– 32,878,076	14.6%
Standard Life Investments	– 7,541,969	3.3%

Employees

The contribution of employees is vital to enable the Group to achieve its commercial and financial objectives. The Group's ability to sustain a competitive advantage over the long term will depend in large part on the continuous development of all employees. The Group is committed to providing a broad and ongoing range of internal education and development programmes designed to meet the needs of all employees. Training is open to all on an equal basis and supports the Group's ethic that the working environment should value and facilitate continuous learning and development for staff across all business areas. The Group seeks to ensure that employees who become disabled are able to continue in their roles where possible or, where appropriate, are given opportunities to take up alternative posts with suitable training and assistance.

The Group has a policy and practice of regular and effective communication with employees in order to promote community and a sense of common purpose and objective. The Group values the input and feedback of employees through open and organised consultation on each area of the business and working life.

The Group operates share option schemes which are available to all employees at the discretion of the Board. The allocation of share options provides employees with a direct stake in the growth and prosperity of the business.

Transactions with directors

Other than the property and loan note interests of Gerald Whitmore set out in note 28 of the financial statements, there were no transactions with directors during the year outside their normal employment.

Donations

The Group's charitable activities comprise the making of direct financial donations to both local and national charities and also the donation by the Group and its staff of other resources to the benefit of local charities and communities.

During the year, the Group made charitable donations totalling £9,097. Of this, donations were made to local community charities totalling £3,119. Individual donations exceeding £200 were as follows: Leonard Cheshire (UK) – £634, County Air Ambulance – £765, Learn to Earn (South Africa) – £665, St John's Parish Church (South Africa) – £1,025. Donations to national charities amounted to £5,978. Individual donations exceeding £200 (all to UK charities) were as follows: NSPCC – £259, The Prince's Trust – £250.

There were no political donations in the period.

Creditor payment policy

It is the Group's policy to pay suppliers in accordance with their agreed terms and conditions. Such terms and conditions are agreed with the supplier in advance of each transaction type and the Group aims to comply with such terms once satisfactory performance or service or receipt of goods is achieved. At 31st December 2002 trade creditors of £3.3 million (2001: £2.4 million) represented 33 days' purchases (2001: 33 days), calculated in accordance with the Companies Act 1985.

Annual general meeting

The annual general meeting will take place at 10.00 am on Monday 19th May 2003 at the Group's offices at Jessop House, Jessop Avenue, Cheltenham, Gloucestershire, GL50 3SH. A separate document, containing the notice of AGM and a letter from the chairman explaining the business to be considered at the meeting, has been sent to shareholders with this report.

Auditors

Following the conversion of the Group's auditors PricewaterhouseCoopers, to a limited liability partnership (LLP) from 1st January 2003, PricewaterhouseCoopers resigned on 29th January 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. Having expressed a willingness to continue in office as auditors, a resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company in accordance with Section 385 of the Companies Act 1985 will be proposed at the next annual general meeting.

BY ORDER OF THE BOARD

Andrew Fritchie, Company Secretary
3rd March 2003

[independent auditors' report to the members of Marlborough Stirling plc]

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the statement of accounting policies. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report ('the auditable part').

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This opinion has been prepared for and only for the company's members in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the directors' remuneration report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report, the unaudited part of the directors' remuneration report, the chairman's statement, the operating and financial review and the corporate governance statement.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

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

Opinion

In our opinion:

The financial statements give a true and fair view of the state of affairs of the company and the Group at 31st December 2002 and of the loss and cash flows of the Group for the year then ended; the financial statements have been properly prepared in accordance with the Companies Act 1985; and those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors

3rd March 2003
1 Embankment Place
London
WC2N 6RH

[consolidated profit and loss account]

For the year ended 31st December 2002

	Notes	2002 £000	2001 £000
Turnover (including share of joint ventures)	2	121,008	73,369
Less share of turnover of joint ventures		(4,353)	(3,622)
Group turnover – continuing		81,879	69,747
– acquisition		34,776	-
Group turnover		116,655	69,747
Cost of sales	3	(57,862)	(29,913)
Gross profit		58,793	39,834
Operating expenses	3	(83,649)	(30,551)
Group operating (loss)/profit – continuing		(26,514)	9,283
– acquisition		1,658	–
Group operating (loss)/profit		(24,856)	9,283
Share of operating (loss) of joint ventures and associates		(352)	(249)
Total operating profit before charges for goodwill amortisation and impairment, employee share options and reorganisation costs – continuing	3	8,968	14,780
– acquisition		2,502	–
		11,470	14,780
Goodwill amortisation – subsidiaries	3	(9,496)	(2,851)
– joint ventures	3	(250)	(250)
Goodwill impairment charge	12	(23,622)	–
Employee share option credit/(charge)	3	778	(1,474)
Reorganisation costs	3	(4,088)	(1,171)
Total operating (loss)/profit including share of joint ventures and associates		(25,208)	9,034
Interest receivable – group	6	900	969
– joint venture	6	49	46
Amounts written off investments	14	(9,052)	–
Interest payable	7	(1,167)	(772)
(Loss)/profit on ordinary activities before taxation	4	(34,478)	9,277
Tax on (loss)/profit on ordinary activities	8	(3,016)	(3,999)
(Loss)/profit for financial year		(37,494)	5,278
Non–equity dividends and preference share appropriation	9	-	(496)
Total non–equity appropriation		–	(496)
(Loss)/profit after non–equity appropriation		(37,494)	4,782
Equity dividends	9	–	(1,718)
Retained (loss)/profit for the financial year	24	(37,494)	3,064
(Loss)/earnings per share	10	(20.0)p	3.6p
Diluted (loss)/earnings per share	10	(20.0)p	2.9p
Adjusted earnings per share	10	3.8p	7.3p
Adjusted diluted earnings per share	10	3.5p	5.9p

Adjusted earnings per share and adjusted diluted earnings per share are calculated before charges for goodwill amortisation and impairment, employee share options, reorganisation costs and amounts written off investments.

There is no material difference between the (losses)/profits reported above and the historic cost (losses)/profits.

[consolidated statement of total recognised gains and losses]

For the year ended 31st December 2002

	Notes	2002	2001
		£000	£000
(Loss)/profit on ordinary activities after taxation		(37,494)	5,278
Exchange adjustments offset in reserves	25	195	(97)
Total gains and losses recognised in the year		(37,299)	5,181

[consolidated balance sheet]

At 31st December 2002

	Notes	31st December 2002 £000	31st December 2002 £000	31st December 2001 £000	31st December 2001 £000
Fixed assets					
Goodwill	12		50,746		84,094
Intangible assets	12		537		–
Tangible assets	13		16,566		13,011
Investments – interests in own shares	14		10,477		20,877
Investment in joint ventures:	15				
share of gross assets		2,430		3,820	
share of gross liabilities		(1,467)		(2,133)	
goodwill arising on acquisition		500		750	
			1,463		2,437
Total fixed assets			79,789		120,419
Current assets					
Debtors	16	32,831		25,201	
Current asset investments	17	529		–	
Cash at bank		21,486		23,022	
		54,846		48,223	
Creditors					
Amounts falling due within one year	19	(38,329)		(36,620)	
Net current assets			16,517		11,603
Total assets less current liabilities			96,306		132,022
Creditors					
Amounts falling due after more than one year	20		(7,007)		(7,938)
Provisions for liabilities and charges	22		(7,535)		(3,897)
Net assets			81,764		120,187
Capital and reserves					
Called up share capital	23		2,257		2,254
Share premium account	24		43,879		43,965
Capital redemption reserve	24		6		6
Merger reserve	24		44,646		68,268
Shares to be issued	23		21		1,161
Profit and loss account	24		(9,045)		4,533
Equity shareholders' funds	25		81,764		120,187

These financial statements on pages 48 to 83 were approved by the board of directors and were signed on its behalf by:

H D Evans – Chairman

R J Beveridge – Finance Director

3rd March 2003

[company balance sheet]

At 31st December 2002

	Notes	31st December 2002 £000	31st December 2002 £000	31st December 2001 £000	31st December 2001 £000
Fixed assets					
Tangible assets	13	7,080		6,216	
Investments – interests in own shares	14	10,453		20,853	
Investments	14	72,539		104,164	
Total fixed assets			90,072		131,233
Current assets					
Debtors	16	11,520		9,082	
Cash at bank		127		4,335	
		11,647		13,417	
Creditors					
Amounts falling due within one year	19	(12,975)		(16,617)	
Net current (liabilities)			(1,328)		(3,200)
Total assets less current liabilities			88,744		128,033
Creditors					
Amounts falling due after more than one year	20		(3,737)		(5,413)
Net assets			85,007		122,620
Capital and reserves					
Called up share capital	23		2,257		2,254
Share premium account	24		43,879		43,965
Capital redemption reserve	24		6		6
Merger reserve	24		37,635		68,268
Shares to be issued	23		21		1,161
Profit and loss account	24		1,209		6,966
Equity shareholders' funds	25		85,007		122,620

These financial statements on pages 48 to 83 were approved by the board of directors and were signed on its behalf by:

H D Evans – Chairman

R J Beveridge – Finance Director

3rd March 2003

[consolidated cash flow statement]

