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Photobox Limited

Report and Financial Statements

31 December 2006

Registered No: 3906401

Directors
S Laurent
M W Chapman

Secretary
J T Longley

Auditors
Ernst & Young LLP
1 More London Place
London
SE1 2AF

Registered office
52 New Inn Hall Street
Oxford,
Oxon,
OX1 2DN

Directors' report

The directors present their report and financial statements for the year ended 31 December 2006.

Results and dividends

The loss for the year, after taxation, is £153,906 (2005 - profit of £132,899). The directors do not recommend the payment of a dividend (2005 - £nil).

Principal activity and review of the business

The company's principal activity during the year continued to be that of business-to-consumer and business-to-business digital photographic and ancillary goods and services.

Turnover increased by 65% during the year primarily due to a successful, continuing campaign of new customer acquisition. Total active customers increased 63% during the year to stand at 295,000 in December 2006. Independently audited UK market share rose from 15% to 26% in 2006. Turnover is expected to be substantially higher in 2007 than that achieved in 2006.

The company made a loss before tax of £153,906 in the current year due primarily to costs associated with the integration of the company with the new parent company, Photoways Inc, as a result of the April 2006 sale of the company. Investments in technology rose 178% year on year and marketing expenditure increased 220% year on year to support the continuing rapid growth of the company. This also contributed to the loss in the current year.

Gross margin however improved year-on-year from 40.4% in 2005 to 41.7 % in 2006, reflecting the early benefit of the combination of the two companies, in respect of scale efficiencies and purchasing power.

Principal risks and uncertainties

Competitive risks

Whilst consolidating its position as market leader in the UK, the company has significant competition from other online specialists, and high-street retailers who wish to have a presence in the market. Continuous investments in marketing, technology, and new products help us to consolidate and extend our leading position in the UK market.

Legislative risks

The company is subject to EU and UK consumer law, including distance-selling, and data-protection directives. In addition, our production facility is subject to further legislation in respect of Health and Safety and Waste Processing. We continue to retain professional advisors in respect of the risk of non-compliance with new and existing directives, and of course we retain legal counsel through which all consumer-facing services, terms and conditions, etc are validated.

Exposure to credit, liquidity and cash flow risk

Practically all company income is via credit card transactions over the Web, reaching our bank accounts in 3 to 4 days. Suppliers are generally paid on 30-day terms or more, therefore our operational working capital risks are negligible. Seasonal variations to our business however require large-scale project expenditure to be carefully planned and monitored over the quieter, first-half of the year.

Future developments

The directors aim to maintain the management policies that have adopted in the current year. They consider that 2007 will show a significant growth in sales from continuing activities.

Events since the balance sheet date

On 26 June 2007 and 09 Aug 2007, the company received loans totalling €700,000 from their ultimate parent undertaking and controlling party, Photoways Incorporated, to support the continued operations and growth of the company. The loans are interest bearing at 4.5% with no fixed repayment date.

Directors' report

Directors

The Directors who served during the year were as follows:

C Glass	(resigned 6 April 2006)
M W Chapman	
G Hobson	(resigned 6 April 2006)
J Longley	(resigned 6 April 2006)
J Bouhelier	(resigned 6 April 2006)
M de Guilhermier	(appointed 6 April 2006; resigned 10 October 2006)
S Laurent	(appointed 10 October 2006)
P Mendoza	(appointed 6 April 2006; resigned 13 July 2007)

Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the directors' report are listed on page 1. Having made enquiries of fellow directors and of the company's auditors, each of these directors confirms that:

- To the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the company's auditors are unaware; and

- Each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the company's auditors are aware of that information.

Auditors

A resolution to reappoint Ernst & Young LLP, who were appointed auditors during the year, will be put to the members at the Annual General Meeting.

By order of the board

28/10/07

Director

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

Independent auditors' report

to the members of Photobox Limited

We have audited the company's financial statements for the year ended 31 December 2006 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet and the related notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

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

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

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

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

Basis of audit opinion

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

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

Independent auditors' report

to the members of Photobox Limited (continued)

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Ernst + Young LLP

Ernst & Young LLP
Registered Auditor
London

31 October 2007

Profit and loss account

for the year ended 31 December 2006

	Notes	2006 £	2005 (restated) £
Turnover	2	8,101,801	4,915,891
Cost of sales		(4,721,365)	(2,925,309)
Gross profit		3,380,436	1,990,582
Administrative expenses		(3,798,342)	(1,864,971)
Other operating income		306,385	12,053
Operating (loss)/profit	3	(111,521)	137,664
Other interest receivable and similar income	4	21,109	23,621
Interest payable and similar charges	5	(28,267)	(16,916)
Loss on disposal of fixed assets	6	(48,340)	–
(Loss)/profit on ordinary activities before taxation		(167,019)	144,369
Taxation on (loss)/profit on ordinary activities	8	13,113	(11,470)
(Loss)/profit for the year	17	(153,906)	132,899

The turnover and operating result arises from the company's continuing operations.

