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THE QUARTO GROUP, INC. ANNUAL REPORT 2000



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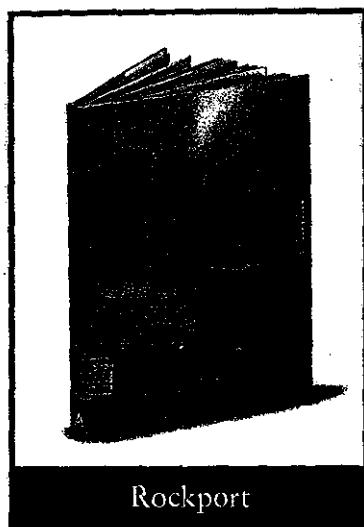
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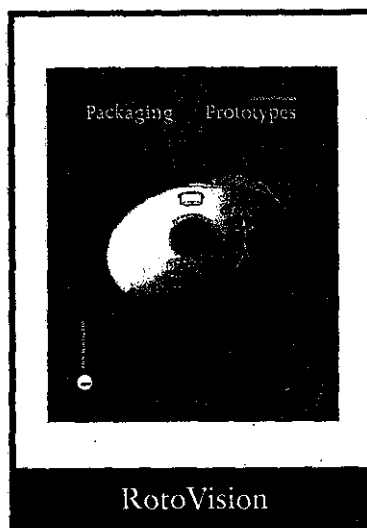
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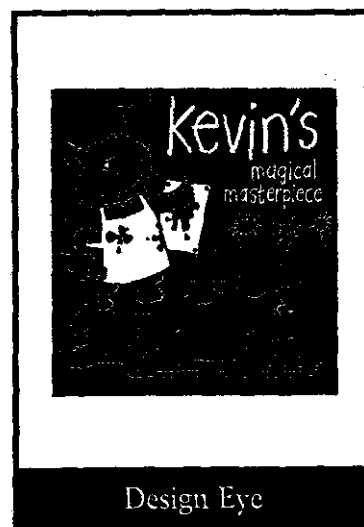
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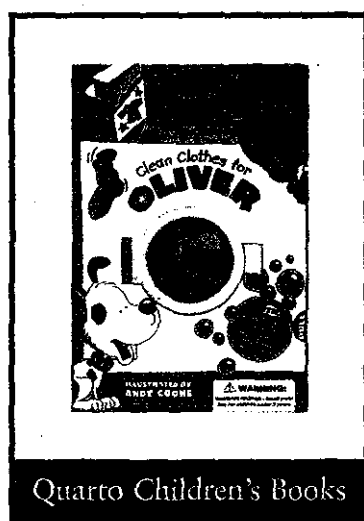
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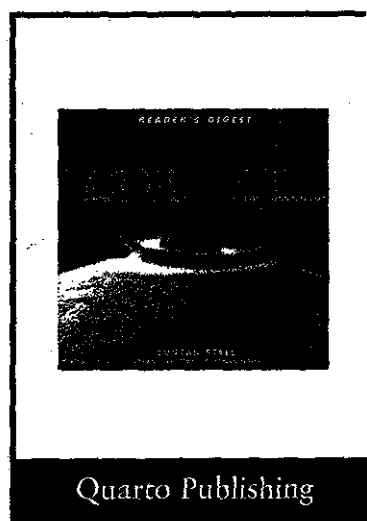
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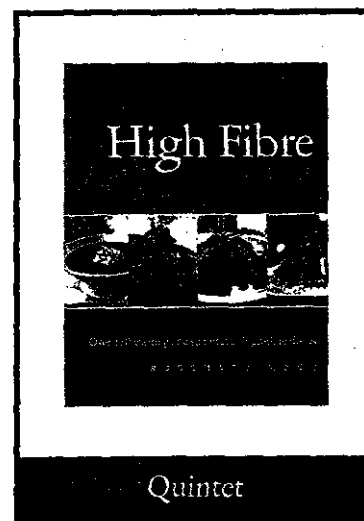
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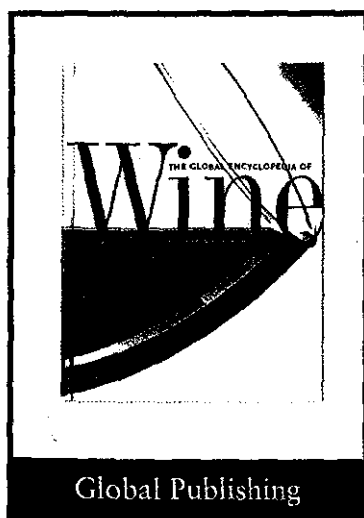
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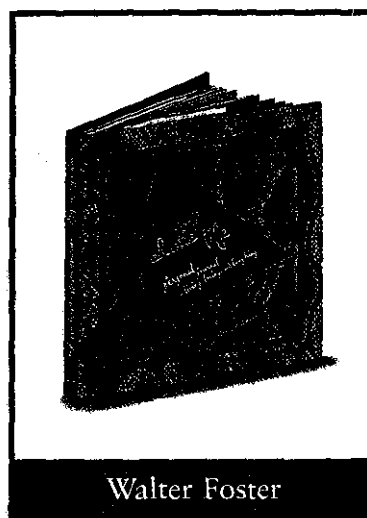
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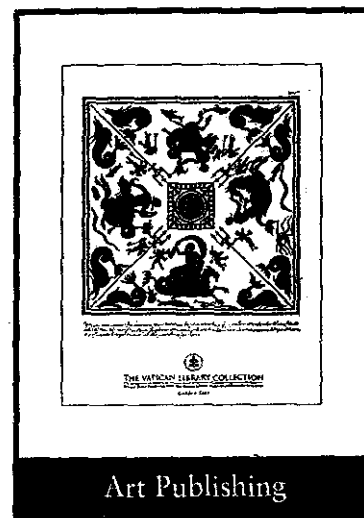
Quintet