For the year ended 31st December 2002

	Notes	31st December 2002 £000	31st December 2001 £000
Net cash inflow from operating activities	29	11,549	13,453
Return on investments and servicing of finance			
Interest paid		(929)	(519)
Interest received		900	972
Non–equity dividends paid to shareholders		–	(1,394)
Interest element of finance lease rentals		(212)	(278)
Net cash (outflow) from returns on investments and servicing of finance		(241)	(1,219)
Taxation (paid)		(3,242)	(1,909)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(5,844)	(5,054)
Purchase of own shares		–	(17,356)
Proceeds from exercise of share options		1,348	161
Sale of tangible fixed assets		102	39
Net cash (outflow) for capital expenditure and financial investment		(4,394)	(22,210)
Acquisitions and disposals			
Purchase of subsidiary undertakings		(4,866)	(26,286)
Investment in joint ventures		(72)	–
Sale of associate undertakings		334	–
Cash acquired with subsidiary undertakings	32	3,486	16,054
Net cash (outflow) for acquisitions and disposals		(1,118)	(10,232)
Equity dividends		(1,244)	(474)
Net cash inflow/(outflow) before management of liquid resources and financing		1,310	(22,591)
Management of liquid resources			
Increase in short–term deposits with banks	17	(529)	–
Net cash outflow from management of liquid resources		(529)	–
Financing			
Capital element of finance lease rentals and increase/(decrease) in advances from finance houses		400	128
Issue of ordinary share capital		227	42,995
Repurchase of preference shares		–	(3,000)
(Decrease) in borrowings		(158)	(6,249)
Repayment of loan and promissory note		(3,206)	–
Net cash (outflow)/inflow from financing		(2,737)	33,874
(Decrease)/increase in net cash in the year	30	(1,956)	11,283

1. Accounting policies

These financial statements are prepared under the historical cost convention. The principal accounting policies set out below have been applied consistently and in accordance with applicable accounting standards.

Basis of consolidation

The financial information comprises the consolidated accounts of Marlborough Stirling plc and all of its subsidiary undertakings and include the Group's share of the profits or losses and net assets of joint venture and associated undertakings. The financial statements have been consolidated using the acquisition method of accounting and prepared in accordance with UK GAAP. The results of subsidiaries acquired are included in the profit and loss account from the date that control passed.

Turnover

Turnover (excluding VAT) represents the value of sales from the Group's software implementation and consultancy activities, outsourcing services and distribution via the Exchange portal.

Revenue from software and consultancy services is principally derived from licence fees for the Group's software and fees for implementation and customisation work. Implementation and customisation work is essential to the functionality of the Group's software products. Accordingly, turnover from licence fees and related customisation fees is recognised on a percentage completion basis, over the work contemplated in the contract to which the licence fee relates, so as to achieve a constant margin under the contract.

Turnover from services is principally comprised of fees for implementation and customisation work and fees based on transaction volumes and is recognised as the related services are performed.

Any estimated potential losses arising on contracts are fully recognised as soon as they are foreseen. The amount by which recorded turnover is in excess of amounts invoiced is included in debtors as accrued income.

Amounts invoiced in excess of recorded turnover are included in creditors as payments on account.

Pre–contract costs

Pre–contract costs represent those external costs incurred on an ongoing basis as part of the process of obtaining new contracts. Such costs *are recognised as an asset from the point at which the Group is virtually certain of control over the rights of access of future economic* benefit from the award of a contract and on the basis that those costs are directly attributable to a contract and can be separately identified and measured reliably.

Pre–contract costs are capitalised and amortised through the profit and loss account over their estimated economic life to reflect the period over which the Group expects to derive economic benefits from those pre–contract costs. The estimated economic life is the period of the contract to which the pre–contract costs relate.

An impairment review is carried out in the year following recognition and at any other time if events or changes in circumstance indicate that the carrying value may not be fully recoverable.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation.

Depreciation is provided at rates calculated to write off the cost less the estimated residual value of each asset over its estimated useful life on a straight line basis, as follows:

Freehold buildings	40 years
Fixtures and fittings	5 years
Computer hardware	3 years
Computer software	3 years
Motor vehicles	4 years

Leasehold improvements are depreciated over the life of the lease.

No depreciation is charged on freehold land. Assets in the course of construction are not depreciated until commissioned.

Joint ventures

The Group's share of the profits or losses of joint ventures is included in the Group profit and loss account. The Group's balance sheet includes the investment in joint ventures as the Group's share of gross assets and liabilities. Goodwill arising on the purchase of an interest in a joint venture is accounted for in the same way as on the purchase of an interest in a subsidiary.

Leasing and hire purchase commitments

When the Group enters into a lease, which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is the shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and the rental charges are charged to the profit and loss account on a straight line basis over the life of the lease.

Deferred taxation

Provision is made for deferred taxation on all material timing differences. Deferred tax assets are recognised where their recovery is considered more likely than not. Deferred tax assets and liabilities have not been discounted.

Research and development

Research and development costs are expensed as incurred.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rate of exchange ruling at the balance sheet date. Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. All differences are taken to the profit and loss account.

The results of overseas subsidiary undertakings are translated at the average exchange rate for the year. The assets and liabilities of such undertakings are translated at year–end exchange rates. Differences on exchange arising on the retranslation of the opening net investment in subsidiary companies are taken to reserves and reported in the statement of total recognised gains and losses.

Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the consideration for acquired businesses over the fair value of the separable net assets acquired. Goodwill is capitalised and amortised through the profit and loss account over its estimated economic life not exceeding 20 years, to reflect the period over which the Group expects to derive economic benefits from that goodwill. An impairment review is carried out in the year following acquisition and at any other time if events or changes in circumstance indicate that the carrying value may not be fully recoverable. Goodwill arising on acquisitions before 1st January 1998 has been deducted from reserves and is charged or credited to the profit and loss account on disposal or closure of the business to which it relates.

Share options

The cost to the company of granting shares or rights to shares, including options, to employees is charged to the profit and loss account over the performance period in which the benefit vests to the employees. The cost is calculated as the difference between the fair value of the shares at the date of grant and the costs to the employee of the rights. Where the commencement of vesting of options is conditional upon an event, such as flotation, the charge is recognised on the date at which that event occurs and over the remaining vesting period of the options.

Employers' National Insurance (NI) contributions on shares options granted

Amounts payable by the company in respect of employers' NI contributions on share options granted under Inland Revenue unapproved share option schemes are charged to the profit and loss account over the performance period in which the benefit vests to the employee. This provision is adjusted at each subsequent balance sheet date between vesting and the exercise of the options to reflect changes in the fair value of the company's shares. Each adjustment is taken to the profit and loss account. Where the commencement of vesting of options is conditional upon an event, such as flotation, the charge is recognised on the date at which that event occurs and over the remaining vesting period of the options. (See note 34).

Employee share ownership plans

Where the company or a subsidiary exerts control over the issue of shares held by employee share ownership plans, the assets and liabilities of the plans are consolidated as if they were assets and liabilities of the company or the relevant subsidiary. Interests in own shares are stated at the lower of cost and net realisable value on a marked to market basis. Any financing and administrative costs are charged as they accrue.

Provisions

Provisions for liabilities are made on the basis that the business has a constructive or legal obligation arising from a past event.

Pension costs

The Group makes contributions to defined contribution pension schemes on behalf of its employees. The amount charged against profits represents the contributions payable in respect of the accounting period.

Bank borrowings

Bank borrowings are stated at the amount repayable net of costs of raising finance. Finance costs are charged to the profit and loss account at a constant rate over the life of the debt.

Financial instruments

The Group does not use derivatives to manage its exposure to interest and foreign exchange rates.

Financial instruments are recognised in the balance sheet at historic cost. Income and expenses arising from financial instruments are recognised as and when they are earned or fall due.

2. Segmental information

In the following analyses, those by business are based on the Group's management structure.

Geographical analysis

	By origin			
	Turnover £000	(Loss)/profit before taxation £000	Net assets £000	Turnover by destination £000
Year ended/at 31st December 2002				
United Kingdom – group	109,261	(23,271)	57,294	108,568
– joint venture	4,226	(157)	1,463	4,226
Rest of the world – group	7,394	(1,585)	5,144	8,087
– joint venture	127	(195)	–	127
	121,008	(25,208)	63,901	121,008
Other	–	(9,270)	17,863	–
	121,008	(34,478)	81,764	121,008

Current year turnover attributable to Exchange FS Group plc (including joint ventures), acquired in November 2001, was £26,214,000 (2001: £4,754,000).

	Turnover £000	(Loss)/profit before taxation £000	Net assets £000	Turnover by destination £000
Year ended / at 31st December 2001				
United Kingdom – group	64,656	9,895	86,809	60,515
– joint venture	3,407	(189)	1,873	3,407
Rest of the world – group	5,091	(612)	168	9,232
– joint venture	215	(60)	564	215
	73,369	9,034	89,414	73,369
Other	–	243	30,773	–
	73,369	9,277	120,187	73,369

Other unallocated net assets comprise assets and liabilities which cannot be attributed to a geographical or business segment and principally comprise cash and bank borrowings, interest in own shares, dividends payable and certain other corporate assets and liabilities.

Business analysis

		Turnover				
		Continuing	Acquisitions in the year	Total	(Loss)/profit before taxation	Net assets
		£000	£000	£000	£000	£000
Year ended/at 31st December 2002						
Software and consultancy – group		57,837	–	57,837	(27,833)	14,473
Services						
Outsourcing	**– group**	8,371	34,776	43,147	3,735	3,104
	– joint venture	4,226	–	4,226	(157)	1,463
Portal services	**– group**	15,671	–	15,671	(758)	44,861
	– joint venture	127	–	127	(195)	–
		86,232	34,776	121,008	(25,208)	63,901
Other		–	–	–	(9,270)	17,863
		86,232	34,776	121,008	(34,478)	81,764
Year ended/at 31st December 2001						
Software and consultancy – group		56,648	–	56,648	9,240	33,402
Services						
Outsourcing	– group	10,384	–	10,384	1,482	2,435
	– joint venture	3,407	–	3,407	(189)	1,873
Portal services	– group	2,715	–	2,715	(1,439)	51,140
	– joint venture	215	–	215	(60)	564
		73,369	–	73,369	9,034	89,414
Other		–	–	–	243	30,773
		73,369	–	73,369	9,277	120,187

Software and consultancy

The Group's software and consultancy activities comprise the sale and delivery of software licences together with related specialist services such as implementation, customisation, consultancy and support and maintenance.