Statement of total recognised gains and losses

There were no recognised gains or losses other than the loss for the year of £153,906 (2005 - profit of £132,899).

Balance sheet

at 31 December 2006

	Notes	2006 £	2005 £
Fixed assets			
Intangible assets	9	23,701	16,754
Tangible assets	10	1,829,387	946,534
		1,853,088	963,288
Current assets			
Stocks	11	251,965	170,403
Debtors	12	661,876	80,921
Cash at bank and in hand		1,402,524	1,292,714
		2,316,365	1,544,038
Creditors: amounts falling due within one year	13	(2,964,474)	(1,419,827)
Net current (liabilities)/assets		(648,109)	124,211
Total assets less current liabilities		1,204,979	1,087,499
Creditors: amounts falling due after more than one year	14	(443,683)	(317,133)
Provisions for liabilities	15	–	(14,565)
		761,296	755,801
Capital and reserves			
Called up share capital	16	65,662	63,005
Share premium account	17	854,821	698,077
Profit and loss account	17	(159,187)	(5,281)
Shareholders' funds	18	761,296	755,801

The financial statements were approved by the board on 25/10/07

Director

Notes to the financial statements

at 31 December 2006

1. Accounting policies

Accounting convention

The financial statements are prepared under the historical cost convention.

Cash flow statement

As the ultimate parent undertaking has published group financial statements, in accordance with Financial Reporting Standard No. 1 (Revised), a cash flow statement is not presented in these financial statements.

Intangible fixed assets

Intangible fixed assets are stated at historical cost. Amortisation is provided on all intangible fixed assets at rates included to write off the cost less estimated residual value of each asset over its expected useful life. In the case of a domain name the useful economic life is considered to be 10 years. Other intangible assets, which represents customer databases, are amortised over 4 years.

The carrying values of intangible fixed assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Tangible fixed assets

Tangible fixed assets are stated at historical cost. Depreciation is provided on all tangible fixed assets at rates calculated to write each asset down to its estimated residual value evenly over its expected useful life, as follows:-

Leasehold improvements	-	over the term of the lease
Plant and machinery	-	20% per annum
Fixtures, fittings and equipment	-	25% - 30% per annum

Software development costs will be amortised over 3 years, commencing when the assets are complete and ready for use.

The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing each product to its present location and condition.

Net realisable value is based on estimated selling price less any further costs expected to be incurred to completion and disposal.

Deferred taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or right to pay less or to receive more, tax, with the following exception:

- Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Government grants

Grants are credited to deferred revenue. Grants towards capital expenditure are released to the profit and loss account over the expected useful life of the assets. Grants towards revenue expenditure are released to the profit and loss account as the related expenditure is incurred.

Notes to the financial statements

at 31 December 2006

1. Accounting policies (continued)

Leased assets and obligations

Where assets are financed by leasing agreements that give rights approximating to ownership ("finance leases"), the assets are treated as if they had been purchased outright. The amount capitalised is the present value of the minimum lease payments payable during the lease term. The corresponding leasing commitments are shown as obligations to the lessor. Lease payments are treated as consisting of capital and interest elements, and the interest is charged to the profit and loss account in proportion to the remaining balance outstanding.

All other leases are "operating leases" and the annual rentals are charged to profit and loss on a straight line basis over the lease term.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are retranslated 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.

2. Turnover

Turnover represents amounts receivable for goods and services provided to customers, stated net of VAT.

The company's turnover and pre-tax result were all derived from its principal activity

	2006	*2005*
Percentage of turnover to non-UK markets	6.00%	6.00%

3. Operating (loss)/profit

	2006	*2005*
	£	*£*
This is stated after charging/(crediting):		
Depreciation and amounts written off tangible fixed assets:		
- owned assets	224,442	97,729
- leased assets	135,933	103,178
Amortisation of intangible fixed assets	3,721	1,229
Operating lease rentals:		
- land and buildings	120,900	91,800
- other	1,126	14,220
Auditors' remuneration:		
- audit fees	21,405	15,000
- taxation services	5,000	–
Government grants	(3,756)	(12,053)
Exceptional professional fees	82,915	35,274

Prior year restatement

Certain costs that were included in cost of sales in the prior year financial statements, are considered to be more accurately described as administrative expenses. The equivalent expenses in the current year have therefore been classified as administrative expenses, with a prior year restatement of £422,816 from cost of sales to administrative expenses.