Global Publishing



Walter Foster



Art Publishing



CHAIRMAN'S LETTER

Dear Shareholder:

Quarto is an international publishing group, with some 80% of its overall business overseas, so it is no surprise that the sustained strength of the dollar and sterling against the euro dashed our expectations, a year ago, to grow the business in 2000. Given this background, which we have fully explained to shareholders, the overall performance for the year has revealed the continuing strengths of the group.

We suffered major setbacks in euro-zone sales of our international co-edition books. As a direct consequence of not making low value sales in the euro-zone, our co-edition margins have improved, and have helped group profits overall. If the euro maintains, and improves upon, its current strength, I believe that some of the sales that were not made in 2000 will prove to be sales deferred, rather than lost.

Qu. FINANCIAL OVERVIEW

For the year ended December 31, 2000, operating profit (before amortization of goodwill and exceptional items) increased to £6.1 million (8.3% of sales), from £5.8 million (7.6% of sales), despite a reduction in turnover to £73.6 million from £76.5 million. The pre-tax profit was an unchanged £4.1 million, before amortization of goodwill and exceptional items, and £3.6 million (1999: £4.1 million) after such deductions. Underlying earnings per share increased to 16.1p from 15.8p in 1999, and basic earnings per share were 13.2p, compared with a basic loss per share of 13.5p in 1999.

The US dollar is the group's major trading currency, and the currency in which the major part of our assets is denominated. As a matter of prudence, our syndicated bank loan and most of our borrowings are also in dollars. At the end of 2000, net debt was unchanged at \$34.3 million. In sterling, however, reflecting the decline of sterling against the dollar, it increased to £23.0 million (1999: £20.9 million). Committed banking facilities at the year end approximated \$60 million, providing very substantial headroom. Net interest payable increased to £2.0 million from £1.7 million as a result of an increased average interest rate and the strength of the US dollar. The net interest charge was covered 3.0 times (1999: 3.4 times) by underlying operating profits. The group continued to generate more than 100% of operating profits in cash.

Qu. COMMENTARY ON RESULTS

The reduction in turnover is substantially explained by the decline in sales to the euro-zone. At the beginning of last year, we anticipated that these would

The vast majority of the books we publish have to earn revenue over many years in order to satisfy our business model. They must have the integrity to stand the tests of time.

fall by £1 million. At the interim stage in August, when it was evident that the euro was still very weak, we revised the shortfall to £4 million. In November, it became clear that the impact was greater and, in the event, group sales to the euro-zone were off by £5.3 million, on which, under normal trading conditions, the gross contribution would have been about £1.5 million. The impact of this cannot be understated. Since this reflects investment and work done in prior periods, the contribution would have dropped almost entirely to the bottom line.