Software and consultancy revenues include licence fees of £5,712,000 (2001: £7,747,000).

Outsourcing services

The Group's outsourcing activities relate to the delivery of a range of services on behalf of financial services companies to transform their administration operations. These services include business process re–engineering, change management, new business processing, customer service, past business reviews, finance and actuarial.

Portal services

The Group's portal services activities are involved in the maintenance of connectivity between product providers and intermediaries in the financial services industry to enable key processes in the sales and distribution of financial services products together with a range of related services.

In addition to the above analysis of the Group's results, turnover can be analysed according to the market served as follows:

	Continuing £000	Acquisitions in the year £000	Total £000
Year ended 31st December 2002			
Life, pensions and investment			
Software and consultancy – group	32,316	–	32,316
Outsourcing – group	8,371	34,776	43,147
	40,687	34,776	75,463
Mortgage			
Software and consultancy – group	9,971	–	9,971
Outsourcing – joint venture	4,226	–	4,226
	14,197	–	14,197
Distribution			
Software and consultancy – group	15,550	–	15,550
Portal services – group	15,671	–	15,671
– joint venture	127	–	127
	31,348	–	31,348
	86,232	34,776	121,008
Year ended 31st December 2001			
Life, pensions and investment			
Software and consultancy – group	44,916	–	44,916
Outsourcing – group	10,353	–	10,353
	55,269	–	55,269
Mortgage			
Software and consultancy – group	8,890	–	8,890
Outsourcing – group	31	–	31
– joint venture	3,407	–	3,407
	12,328	–	12,328
Distribution			
Software and consultancy – group	2,842	–	2,842
Portal services – group	2,715	–	2,715
– joint venture	215	–	215
	5,772	–	5,772
	73,369	–	73,369

3. Cost of sales, gross profit and operating profit

	2002			2001
	Continuing £000	Acquisitions in the year £000	Total £000	Total £000
Year ended 31st December 2002				
Total Group turnover (excluding joint ventures)	81,879	34,776	116,655	69,747
Cost of sales	(40,878)	(16,984)	(57,862)	(29,913)
Gross profit	41,001	17,792	58,793	39,834
Operating expenses				
Goodwill amortisation	9,472	24	9, 496	2,851
Intangible amortisation	–	72	72	–
Goodwill impairment charge	23,622	–	23,622	–
Depreciation	4,105	399	4,504	3,074
Research and development costs	5,133	–	5,133	4,938
Reorganisation costs (a)	3,268	820	4,088	1,171
Employee share option (credit)/charge (b)	(778)	–	(778)	1,474
Other administrative costs	22,693	14,819	37,512	17,043
Total administrative costs	67,515	16,134	83,649	30,551
Group operating (loss)/profit	(26,514)	1,658	(24,856)	9,283
Share of operating loss of joint ventures and associates	(352)	–	(352)	(249)
Total operating profit/(loss) including share of joint ventures and associates	(26,866)	1,658	(25,208)	9,034
Total operating profit before charges for goodwill amortisation and impairment, employee share options and reorganisation costs (including joint ventures and associates)	8,968	2,502	11,470	14,780
Goodwill amortisation	(9,722)	(24)	(9,746)	(3,101)
Goodwill *impairment charge*	(23,622)	–	(23,622)	–
Reorganisation costs (a)	(3,268)	(820)	(4,088)	(1,171)
Employee share option credit/(charge) (b)	778	–	778	(1,474)
Total operating profit including share of joint ventures and associates	(26,866)	1,658	(25,208)	9,034

(a) In the early part of 2002, the Group completed the integration programme relating to the acquisition of Exchange FS Group plc which resulted in reorganisation costs being incurred. Following the acquisition of Marlborough Stirling Life and Pensions Services Limited (MSLPS) on 1st March 2002, the Group incurred reorganisation costs in connection with bringing MSLPS under the Group's management which are disclosed separately above. In addition, during the second half of 2002 the Group initiated a cost reduction programme across the Group. As a result of these activities, the Group incurred during the year a total of £4.1 million of reorganisation costs which comprise principally redundancy and other personnel costs together with charges in respect of vacant property.

(b) The employee share option credit reflects an adjustment in respect of a provision for National Insurance payable on the grant of employee share options.

4. (Loss)/profit on ordinary activities before taxation

		31st December 2002	31st December 2001
		£000	£000
(Loss)/profit on ordinary activities before taxation is stated after charging/(crediting)			
Auditors' remuneration (see below):			
	– audit fees	398	251
	– audit related services	23	–
	– other tax and advisory services	78	77
Depreciation of tangible fixed assets:			
	– owned assets	3,506	2,084
	– leased assets	998	990
Amortisation of goodwill	– group	9,496	2,851
	– joint venture	250	250
Amortisation of intangible assets		72	–
(Profit)/loss on sale of fixed assets		(32)	9
Operating lease rentals	– land and buildings	1,618	1,271
	– other	329	–
Research and development costs		5,133	4,938

Auditors' remuneration in respect of the company was £22,000 (2001: £20,000).

In addition to the costs charged to the profit and loss account in the period in respect of services provided by the auditors disclosed above, the Group has paid further amounts to its auditors of £71,000.

5. Staff numbers and costs

Directors' emoluments and interests

Detailed disclosures of directors' individual emoluments and share options are given in the remuneration committee report on pages 37 to 38 and 40 to 41. Directors' interests are given in the directors' report on page 43. These disclosures form part of the financial statements.

Staff numbers

The average number of persons employed by the Group (including directors) during the period analysed by business categories, was as follows:

	31st December 2002	31st December 2001
Life, pensions and investments	1,024	519
Mortgage	140	179
Distribution	334	83
Other	490	271
	1,988	1,052
Software and consultancy	715	474
Services	783	307
Other	490	271
	1,988	1,052

Staff costs

The aggregate payroll costs (including directors' emoluments) of these persons were as follows:

	31st December 2002	31st December 2001
	£000	£000
Wages and salaries	57,774	34,729
Social security costs	6,141	3,132
Pension costs (see note 27)	3,319	1,305
	67,234	39,166

6. Interest receivable

	31st December 2002	31st December 2001
	£000	£000
Interest receivable : continuing operations – group	900	969
– joint ventures	49	46
Total interest receivable	949	1,015

7. Interest payable

	31st December 2002	31st December 2001
	£000	£000
Group continuing operations		
Interest payable on bank loans and overdrafts	809	494
Finance charges in respect of finance leases and hire purchase contracts	358	278
Total interest and similar charges payable	1,167	772

8. Tax charge on profit on ordinary activities

	31st December 2002	31st December 2001
	£000	£000
(a) Analysis of charge in the period		
Current tax		
UK corporation tax at 30% (2001: 30%) on profits for the year	(197)	4,017
Share of joint ventures	–	11
Adjustment in respect of previous periods	(191)	(16)
	(388)	4,012
Overseas tax	*246*	*119*
Total current tax (credit)/charge	(142)	4,131
Deferred tax origination and reversal of timing differences – current year charge/(credit)	2,813	(189)
– prior year charge	276	57
	3,089	(132)
Share of joint venture	69	–
Tax charge on (loss)/profit on ordinary activities	3,016	3,999

(b) Factors affecting the current tax charge for the period

The tax assessed in each year varies from the standard rate of corporation tax in the UK in the relevant years.

The differences are explained below:

	31st December 2002	31st December 2001
(Loss)/profit on ordinary activities before taxation	(34,478)	9,277
(Loss)/profit on ordinary activities before taxation multiplied by standard rate of UK corporation tax of 30% (2001: 30%)	(10,343)	2,783
Goodwill amortisation	2,923	930
Goodwill impairment charge	7,087	–
Amounts written off investments	2,715	–
Overseas losses not recognised	321	369
Fair value adjustments	(1,141)	–
Rate differences on overseas entities	(115)	(140)
Losses brought forward	(999)	–
Adjustments to tax in previous periods	(191)	(16)
Depreciation charges in excess of capital allowances and other timing differences	(631)	189
Permanent differences and other	232	16
Current tax (credit)/charge for period	(142)	4,131

9. Dividends

	31st December 2002	31st December 2001
	£000	£000
Equity dividends		
Ordinary shares of 1p each – interim 0.00 pence per share paid (2001: 0.33 pence paid)	–	474
Ordinary shares of 1p each – final 0.00 pence per share proposed (2001: 0.67 pence paid)	–	1,244
	–	1,718
Non-equity dividends		
$6^1/_3$% preference shares of 10p each	–	52
Convertible redeemable preference shares of 0.5p each	–	123
B convertible redeemable preference shares of 0.1p each	–	169
	–	344
Non-equity appropriations		
Convertible redeemable preference shares of 0.5p each	–	116
B convertible redeemable preference shares of 0.1p each	–	36
	–	152

The three employee share ownership trusts (note 14) have waived their right to dividends.

10. Earnings per share

Basic earnings per share (EPS) is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding those held by the Employee Share Ownership Trusts which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. This includes share options in issue where the exercise price is less than the average market price together with other convertible and contingently issuable shares.