Notes to the financial statements

at 31 December 2006

4. Interest receivable and similar income

	2006	2005
	£	£
Bank interest	21,109	23,621

5. Interest payable and similar charges

	2006	2005
	£	£
Finance leases and hire purchase contracts	28,267	16,916

6. Exceptional items

	2006	2005
	£	£
Recognised below operating profit:		
Loss on disposal of plant and machinery	48,340	–

7. Staff costs

(a) Staff costs

	2006	2005
	£	£
Wages and salaries	2,419,811	1,198,142
Social security costs	228,646	114,449
	2,648,457	1,312,591

The average monthly number of employees (including directors) during the year was made up as follows:

	2006	2005
	No.	No.
Administration	32	15
Production	55	34
	87	49

Notes to the financial statements

at 31 December 2006

7. Staff costs (continued)

(b) Directors' emoluments

	2006 £	*2005* £
Aggregate emoluments in respect of qualifying services	226,054	228,534

	2006 *No.*	*2005* *No.*
Number of directors who received shares in respect of qualifying services	–	–
Number of directors who exercised share options	–	–

The amounts in respect of the highest paid director are as follows:

	2006 £	*2005* £
Aggregate emoluments	119,532	82,750

8. Tax

(a) Tax on (loss)/profit on ordinary activities

The tax (credit)/charge is made up as follows:

	2006 £	*2005* £
Current tax:		
UK corporation tax on the (loss)/profit for the year	–	–
Total current tax	–	–
Deferred tax:		
Origination and reversal of timing differences	(13,113)	11,470
Total deferred tax (note 15)	(13,113)	11,470
Total tax (credit)/charge for year	(13,113)	11,470

Notes to the financial statements

at 31 December 2006

8. Tax (continued)

(b) Factors affecting current tax for the year:

The tax assessed for the year differs from the standard rate of corporation tax in the UK of 30% (2005 - 19%). The differences are explained below:

	2006 £	*2005* £
(Loss)/profit on ordinary activities before tax	(167,019)	144,369
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2005 - 19%)	(31,734)	27,430
Effects of:		
Expenses not deductible for tax purposes	19,356	10,886
Capital allowances in advance of depreciation	(31,373)	(28,824)
Utilisation of tax losses	–	9,127
Other timing differences	–	(18,619)
Unrelieved tax losses carried forward	43,751	–
Current tax for the year (note 8(a))	–	–

(c) Deferred tax

At 1 January 2006	11,470
Charged in the year	(12,378)
Adjustment in respect of prior years	(735)
At 31 December 2006	(1,643)

	2006 £	*2005* £
The deferred tax (asset)/liability is made up as follows:		
Accelerated capital allowances	88,218	54,481
Unrealised tax losses	(89,861)	(43,011)
	(1,643)	11,470

The deferred tax asset arose due to the estimated tax losses of £230,267 being greater than the net position of the capital allowances in excess of the depreciation of qualifying assets after taking into account of the loss on sale of qualifying assets. The difference between these amounts at 19% has been charged to the profit and loss account in the current year.

The company has invested heavily in the current year in the expectation of being profitable in the very near future. The company made a tax loss in 2005 as a result of capital allowances it claimed in respect of capital expenditure. Furthermore, the company is expecting to increase profitability from synergies available to the business following the acquisition by Photoways Inc.

Notes to the financial statements

at 31 December 2006

9. Intangible fixed assets

	Domain names	*Other*	*Total*
	£	£	£
Cost:			
At 1 January 2006	17,983	–	17,983
Additions	2,668	8,000	10,668
At 31 December 2006	20,651	8,000	28,651
Amortisation:			
At 1 January 2006	1,229	–	1,229
Charged in the year	1,888	1,833	3,721
At 31 December 2006	3,117	1,833	4,950
Net book value:			
At 31 December 2006	17,534	6,167	23,701
At 1 January 2006	16,754	–	16,754

10. Tangible fixed assets

	Plant and machinery	*Fixtures fittings and equipment*	*Short Leasehold improvements*	*Software development*	*Total*
	£	£	£	£	£
Cost:					
1 January 2006	1,229,685	297,219	66,767	–	1,593,671
Additions	814,880	300,632	129,776	238,040	1,483,328
Disposals	(300,125)	–	–	–	(300,125)
At 31 December 2006	1,744,440	597,851	196,543	238,040	2,776,874
Depreciation:					
1 January 2006	536,905	101,886	8,346	–	647,137
Provided during the year	222,385	106,356	31,634	–	360,375
Disposals	(60,025)	–	–	–	(60,025)
At 31 December 2006	699,265	208,242	39,980	–	947,487
Net book value:					
At 31 December 2006	1,045,175	389,609	156,563	238,040	1,829,387
At 1 January 2006	692,780	195,333	58,421	–	946,534

The net book value of plant and machinery includes £741,231 (2005 - £562,195) in respect of assets held under finance leases or hire purchase contracts.