The shortfall in euro-zone sales impacted the International Co-edition Book Publishing Division, where sales of £43.5 million were down by £3.6 million (1999: £47.1 million). Despite this, operating profit, before amortisation of goodwill and exceptional items, as a percentage of sales, increased to 12.5% (1999: 12.3%), as the gross margin improved to 34% (1999: 32%).

Investment in new titles, which is expensed, increased to £6.1 million (1999: £5.8 million) and drives our backlist sales of co-editions in future years. Even in 2000, with the dramatic fall we experienced in co-edition sales to the euro-zone, backlist sales (derived from investment in new titles in prior years) were responsible for 64% of the division's revenue (1999: 69%).

As businesses within the group trade with each other, the consolidated figures do not reflect accurately the volume of sales or the performance of individual units, which I cover below, in my operational summary.

The Publishing Division's sales, at £30.1 million (1999: £29.4 million), were mostly in currencies other than sterling. Sterling has weakened against the US dollar, so the sterling figure misleadingly suggests that sales for the division moved ahead. On the book and services sides, sales did advance. On the art publishing side, in our efforts to turn around this business, sales were allowed to decline in a successful effort to reduce losses while returning the business to profitability. Overall, the division's operating profit improved by 58% to £1.9 million (1999: £1.2 million).

Exceptional costs were incurred in the considerable restructuring that took place during the year, mostly relating to the operational issues discussed below. The costs were in line with our expectations. In 2001, we have already placed our art publishing businesses under common management, but most of the groundwork for this was done, and the costs were expensed, in 2000.



■ REVIEW OF THE YEAR

I wrote to you in November to advise you that Terry Hancock had left Quarto, and that the board had decided not to appoint a replacement Chief Operating Officer. Since Terry's departure, I have resumed direct responsibility for the international co-edition book publishing part of the group, which continues to be our core activity, and the one most affected by currency issues.

INTERNATIONAL CO-EDITION BOOK PUBLISHING

In the second half of the year and, especially, towards the very end of the period, substantial headway was made in changing and refocusing the business.

Rockport and RotoVision were more closely integrated. They have separate editorial identities and visions, but now share sales forces, production, and accounting, under the overall direction of Ken Fund. Design Eye and Quarto Children's Books have been organized into a children's publishing division, headed by Sally Gritten, who joined us in late November. Design Eye had never fully recovered from the tragic, early death of one of its founders, in August 1999, and we have now relocated it to London.

Quarto Publishing produced a vigorous range of titles and goes from strength to strength. It has a new editorial voice, new titles are performing well, and margins are improving. Quantum, whose business is to exploit our older material in tertiary and special markets, rebounded from an ill-advised effort in 1999 to generate a great deal of its own, new material. Quintet suffered from a lack of direction and I am still searching for a new publisher who will bring new vitality and an individual voice to Quintet's publishing program, which it surely needs. The first books appeared from Global Publishing, and made a very useful contribution to the results.

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PUBLISHING

Most of the group's publishing businesses are in the United States. On the book side, Book Sales had a very successful year, and Walter Foster launched an innovative range of journals and ancillary products under the My Chaotic Life imprint. This range is a complete departure from anything that Walter Foster, or any group company, has published before, and we are all very impressed and excited by the range. We now have to find the way to market it effectively.

Our art publishing is still not where it should be. This is a disappointment, as the marketplace has been solid and we haven't capitalized on all of the opportunities. What we have focused on, namely the images we publish, we have improved significantly. We now have to bolster the sales side. We have simplified the business structurally, and now operate essentially from just New York and Melbourne as the Art Publishing Group, having wound down our presence in Sydney and San Diego. This rationalization did, of course, distract management somewhat, but it is now behind us.

PUBLISHING SERVICES

The group's publishing services, which provide production services to publishers, and point of sale materials for marketing support, were very successful in 2000. Regent and ProVision, which are in the international co-edition book division, worked hard, and successfully, to deal with the twin challenges of a strong dollar and very high paper and raw material prices. In the UK, Western and AP, whose results are recorded in the Publishing Division, had very good years, and are continuing to invest in future growth opportunities.