	Year ended 31st December 2002	Year ended 31st December 2001
	£000	£000
Earnings		
(Loss)/profit attributable to ordinary shareholders	(37,494)	4,782
Goodwill amortisation	9,746	3,101
Employee share option (credit)/charge	(563)	1,086
Reorganisation costs	2,862	820
Goodwill impairment charge	23,622	–
Amounts written off investments	9,052	–
Profit before goodwill amortisation and impairment, employee share option charges, reorganisation costs and amounts written off investments	7,225	9,789
Weighted average number of shares		
Basic	187,707,473	134,007,265
Dilution	21,257,102	30,860,668
Diluted number of shares	208,964,575	164,867,933
(Loss)/earnings per share (pence)		
Basic	(20.0)	3.6
Adjusted basic (i)	3.8	7.3
Diluted (ii)	(20.0)	2.9
Adjusted diluted (i)	3.5	5.9

(i) Adjusted earnings per share and adjusted diluted earnings per share are calculated before charges for goodwill amortisation and impairment, employee share options, reorganisation costs and amounts written off investments. This supplementary EPS information has been provided as the directors consider it gives a clearer indication of the underlying trading performance of the Group.

(ii) In the year ended 31st December 2002, the Group made a loss, consequently the effect of share options is anti–dilutive. Therefore there is no difference between the weighted average number of shares for the basic and diluted loss per share. The dilutive effect on the basic earnings per share is shown.

11. Profits of the holding company

The board of directors has taken advantage of s.230 of the Companies Act 1985 and has not presented a separate profit and loss account for the company.

	31st December 2002	31st December 2001
	£000	£000
(Losses)/profits dealt with by the holding company	(36,390)	6,249
Retained (loss)/profit for the year for the holding company	(36,390)	4,035

12. Intangible fixed assets

	Goodwill	Pre–contract costs	Total
	£000	£000	£000
Group			
Cost			
At 1st January 2002	87,402	–	87,402
Additions	200	609	809
Exchange differences	(181)	–	(181)
Fair value adjustment in respect of 2001 acquisitions	(330)	–	(330)
At 31st December 2002	**87,091**	**609**	**87,700**
Amortisation			
At 1st January 2002	3,308	–	3,308
Charge for year	9,496	72	9,568
Impairment charge	23,622	–	23,622
Exchange differences	(81)	–	(81)
At 31st December 2002	**36,345**	**72**	**36,417**
Net book value at 31st December 2002	**50,746**	**537**	**51,283**
Net book value at 31st December 2001	84,094	–	84,094

During 2000, the company acquired 100% of the share capital of Life Strategies Limited, WebTech Software Limited and Plexus Systems Design Limited. Goodwill arising is being amortised on a straight–line basis over five years.

On 1st November 2001, the company acquired 100% of the share capital of Exchange FS Group plc. Goodwill arising is being amortised on a straight–line basis over ten years.

On 1st March 2002, the company acquired 100% of the share capital of Marlborough Stirling Life and Pensions Services Limited (formerly Sun Life of Canada (UK) Group Services Limited) and simultaneously commenced an outsourcing services contract with Sun Life Financial of Canada (UK). Goodwill and pre–contract costs relating to this acquisition/contract are being amortised on a straight–line basis over seven years, this being the duration of the contract.

For each acquisition the directors have estimated the economic life of the goodwill having regard principally to the market position, customer base and products of the acquired entities.

In accordance with FRS 11 the Group has undertaken post acquisition impairment reviews of the acquired Exchange businesses considering the portal and software income generating units separately. This review has resulted in an impairment charge of £23.6 million in respect of all the goodwill relating to the software business formerly known as Crisp Computing Limited. There was no impairment on the portal business.

The impairment reviews were undertaken using a post tax discount rate of 13.75% per annum and a long term annual growth rate of 2.25% after five years.

13. Tangible fixed assets

	Freehold land and buildings £000	Leasehold buildings £000	Motor vehicles £000	Fixtures and fittings £000	Computer equipment £000	Total £000
Group						
Cost						
At 1st January 2002	4,960	1,513	1,299	2,067	11,895	21,734
Additions	2	1,014	167	302	5,228	6,713
Acquisitions	–	–	24	272	1,175	1,471
Disposals	–	–	(349)	–	(18)	(367)
Exchange adjustments	1	–	9	1	5	16
At 31st December 2002	**4,963**	**2,527**	**1,150**	**2,642**	**18,285**	**29,567**
Depreciation						
At 1st January 2002	251	–	698	717	7,057	8,723
Charge for period	94	61	291	503	3,555	4,504
Fair value adjustment	–	–	–	62	–	62
Disposals	–	–	(294)	–	(5)	(299)
Exchange adjustments	1	–	5	(6)	11	11
At 31st December 2002	**346**	**61**	**700**	**1,276**	**10,618**	**13,001**
Net book value at 31st December 2002	**4,617**	**2,466**	**450**	**1,366**	**7,667**	**16,566**
Net book value at 31st December 2001	4,709	1,513	601	1,350	4,838	13,011

Included in the figures above are assets held under finance leases, principally comprising fixtures and fittings and computer equipment, as follows:

	31st December 2002 £000	31st December 2001 £000
Cost	**6,404**	4,671
Aggregate depreciation	**(3,486)**	(2,488)
Net book value	**2,918**	2,183

Company	Freehold land and buildings £000	Leasehold buildings £000	Total £000
Cost			
At 1st January 2002	4,951	1,513	6,464
Additions	–	1,014	1,014
At 31st December 2002	**4,951**	**2,527**	**7,478**
Depreciation			
At 1st January 2002	248	–	248
Charge for period	89	61	150
At 31st December 2002	**337**	**61**	**398**
Net book value at 31st December 2002	**4,614**	**2,466**	**7,080**
Net book value at 31st December 2001	4,703	1,513	6,216

Group and company

Leasehold buildings at 31st December 2002 include £nil (2001: £1,513,000) of assets under the course of construction which, under the Group's policy, are not depreciated until commissioned. The company has no assets held under finance leases. A 25 year term loan is secured on Allen Jones House, the freehold property.

14. Investments - interests in own shares and investments

	Total
Group	£000
At 1st January 2002	20,877
Amounts written off investments	(9,052)
Shares transferred on exercise of employee options	(1,348)
At 31st December 2002	**10,477**

The value of the interest in own shares held in employee related share trusts has been assessed and marked to market at the balance sheet date. Based on the share price of £0.355 at 31st December 2002 and the 36,827,246 shares held by these trusts at that date, an amount of £9,052,000 has been provided against the carrying value of the interest in own shares. Based on the latest available share price of £0.28 on 3rd March 2003, a further provision of £1,646,000 would be required.

Employee Share Ownership Trust 1 (ESOT 1) (Group and company)

ESOT 1 was established by a trust deed dated 11th January 2001 and its appointed trustee is Abacus Corporate Trustees Limited. At 31st December 2002, ESOT 1 held 3,931,630 ordinary shares (2001: 3,931,630 ordinary shares). The market value of the shares at 31st December 2002, based upon their value of £0.355 per share (2001: £2.05), was £1,396,000 (2001: £8,060,000). These shares will be used to meet obligations under the company's share option schemes. The costs of funding and administering ESOT 1 are charged to the profit and loss account of the company in the period to which they relate.

Employee Share Ownership Trust 2 (ESOT 2) (Group and company)

ESOT 2 was established by a trust deed dated 18th March 2001 and its appointed trustee is Abacus Corporate Trustees Limited. At 31st December 2002, ESOT 2 held 32,878,076 ordinary shares (2001: 35,815,694 ordinary shares). The market value of the shares at 31st December 2002, based upon their value of £0.355 per share (2001: £2.05), was £11,672,000 (2001: £73,422,000). These shares will be used to meet obligations under the company's share option schemes. The costs of funding and administering ESOT 2 are charged to the profit and loss account of the company in the period to which they relate.

The Colm Fagan Discretionary Trust (Life Strategies Limited) (Group)

Interests in own shares also includes the cost of 17,540 ordinary shares held by a trust at 31st December 2002 (2001: 17,540 ordinary shares) whose beneficiaries are the employees of Life Strategies Limited. The costs of funding and administering the trust are charged to the profit and loss account in the period to which they relate. The market value of the shares at 31st December 2002, based upon their value of £0.355 per share (2001: £2.05) was £6,000 (2001: £36,000).

Company

	Interest in joint venture	Shares in group undertakings	Interest in own shares	Total
	£000	£000	£000	£000
At 1st January 2002	2,000	102,164	20,853	125,017
Impairment charge	–	(30,633)	–	(30,633)
Adjustment to market value	–	–	(9,052)	(9,052)
Adjustment on exercise of share options	–	(25)	–	(25)
Adjustment to shares to be issued	–	(967)	–	(967)
Shares transferred on exercise of employee options	–	–	(1,348)	(1,348)
At 31st December 2002	**2,000**	**70,539**	**10,453**	**82,992**

The principal subsidiaries of the company at 31st December 2002 were as follows:

Subsidiary	Country of incorporation	Principal activity	Percentage of ordinary shares owned
The Marlborough Stirling Group plc	England and Wales	Software services	100%
Marlborough Stirling Administration Limited	England and Wales	Life and pensions outsourcing services	100%
Marlborough Stirling Life and Pensions Services Limited * (formerly Sun Life of Canada (UK) Group Services Limited)	England and Wales	Life and pensions outsourcing services	100%
Life Strategies Limited	Ireland	Actuarial consultancy	100%
Marlborough Stirling WebTech Limited	Isle of Man	Software services	100%
Marlborough Stirling (South Africa) Pty Limited	South Africa	Software services	100%
Marlborough Stirling Canada Limited	Canada	Software services	100%
Exchange FS Limited *	England and Wales	Portal services	100%
Crisp Computing Limited *	England and Wales	Software services	100%
Marlborough Stirling España * (formerly PuntoSeguro S.L.)	Spain	Software services	100%
Marlborough Stirling Italia s.p.a. *	Italy	Software services	100%
Life Strategies Italia s.r.l. *	Italy	Actuarial consultancy	100%

The principal joint ventures of the company at 31st December 2002 were as follows:

Joint venture	Country of incorporation	Principal activity	Percentage of ordinary shares owned
Marlborough Stirling Mortgage Services Limited	England and Wales	Mortgage outsourcing services	50.1%

The company holds 100% of preference shares in Marlborough Stirling Mortgage Services Limited (MSMS). MSMS is managed under a joint venture agreement.