Notes to the financial statements

at 31 December 2006

11. Stocks

	2006	*2005*
	£	*£*
Raw materials and consumables	251,965	170,403

12. Debtors

	2006	*2005*
	£	*£*
Trade debtors	128,176	8,947
Other debtors	29,475	28,015
Prepayments	90,405	43,959
Amounts owed by parent undertaking	300,069	–
Amounts owed by group undertakings	112,108	–
Deferred tax asset	1,643	–
	661,876	80,921

Other debtors include an amount of £27,985 (2005 - £27,985) due after more than one year. This is the deposit on the leased office premises.

13. Creditors: amounts falling due within one year

	2006	*2005*
	£	*£*
Obligations under finance leases (note 19)	212,570	176,261
Trade creditors	775,175	417,056
Taxation and social security	360,332	183,475
Accruals and deferred income	829,424	643,035
Amounts owed to parent undertaking	308,983	–
Amounts owed to group undertakings	477,990	–
	2,964,474	1,419,827

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

	2006	*2005*
	£	*£*
Obligations under finance leases - due within two to five years (note 19)	443,683	317,133

Obligations under finance leases disclosed above and in note 13 are secured on the related assets.

Notes to the financial statements

at 31 December 2006

15. Provision for liabilities

	Deferred tax	*Other provisions*	*Total*
	£	*£*	*£*
At 1 January 2006	11,470	3,095	14,565
Credit to profit and loss account	(11,470)	–	(11,470)
Transferred to creditors falling due within one year	–	(3,095)	(3,095)
At 31 December 2006	–	–	–

16. Share capital

		Authorised
	2006	*2005*
	£	*£*
50,000,000 ordinary shares of 0.5p each	250,000	250,000

	Allotted, called up and fully paid			
		2006		*2005*
	No.	*£*	*No.*	*£*
Ordinary shares of 0.5p each	13,132,300	65,662	12,600,967	63,005

During the year all directors and key staff holding warrants and share options under an approved share option scheme exercised their right to purchase a total of 531,333 ordinary shares at 30p. The company issued these 531,333 ordinary shares for a cash consideration of £159,401 on 6 April 2006.

All of the shareholders subsequently sold all of their shares to the parent undertaking, Photoways Inc.

17. Statement of movement on reserves

	Share premium account	*Profit and loss account*
	£	*£*
At 1 January 2006	698,077	(5,281)
Share premium on shares issued	156,744	–
Loss for the year	–	(153,906)
31 December 2006	854,821	(159,187)

Notes to the financial statements

at 31 December 2006

18. Reconciliation of movement in shareholders' funds

	2006 £	*2005* £
Opening shareholders' funds	755,801	457,113
(Loss)/profit for the financial year	(153,906)	132,899
Shares issued at nominal value	2,657	2,763
Share premium on shares issued	156,744	163,026
Closing shareholders' funds	761,296	755,801

19. Obligations under leases and hire purchase contracts

Amounts due under finance leases and hire purchase contracts:

	2006 £	*2005* £
Amounts payable:		
Within one year	212,570	176,261
In two to five years	443,683	317,133
	656,253	493,394

20. Commitments under operating leases

At 31 December, the company had annual commitments under non-cancellable operating leases as follows:

	2006 £	*2005* £
Plant and machinery		
expiring in the second to fifth year	3,003	2,698
Land and buildings:		
expiring in the second to fifth year	77,600	77,600
expiring after five years	43,300	43,300

21. Related party transactions

The company has taken advantage of the exemption contained within Financial Reporting Standard No 8 "Related Party Disclosures", and has not disclosed transactions with other group companies.

The company paid non-executive directors' fees and training costs of £nil (2005 - £14,252) to Springboard 4 Business Limited, a company controlled by Colin Glass, while he was a director of the company. The company also paid consultancy fees of £5,217 (2005 - £36,633) to James Longley, while he was a director of the company.

Additional amounts were paid to companies owned by these individuals during the year, in the period after the resignation of these directors. These payments were for consultancy services provided to Photobox Limited. The additional amounts paid were £20,391 to Chapman Longley Limited, (a company controlled by James Longley), and £21,388 to Springboard 4 Business Limited.

Notes to the financial statements

at 31 December 2006

22. Ultimate parent undertaking and controlling party

In the directors' opinion, the company's immediate and ultimate parent undertaking and controlling party is Photoways Inc which is incorporated in the USA. This is the smallest and largest group in whose financial statements the company is consolidated. Copies of the group financial statements are available from 92 Hayden Avenue, Lexington, MA02421-7951, USA.