A full list of the subsidiaries of the company is available from the company secretary on request.

The companies shown above (*) are held indirectly. All other interests shown above are held directly by the company.

15. Joint ventures and associated undertakings

Interest in joint ventures	2002
	£000
Group	
Cost	
At 1st January 2002	2,687
Disposals	(369)
Adjustment for unrealised profit on sales from group companies	(169)
Share of retained (loss)	(186)
At 31st December 2002 – net assets	963
– goodwill	1,000
Cost at 31st December 2002	1,963
Goodwill amortisation	
At 1st January 2002	250
Charge for period	250
At 31st December 2002	500
Net book amount at 31st December 2002	
Net assets	963
Goodwill	500
	1,463

Disposals

eXtrahyp.de

On 31st May 2002, the Group disposed of its 50% interest in eXtrahyp.de for nil consideration. The Group's share of the turnover in eXtrahyp.de for the period prior to disposal was £128,000. During 2002 the Group contributed a further £65,000 to the joint venture prior to disposal.

Loss on disposal of eXtrahyp.de

	£000
Proceeds	-
Net asset disposal	441
Goodwill	–
Loss on disposal	441

Financial Express Prestel Limited

On 25th June 2002, the Group disposed of its 25.5% shareholding in Financial Express Prestel Limited for total consideration of £1.0 million (£666,000 deferred consideration).

Profit on disposal of Financial Express Prestel Limited

	£000
Share of net asset at disposal	77
Profit on disposal	923
Consideration	1,000
Consideration comprises	£000
Cash	334
Deferred consideration	666
	1,000

Both eXtrahyp.de and Financial Express Prestel Limited were acquired as part of the Exchange FS Group plc acquisition in November 2001. To this extent any gains or losses recognised on the disposal of these entities have been adjusted through fair value and not taken to the Group's profit and loss account for 2002.

16. Debtors

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
Trade debtors	18,958	–	17,897	–
Amounts owed by group undertakings	–	11,495	–	8,670
Corporation tax recoverable	555	–	153	–
Deferred taxation	2,798	–	732	–
Accrued income	6,270	–	3,991	–
Prepayments and other debtors	4,250	25	2,428	412
	32,831	11,520	25,201	9,082

Included in deferred taxation above is an estimated asset of £1,048,000 recoverable in excess of one year.

17. Current asset investments

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
Short–term deposits with banks	529	–	–	–
	529	–	–	–

18. Deferred tax

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
At 1st January	732	(276)	167	(120)
Deferred tax on acquisition	5,143	–	433	–
Exchange movement	12	–	–	–
(Charged)/credited in the period	(3,089)	(183)	132	(156)
	2,798	(459)	732	(276)
The deferred tax asset at 31st December comprises:				
Accelerated capital allowances	2,753	(459)	688	(276)
Other	45	–	44	–
	2,798	(459)	732	(276)
Unprovided deferred tax assets, comprising amounts in respect of taxation losses	404	–	494	–

There are certain losses carried forward which can be utilised solely in respect of profits in the same entities for which no deferred tax asset has been recognised as their utilisation is not considered more likely than not.

19. Creditors: amounts falling due within one year

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
Bank and other borrowings (note 21)	7,515	11,441	7,745	9,305
Trade creditors	3,268	22	2,365	11
Amounts owed to group undertakings	–	245	–	3,802
Corporation tax	309	48	2,400	–
Overseas tax	328	–	141	–
Other tax and social security	3,684	–	3,646	9
Other creditors	636	46	–	–
Deferred taxation	–	459	–	276
Accruals	9,052	714	10,491	1,970
Payments on account and deferred income	12,865	–	8,430	–
Deferred consideration on acquisitions	672	–	158	–
Dividend proposed	–	–	1,244	1,244
	38,329	12,975	36,620	16,617

20. Creditors: amounts falling due after more than one year

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
Bank and other borrowings (*note 21*)	5,389	3,167	7,766	5,413
Deferred consideration on acquisitions	1,048	–	–	–
Other creditors	570	570	172	–
	7,007	3,737	7,938	5,413

21. Bank and other borrowings

	Note	31st December 2002		31st December 2001	
		Group	Company	Group	Company
		£000	£000	£000	£000
Bank overdraft					
Due within one year		5,048	11,247	4,860	9,147
		5,048	11,247	4,860	9,147
Secured term loan	(i)				
Due within one year		158	158	158	158
Due after more than one year		3,167	3,167	3,325	3,325
		3,325	3,325	3,483	3,483
Other loans	(ii)				
Due within one year		89	–	90	–
Due after more than one year		23	–	124	–
		112	–	214	–
Loan notes					
Due within one year	(iii)	36	36	1,080	–
Due after more than one year	(iv)	–	–	2,088	2,088
		36	36	3,168	2,088
Amounts advanced by finance houses for the purchase of fixed assets	(v)				
Due within one year		739	–	669	–
Due after more than one year		578	–	858	–
		1,317	–	1,527	–
Finance lease obligations	(v)				
Due within one year		1,445	–	888	–
Due after more than one year		1,621	–	1,371	–
		3,066	–	2,259	–
Total bank and other borrowings					
Due within one year		7,515	11,441	7,745	9,305
Due after more than one year		5,389	3,167	7,766	5,413
		12,904	14,608	15,511	14,718

(i) The secured term loan bears interest at 1.625% above LIBOR and is secured by a first fixed legal charge over Allen Jones House and a fixed and floating charge over all assets of the Group. The secured term loan is repayable quarterly over a period of 25 years from the date that the facility was granted.

(ii) Other loans comprise non–interest bearing promissory notes. Repayments are made monthly over 40 months.

(iii) The loan notes were issued in lieu of all or part of the cash consideration under the offer for Moneyworld (UK) Limited by Exchange FS Group plc. The notes bear interest payable six months in arrears at the rate of 1% below Barclays Bank plc base rate.

(iv) The loan notes were issued in lieu of all or part of the cash consideration under the offer for Exchange FS Group plc to those shareholders who elected to receive them. The notes bear interest payable six months in arrears at the rate of 1% below six month LIBOR.

(v) Advances from finance houses and finance lease obligations are secured over the assets to which the agreements relate and have a term varying from 36 to 60 months. Equal monthly repayments are made over the term of each agreement.
A maturity analysis of bank and other borrowings is included in note 33.

22. Provisions for liabilities and charges

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
Employee related reorganisation provisions (i)	3,544	–	1,083	–
Property related reorganisation provisions (ii)	3,823	–	1,730	–
Other provisions (iii)	168	–	1,084	–
	7,535	–	3,897	–

The movement in provisions for the year ended 31st December 2002 is detailed below.

	Provision at 1st January 2002	Acquired	Established to fair value	Established/ released	Utilised	Provision at 31st December 2002
	£000	£000	£000	£000	£000	£000
Employee related reorganisation provisions (i)	1,083	6,473	–	3,012	(7,024)	3,544
Property related reorganisation provisions (ii)	1,730	–	2,533	847	(1,287)	3,823
Other provisions (iii)	1,084	–	(93)	(802)	(21)	168
	3,897	6,473	2,440	3,057	(8,332)	7,535

(i) Employee related reorganisation provisions relate principally to redundancy, which are expected to be utilised within the next 12 months.

(ii) Property provisions relate to onerous leasehold properties and are expected to be utilised within the next three years, representing the directors' estimate of the net unrecovered costs of the remaining period of the leases.

(iii) Other provisions will be utilised over the next six months.

23. Called up share capital

	31st December 2002	31st December 2001
	£000	£000
Group and company		
Authorised		
411,564,787 ordinary shares of 1p each (2001: 411,564,787)	4,116	4,116
Allotted, called up and fully paid		
225,716,013 ordinary shares of 1p each (2001: 225,472,528)	2,257	2,254
Shares to be issued	21	1,161

	£000
Shares to be issued at 1st January 2002	1,161
Lapsed/revaluation	(992)
Exercised	(148)
Shares to be issued at 31st December 2002	21

During the year 243,485 new shares were issued for a consideration of £227,000 as a result of employees exercising their options.

Shares to be issued

Under the terms of the agreement for the acquisition of Exchange FS Group plc, additional consideration will be payable. Options over 2,514,209 Marlborough Stirling shares were granted in substitution for options held over Exchange FS Group shares. Provision has been made in the financial statements on the basis that the additional consideration will be paid representing the difference between the exercise price and the market price at the year-end.

Share option schemes

The number of ordinary shares subject to options, the periods in which they were granted and the exercise prices are given below. Note that until 16th March 2001 options were held over ordinary shares of 0.5p each. In the table below options are assumed to have been over ordinary shares of 1p each throughout the periods set out in the table.

		Year of grant of option						
	Exercise price	1997	1998	1999	2000	2001	2002	Total
	(£)	number	number	number	number	number	number	number
At 1st January 2001		13,168,800	13,363,820	6,329,190	15,755,330	–	–	48,617,140
Granted	0.90 – 2.00	–	–	–	–	7,510,169	–	7,510,169
Exchange FS rollover	0.25 – 2.65	–	–	301,966	794,585	1,417,658	–	2,514,209
Exercised		(2,982,980)	(4,246,890)	(1,611,520)	(3,287,586)	(121,710)	–	(12,250,686)
Lapsed		(420,900)	(24,800)	(117,500)	(333,750)	(242,627)	–	(1,139,577)
At 1st January 2002		**9,764,920**	**9,092,130**	**4,902,136**	**12,928,579**	**8,563,490**	**–**	**45,251,255**
Granted	0.375–2.01	–	–	–	–	–	6,094,218	6,094,218
Exercised		(340,000)	(1,286,130)	(73,809)	(1,344,590)	(136,574)	–	(3,181,103)
Lapsed		(92,700)	(269,350)	(827,061)	(740,194)	(512,640)	(171,398)	(2,613,343)
At 31st December 2002		**9,332,220**	**7,536,650**	**4,001,266**	**10,843,795**	**7,914,276**	**5,922,820**	**45,551,027**

On 1st November 2001, as part of the acquisition of Exchange FS Group plc, 14,005,397 share options in that company were rolled over into 2,514,209 Marlborough Stirling options. This included the grant of 991,132 Marlborough Stirling options in respect of the Exchange FS Group plc Sharesave Scheme.

The above exercise prices exceed or are equal to the agreed market value of the company's shares at the date of each grant of options, with the exception of 229,950 share options granted at a discount.

As described in note 14, two employee share ownership trusts hold 36,809,706 ordinary shares to go towards meeting the share option obligations of 45,551,027 ordinary shares detailed above.

Vesting schedule for subsisting options

Earliest exercise date	Exercise price (£)	Approved	Unapproved	Sharesave	Total
At today's date	0.14–2.00	4,211,839	736,800	–	4,948,639
April 2003	0.14–2.00	8,169,678	12,422,912	–	20,592,590
June 2003	2.65	75,587	31,012	–	106,599
July 2003	1.35–2.00	–	228,000	–	228,000
December 2003	1.09	192,227	35,905	–	228,132
March 2004	1.25	17,953	–	–	17,953
April 2004	0.14–2.00	17,953	10,280,580	–	10,298,533
June 2004	0.71–0.90	189,320	83,803	769,159	1,042,282
July 2004	1.35–2.00	–	304,000	–	304,000
October 2004	1.41–1.66	95,362	163,092	–	258,454
November 2004	1.73	–	137,342	–	137,342
April 2005	0.14–2.01	83,825	624,796	–	708,621
October 2005	1.41–1.66	95,362	163,092	–	258,454
November 2005	1.73	–	137,342	–	137,342
December 2005	0.37	899,390	798,420	–	1,697,810
April 2006	1.92–2.01	83,825	172,895	–	256,720
June 2006	0.90	–	–	210,197	210,197
October 2006	1.41–1.66	98,252	168,034	–	266,286
November 2006	1.73	–	141,504	–	141,504
December 2006	0.37	899,390	798,420	–	1,697,810
April 2007	1.92–2.01	86,365	178,136	–	264,501
December 2007	0.37	926,644	822,614	–	1,749,258
Total		16,142,972	28,428,699	979,356	45,551,027

Options issued by the company have a variety of performance conditions related to their exercise.

All approved and unapproved options that were issued prior to the flotation of the company become exercisable, subject to the option holder either remaining an employee or, as a result of the passage of defined periods of time following the flotation of the company (under the unapproved pre–float scheme the Group has discretion to permit employees to retain options post–termination of employment in exceptional circumstances). At 31st December 2002, in aggregate 36,568,591 options were in issue to which these conditions apply and the majority of such options that were not already exercisable become exercisable on 9th April 2003 or 9th April 2004.

Options that were issued as a result of the roll–over of options previously held over shares in Exchange FS Group plc or previously under the Crisp Stakeholder Scheme are subject to one of two different performance criteria. In all cases option holders are entitled to exercise their options during the six months after leaving the Group's employment, provided that they do not leave or are not dismissed in circumstances which would entitle the Group to summarily terminate their contracts. At 31st December 2002 there were 1,853,335 Exchange/Crisp options outstanding. Included within this figure were 979,356 outstanding options under the Exchange Sharesave Scheme. Under this Scheme options lapse if employees (i) are dismissed as 'bad leavers' or (ii) leave voluntarily before the Bonus Date (ie the date upon which the savings contract matures). Employees who leave as 'good leavers' after the Bonus Date have six months from termination in which to exercise any options outstanding.

Options issued by the company since its flotation become exercisable as to 33% 36 months after grant, a further 33% 48 months after grant and 34% 60 months after grant, subject to option holders remaining employees of the Group and the company achieving a compound annual growth in earnings per share equal to or in excess of 5% above the 'All Items' series of the Retail Prices Index for the relevant period. Employees who are unable to continue working due to ill–health, injury or disability, who are made redundant, who retire or who are employed by a Group company which is sold are permitted to exercise options until the later of six months from ceasing to be an employee of the Group and 42 months after the date of grant. As with some pre–float options (see above) the Group has discretion to permit retention of post–float options beyond cessation of employment in other exceptional circumstances. At 31st December 2002 there were 7,129,101 options in issue to which these conditions apply and they become exercisable from October 2004 onwards.

The number of options in existence at 31st December 2002 at each exercise price is set out in the table below.

Exercise price (£)	Approved	Unapproved	Sharesave	Total
0.14	3,866,120	2,043,400	–	5,909,520
0.19	5,156,550	1,210,120	–	6,366,670
0.25	230,219	–	–	230,219
0.26	330,000	1,687,490	–	2,017,490
0.33	341,350	–	–	341,350
0.37	–	2,645,790	–	2,645,790
0.38	2,725,423	2,419,454	–	5,144,877
0.50	2,058,510	1,299,900	–	3,358,410
0.60	210,687	–	–	210,687
0.71	189,320	83,803	–	273,123
0.73	–	5,040,000	–	5,040,000
0.90	–	2,738,740	–	2,738,740
0.90	–	–	979,356	979,356
0.97	17,953	–	–	17,953
1.09	192,227	35,905	–	228,132
1.10	–	5,110,000	–	5,110,000
1.25	17,953	–	–	17,953
1.35	140,261	489,623	–	629,884
1.41	288,977	236,685	–	525,662
1.66	–	257,532	–	257,532
1.73	–	416,187	–	416,187
1.92	254,015	417,746	–	671,761
2.00	47,820	2,159,130	–	2,206,950
2.01	–	106,182	–	106,182
2.65	75,587	31,012	–	106,599
Total	16,142,972	28,428,699	979,356	45,551,027

24. Reserves

Group

	Capital redemption reserve £000	Share premium account £000	Merger reserve £000	Profit and loss account £000
At 1st January 2002	6	43,965	68,268	4,533
Premium on issue of ordinary shares	–	373	–	–
Costs of share issues	–	(459)	–	–
Impairment charge transferred to merger reserve	–	–	(23,622)	23,622
Share option adjustment	–	–	–	99
Retained loss for the year	–	–	–	(37,494)
Exchange adjustments	–	–	–	195
At 31st December 2002	**6**	**43,879**	**44,646**	**(9,045)**

Cumulative goodwill relating to acquisitions made prior to 1999, which has been eliminated against the merger reserve, amounts to £2,861,000 (2001: £2,861,000). The current year impairment charge of £23.6 million has been eliminated against the merger reserve established on the issue of shares in connection with the acquisition of the issued share capital of Exchange FS Group plc in November 2001.

Company	Capital redemption reserve £000	Share premium account £000	Merger reserve £000	Profit and loss account £000
At 1st January 2002	6	43,965	68,268	6,966
Premium on issue of ordinary shares	–	373	–	–
Costs of share issues	–	(459)	–	–
Impairment charge transferred to merger reserve	–	–	(30,633)	30,633
Retained loss for the year	–	–	–	(36,390)
At 31st December 2002	**6**	**43,879**	**37,635**	**1,209**

The current year impairment charge of £30.6 million has been eliminated against the merger reserve established on the issue of shares in connection with the acquisition of the issued share capital of Exchange FS Group plc in November 2001.

25. Shareholders' funds

	31st December 2002		31st December 2001	
	Group	Company	Group	Company
	£000	£000	£000	£000
(Loss)/profit for the financial year	(37,494)	(36,390)	5,278	6,249
Dividends and appropriations	–	–	(2,214)	(2,214)
	(37,494)	(36,390)	3,064	4,035
Exchange rate adjustments offset in reserves	195	–	(97)	–
Nominal value of ordinary shares issued	3	3	2,254	2,254
Cancellation of opening share capital	–	–	(360)	(360)
Premium on share issues to vendors of Life Strategies Ltd	–	–	745	745
Bonus issue	–	–	(3,213)	(3,213)
Repurchase of preference shares	–	–	(600)	(600)
Repurchase of deferred shares of 0.5p each	–	–	6	6
Costs of share issues	(459)	(459)	(5,479)	(5,479)
Adjustments to shares to be issued	(1,140)	(1,140)	334	334
Premium (net of expenses) on issue of ordinary shares	373	373	112,883	112,883
Share options adjustment	99	–	105	–
Preference share appropriation	–	–	152	152
Net addition to shareholders' funds	(38,423)	(37,613)	109,794	110,757
Opening shareholders' funds at 1st January	120,187	122,620	10,393	11,863
Closing shareholders' funds	81,764	85,007	120,187	122,620

26. Financial commitments

Operating lease commitments

At each year end, annual commitments under non–cancellable operating leases were as follows:

		Land and buildings	
		31st December 2002	31st December 2001
		£000	£000
Group			
Operating leases which expire	Within one year	625	210
	In the second to fifth years inclusive	2,372	1,018
	Over five years	1,639	3,082
		4,636	4,310
Company			
Operating leases which expire	Within one year	–	46
	In the second to fifth years inclusive	–	–
	Over five years	899	816
		899	862

27. Pension scheme

The assets of the pension schemes to which the Group contributes on behalf of a number of employees are held within independently administered funds. The schemes are all defined contribution and thus the Group's obligation is solely to make contributions based on a percentage of salaries. The total contributions charged in the period were £3,319,000 (2001: £1,305,000). Outstanding contributions of £40,000 are included in creditors at the period end (2001: £12,000).

28. Related party transactions

In accordance with the exemption afforded by FRS 8 'Related Party Transactions', there is no disclosure in these financial statements of transactions between entities that are part of the Group.

Gerald Whitmore

Gerald Whitmore has a 50% interest in Crisp Properties, a partnership which rents offices to the Group under an arm's length lease at market rates equating to £56,770 per annum.

Gerald Whitmore had a beneficial interest in £1,609,385 of loan notes issued by Marlborough Stirling plc pursuant to the terms of the acquisition of Exchange FS Group plc. These loan notes were fully repaid during 2002.

Jon Whitmore, the son of Gerald Whitmore, had a beneficial interest in £318,799 of loan notes issued by Marlborough Stirling plc pursuant to the terms of the acquisition of Exchange FS Group plc. These loan notes were fully repaid during 2002.

Marlborough Stirling Mortgage Services Limited (MSMS)

During the year the Group made sales to MSMS, a joint venture with Egg plc, of £2,391,930 (2001: £1,198,000). At 31st December 2002, £1,605,594 (2001: £627,000) was receivable in respect of these sales. During the year recharges of expenses were made by the Group to MSMS of £328,690. At 31st December 2002, £55,872 was receivable in respect of these recharges. During the year purchases of £7,296 (2001: £nil) were made from MSMS and no amounts were payable at 31st December 2002.

29. Reconciliation of operating profit to operating cash flow

	31st December 2002	31st December 2001
	£000	£000
Group operating (loss)/profit	(24,856)	9,283
Depreciation charge	4,504	3,074
Goodwill and intangible asset amortisation and impairment	33,190	2,851
(Profit)/loss on sale of tangible fixed assets	(32)	9
Adjustment for unrealised profit on sales to joint venture	169	–
Decrease/(increase) in debtors	2,641	(1,014)
Increase/(decrease) in creditors	1,033	(4,345)
(Decrease)/increase in provisions	(5,100)	3,595
Net cash inflow from operating activities	11,549	13,453

30. Reconciliation of net cash flow to movement in net funds

	31st December 2002	31st December 2001
	£000	£000
(Decrease)/increase in cash	(1,956)	11,283
Borrowings net of short-term deposits acquired with subsidiaries	–	(1,080)
New short term deposits	529	–
Movement in borrowings	2,964	4,049
Inception of new finance leases	(196)	(158)
Currency translation differences	259	(90)
Movement in net funds	1,600	14,004
Net funds/(debt) at 1st January	7,511	(6,493)
Net funds at 31st December	9,111	7,511

31. Analysis of movement in net cash

	At 1st January 2002	Cash flow	Acquisitions	Exchange differences	Finance leases	At 31st December 2002
	£000	£000	£000	£000	£000	£000
Cash at bank and in hand	23,022	(5,251)	3,486	229	–	21,486
Overdrafts	(4,860)	(191)	–	3	–	(5,048)
	18,162	(5,442)	3,486	232	–	16,438
Current asset investments	–	529	–	–	–	529
Bank and term loans	(3,483)	158	–	–	–	(3,325)
Other loans	(3,382)	3,206	–	28	–	(148)
Finance leases and advances from finance houses	(3,786)	(400)	–	(1)	(196)	(4,383)
	7,511	(1,949)	3,486	259	(196)	9,111

32. Acquisitions

a) Marlborough Stirling Life and Pensions Services Limited

On 1st March 2002 the Group acquired 100% of the share capital of Sun Life of Canada (UK) Group Services Limited for consideration of £4,184,000 including deferred consideration of £1,720,000. On 4th March 2002 the acquired company's name was changed to Marlborough Stirling Life and Pensions Services Limited (MSLPS).

Deferred consideration is payable to the extent that the Group is able to utilise capital allowances transferred with the entity acquired. The Group has estimated that the deferred tax asset recognised in the fair value balance sheet will be utilised over five years.

	Book value	Revaluations	Fair value
	£000	£000	£000
Tangible fixed assets	1,471	–	1,471
Debtors and prepayments	7,601	–	7,601
Deferred tax asset	4,600	(2,234)	2,366
Cash at bank and in hand	3,486	–	3,486
Creditors – amounts falling due within one year	(4,267)	(200)	(4,467)
Provisions	(6,473)	–	(6,473)
Net tangible assets acquired	**6,418**	**(2,434)**	**3,984**
Goodwill			200
			4,184

Total consideration is made up as follows:

	£000
Cash	2,464
Deferred consideration	1,720
	4,184

The above fair values are provisional pending the resolution of certain matters with the vendor and will be subject to finalisation during the year to 31st December 2003 and relates to a revaluation of a deferred tax asset, adjustments in respect of corporation tax liabilities and certain unrecorded liabilities. Included in the acquisition balance sheet are provisions of £6,473,000 relating to employee related reorganisation costs committed prior to acquisition.

The results of MSLPS for the year ended 31st December 2001, the two month period from 1st January 2002 pre-acquisition and the 10 month period post-acquisition are shown below:

	Year ended 31st December 2001 £000	Two months to 28th February 2002 £000	Ten months to 31st December 2002 £000
Turnover	–	–	34,776
Cost of sales	–	–	(17,022)
Gross profit	–		17,754
Net operating expenses	(32,634)	1,023	(16,042)
Operating (loss)/profit	(32,634)	1,023	1,712
Interest	306	97	23
(Loss)/profit before taxation	(32,328)	1,120	1,735
Taxation	3,249	4,420	(515)
(Loss)/profit attributable to shareholders	(29,079)	5,540	1,220

The effects of the acquisition of MSLPS on the consolidated cash flow movement during the ten month period post-acquisition were as follows:

	£000
Net cash flow from operating activities	4,218
Net cash inflow before financing	1,014

b) Exchange FS Group plc

On 1st November 2001 the company acquired 100% of the share capital of Exchange FS Group plc. The following table sets out the final fair values for each major class of assets and liabilities acquired included in these financial statements with the provisional fair value established at 31st December 2001. The acquisition has been accounted for by adopting acquisition accounting.

		Provisional fair value to the Group £000	Completion and hindsight period adjustments £000	Final fair value to the Group £000
Tangible fixed assets – group	(i)	1,180	(62)	**1,118**
Joint venture and associates	(ii)	651	537	**1,188**
Debtors and prepayments	(iii)	8,042	2,832	**10,874**
Cash at bank and in hand		16,054	–	**16,054**
Creditors – amounts falling due within one year	(iv)	(11,416)	(1,705)	**(13,121)**
Creditors – amounts falling due after more than one year		(3)	–	**(3)**
Provisions	(v)	(2,225)	(2,264)	**(4,489)**
Net tangible assets acquired		12,283	(662)	11,621
Goodwill		79,617	(330)	79,287
Consideration for acquisition (note 23)		91,900	(992)	90,908

The above hindsight period adjustments to the provisional fair values relate to:

(i) the write off of leasehold improvements

(ii) sale of associates and joint ventures following acquisition

(iii) the establishment of a deferred tax asset and reassessment of bad debt provisions

(iv) adjustments to deferred income in relation to implementation contracts in progress at the date of acquisition, including the establishment of provisions for losses on contracts resulting from pre-acquisition commitments, together with adjustments for certain unrecorded liabilities

(v) adjustments in respect of the establishment of provisions in respect of onerous leasehold space vacated prior to acquisition

33. Financial instruments

Overview of treasury activities

The principal financing and treasury exposures faced by the Group relate to working capital management, the financing of acquisitions and tangible fixed assets, the management of interest rate and currency positions and the investment of surplus cash.

The Group has generally followed a policy of using long-term borrowings including finance leases in specific circumstances for the purchase of fixed assets or property.

The Group has held no derivative, hedging, interest rate or foreign exchange management financial instruments in the period to 31st December 2002. This reflects the Group's continuing policy in these areas.

The Group followed a policy during the year of investing cash on overnight or seven day deposits to maximise interest receivable whilst providing flexibility to the Group.

The Group also has financial instruments in the form of short term debtors and creditors which arise in the normal course of business and are not discounted, securitised or pledged in any way. Short term debtors and creditors have been excluded from the disclosures which follow, other than the currency risk disclosure.

Financing and liquidity risk

The Group maintains unutilised banking facilities to mitigate any liquidity risk it may face.

The Group has undrawn committed floating rate borrowing facilities available at 31st December 2002 of £8,000,000 (2001: £8,000,000) which expire in April 2004 together with an £12,000,000 (2001: £8,300,000) undrawn working capital facility repayable on demand.

Interest rate risk

The Group's main exposure to interest rate risk is through bank loans, overdrafts and loan notes issued in connection with acquisitions. All of these attract interest at rates based on LIBOR.

Interest on cash and short-term deposit balances is receivable at rates based on LIBOR in respect of sterling denominated balances and local floating bank rates in overseas locations.

Currency risk

Transactional

The Group has not hedged any of its transactional exposures to date.

Translational

The Group's reporting currency is sterling, and it therefore faces currency exposures on the translation of profits earned in foreign currencies and on the retranslation of their net assets from year to year. It is the Group's policy not to hedge its profit translation exposures as these represent an accounting rather than a cash exposure.

Interest rate and currency risk profile of financial liabilities

The following tables analyse the currency and interest rate composition of the Group's financial liabilities, comprising borrowings and other contractual obligations to deliver cash or other financial assets to another entity:

Group financial liabilities – at 31st December 2002

	Floating rate financial liabilities	**Fixed rate financial liabilities**
	£000	**£000**
Currency		
Sterling	**8,268**	**4,347**
Canadian Dollar	**148**	**141**
At 31st December 2002	**8,416**	**4,488**

Group financial liabilities – at 31st December 2001

	Floating rate financial liabilities	Fixed rate financial liabilities
	£000	£000
Currency		
Sterling	11,407	3,751
Canadian Dollar	139	214
At 31st December 2001	11,546	3,965

The Group has not entered into any interest rate swaps or any other interest rate hedging instruments during the year ended 31st December 2002 (2001: nil).

Fixed rate financial liabilities mainly comprise finance leases.

Floating rate financial liabilities mainly comprise bank borrowings and loan notes relating to acquisitions which bear interest based on the relevant inter-bank lending rate.

Group financial liabilities – at 31st December 2002
Fixed rate financial liabilities

	Weighted average interest rate	**Weighted average period for which rate is fixed**
	%	**Years**
Currency		
Sterling	6.67	2.14
Canadian Dollars	7.11	1.33
At 31st December 2002	6.67	2.13

Group financial liabilities – at 31st December 2001
Fixed rate financial liabilities

	Weighted average interest rate	Weighted average period for which rate is fixed
	%	Years
Currency		
Sterling	7.60	3.50
Canadian Dollars	7.25	2.20
At 31st December 2001	7.59	3.50

The following table analyses the maturity profile of the Group's financial liabilities, which are repayable as follows:

Group financial liabilities – at 31st December 2002

	Loan notes and other loans	Bank overdraft/loans	Finance leases and advances from finance houses
	£000	£000	£000
Within one year	125	5,206	2,184
Between one and two years	23	158	1,637
Between two and five years	–	475	562
After five years	–	2,534	–
	148	8,373	4,383

Group financial liabilities – at 31st December 2001

	Loan notes and other loans	Bank overdraft/loans	Finance leases and advances from finance houses
	£000	£000	£000
Within one year	1,170	5,018	1,556
Between one and two years	124	158	2,153
Between two and five years	2,088	475	77
After five years	–	2,692	–
	3,382	8,343	3,786

Loan notes, issued in connection with the acquisition of Exchange FS Group plc (note 32b) are supported by a cash collaterised guarantee from Bank of Scotland, having a maximum guarantee of 110% of the principal amount of the loan notes issued.

Interest rate and currency risk profile of financial assets

The following tables analyse the currency and interest rate composition of the Group's financial assets:

Group financial assets – at 31st December 2002

	Short-term deposits	Cash at bank and in hand	Total
	£000	£000	£000
Currency			
Sterling	–	19,701	19,701
South African Rand	529	1,300	1,829
Euro	–	485	485
At 31st December 2002	529	*21,486*	*22,015*
Floating rate at 31st December 2002	529	21,486	22,015

Short-term deposits represent amounts held in an interest bearing deposit account with 32 days notice.

Group financial assets – at 31st December 2001

	Cash at bank and in hand
	£000
Currency	
Sterling	21,817
South African Rand	779
Irish Punt	358
Other	68
At 31st December 2001	23,022
Floating rate at 31st December 2001	23,022

Currency exposure of the Group's net assets by currency

The currency exposure (i.e. those transactional exposures that give rise to the net currency gains and losses recognised in the profit and loss account) of the Group's net monetary assets/(liabilities) is shown below. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating (or functional) currency of the operating unit involved.

	Net foreign currency monetary assets/(liabilities) (£000)				
	Sterling	**Rand**	**Can $**	**Euro**	**Other**
At 31st December 2002					
Functional currency of Group operations					
Sterling	–	177	1,879	629	–
South African Rand	(1,228)	–	–	–	–
Euro	(385)	–	–	–	–
Canadian Dollar	(246)	–	–	–	–

	Net foreign currency monetary assets/(liabilities) (£000)				
	Sterling	Rand	Can $	Irish £	Other
At 31st December 2001					
Functional currency of Group operations					
Sterling	–	174	1,774	–	–
South African Rand	(622)	–	–	–	–
Irish Punt	(212)	–	–	–	–

Fair values of financial instruments

Set out below is a comparison between book value and fair value of all the Group's financial assets and liabilities:

	Book value £000	**Fair value £000**
At 31st December 2002		
Primary financial instruments held or issued to finance the Group's operations:		
Bank borrowings	8,373	8,373
Finance leases	4,383	4,383
Loan notes and other loans	148	148
Cash at bank and in hand	21,486	21,486
Short-term deposits	529	529

	Book value £000	Fair value £000
At 31st December 2001		
Primary financial instruments held or issued to finance the Group's operations:		
Bank borrowings	8,343	8,343
Finance leases	3,786	3,786
Loan notes and other loans	3,382	3,382
Cash at bank and in hand	23,022	23,022

The fair value, at 31st December 2002, of the Group's short term borrowings, loan notes, short term deposits and cash at bank and in hand, all of which bear interest at variable rates, are equivalent to their book values. For finance leases, included in long term borrowings, the fair value approximates to their book values as the interest rates inherent in these arrangements are similar to the interest rates available on replacement facilities.

34. Contingent liabilities

Potential liability to pay National Insurance (NI)

The Group has a potential liability to pay NI contributions in relation to certain options over its ordinary shares.

11,651,850 share options were in issue at 31st December 2002 which had been granted after 19th May 2000 where the company potentially has a liability to pay NI. These options have an aggregate exercise price of £10,021,000. As the employers' NI liability cannot be capped, the potential liability is dependent on the share price on the dates of exercise. Employers' NI has been provided for at the balance sheet date, based on the share price of the company at that date.

There are further ordinary shares held in a number of share trusts which may be distributed to employees in the future. The allocation of certain of the shares may give rise to a liability to employers' NI depending on the circumstances at the date of transfer.

Property development agreement

Under a development agreement signed in January 2001 relating to the construction of the Group's head office in Cheltenham, to which the company is a party, in the event that there is a change of owner from the present developer for the building within five years of the development agreement, the company would be potentially liable to Cheltenham Borough Council for an amount of £250,000.

Litigation

There are contingent liabilities of the Group in respect of certain legal and other claims or potential claims. None of these claims is expected to result in a material loss to the Group.

[five year trading summary]

Year ended 31st December

	1998 £000	1999 £000	2000 £000	2001 £000	2002 £000
Turnover (including share of joint ventures)	19,957	26,912	50,080	73,369	121,008
Less share of turnover of joint ventures	–	–	–	(3,622)	(4,353)
Total Group turnover	19,957	26,912	50,080	69,747	116,655
Cost of sales	(10,303)	(12,302)	(20,369)	(29,913)	(57,862)
Gross profit	9,654	14,610	29,711	39,834	58,793
Total operating profit/(loss) before charges for goodwill amortisation and impairment, employee share options and reorganisations costs (including share of joint ventures and associates)	**(1,624)**	**947**	**9,237**	**14,780**	**11,470**
Total operating profit/(loss) (including share of joint ventures and associates)	(1,624)	941	8,786	9,034	(25,208)
Net interest (payable)/receivable	(44)	(512)	(449)	243	(218)
Amounts written off investments	–	–	–	–	(9,052)
Profit/(loss) on ordinary activities before taxation	(1,668)	429	8,337	9,277	(34,478)
Taxation on profit/(loss) on ordinary activities	631	(193)	(2,846)	(3,999)	(3,016)
Profit/(loss) on ordinary activities after taxation	(1,037)	236	5,491	5,278	(37,494)
Non–equity dividends and appropriations	(567)	(939)	(1,793)	(496)	–
Profit/(loss) for the financial year	**(1,604)**	**(703)**	**3,698**	**4,782**	**(37,494)**
Equity dividends	–	–	–	(1,718)	–
Retained profit/(loss) for the financial year	**(1,604)**	**(703)**	**3,698**	**3,064**	**(37,494)**
Basic earnings per share	–	–	–	3.6p	(20.0p)
Diluted earnings per share	–	–	–	2.9p	(20.0p)
Adjusted basic earnings per share	–	–	–	7.3p	3.8p
Adjusted diluted earnings per share	–	–	–	5.9p	3.5p
Net cash inflow/(outflow) from operating activities	(2,348)	3,822	12,263	13,453	11,549
Net cash/(debt)	(3,352)	(3,949)	(6,493)	7,511	9,111
Average number of employees	428	504	686	1,052	1,988

No earnings per share have been presented for the years ended 31st December 1998, 1999 and 2000 as there were no equity shares in issue during those years.

[advisers]

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[shareholding structure]

58%	*institutional and private shareholders*
24%	directors
16%	employee share ownership trusts
2%	other employee shareholdings

Based on shareholdings at 31st December 2002 and 225.7 million shares in issue on that date.

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