GROUP DIRECTION

Quarto has played a leading role in the illustrated co-edition book publishing industry for nearly 25 years. Our business model has stood the test of time, and of repeated re-examinations. Provided that it is applied in a disciplined, not slavish, manner, it assists us by focusing our attention on the markets for our books. Our success has been to marry this discipline to a keen ability to anticipate the market and produce exciting, relevant, and useful books.

Our short-term objective is to return to historic profit levels, and we are targeting an operating profit margin of 10%, the effect of which would be to increase substantially our earnings per share. When we have achieved this target – which is neither unrealistic, nor undemanding, as a short-term objective – we hope that this will give us a greater freedom of maneuver to pursue longer-term strategic ambitions.

We regard improving the trading performance of the group to be the best way of enhancing shareholder value. Other options have been considered and are reviewed by the Board and its advisors on a regular basis.

Our most important assets are our book properties. This is self-evident, but it cannot be overemphasized. The vast majority of the books we publish have to earn revenue over many years in order to satisfy our business model. They

must have the integrity to stand the tests of time. I have long maintained that, in our efforts to keep the primacy of our products at the core of our illustrated co-edition book publishing, we must limit the size of our publishing units. Ideally, they should be small enough to be managed by someone whose major focus is creative, but large enough to obtain some economies of scale. We are a product-rich business and must nurture the vitality, inventiveness, and individuality that are necessary in publishing.

We have been performing below par, and our core business has suffered. We cannot do much about unfavorable exchange rates, but we can pay close attention to our own publishing programs. Quarto Publishing's adult list stands as a stellar example of what can be done, even in tough times. New appointments, and sweeping away some of the cumbersome bureaucracy that has been developed, will help the re-invigoration that we are all seeking. I expect people to establish more clearly their objectives, and to test their actions against these objectives. I have absolute confidence that we will restore luster to our co-edition publishing business. Its weaker than expected performance this year has been a problem for the group, and turning this around is of the utmost priority.

What about our other activities? The book publishing businesses, operating almost entirely in their domestic UK and US markets, have been performing to plan. Sales growth has been anemic, and this is a concern, but operating margins have improved. The art publishing units, historically such a profitable part of the group but, for the last few years, loss-making, are showing clear signs of improvement. Their revival is taking longer than I expected. I failed to appreciate the extent of drift, and the difficulties of turning things around. The most crucial oversight was not to highlight to shareholders and staff that, precisely because the art publishing units derived over 70% of their annual revenues from backlist sales, the impact of several seasons of poor publishing programs would take considerable time to overcome. Finally, the publishing services units, involved in printing and print broking for group but, predominantly, third-party customers, are continuing to perform well.

■ STRATEGY

What is our strategy? The group has been, for many years, a portfolio of related businesses, as is commonplace in the book publishing industry, and is explained by the need to keep the creative edge. This will not change, and the board is keen to ensure that the businesses are related to our core activities, that they bring real benefits to the group, and that the group can bring definite advantages to the individual units. These considerations will guide the board's assessment of each operating unit and division.

People and businesses today require useful, relevant information and instruction.

This means that skilled editing, allied with a clear sense of market needs, is the direction for informational publishers to pursue.

In the broadest sense, the core activities of the group have been focused in informational and instructional publishing. The how-to and reference books that made our reputation were, initially, produced for the broad consumer audience. Over time, we have branched out into publishing instructional and informational books for semi-professionals and professionals, particularly in the graphics and commercial arts fields. There are sound reasons for us to build upon this core direction, not least of which are our strengths in making these books, our understanding of their markets, and the evident need for good instructional and informational material.

People and businesses today require useful, relevant information and instruction. This means that skilled editing, allied with a clear sense of market needs, is the direction for informational publishers to pursue.

Our longer-term strategy is to focus on the growth potential for Quarto in the informational and instructional areas. We don't intend to confine ourselves to books, or even to print media. The potential for us to expand in quasi-educational, professional training, and even educational areas, is immense. It does require that we identify our target areas very carefully, with due regard to what the group can bring to the party.

PROSPECTS

The board is determined to improve the cash flow of the group, and to drive down our borrowings. Capital allocation is a major preoccupation of management. We will allocate capital and resources to successful businesses. Of course, all units have their ups and downs. A temporary setback will not disqualify a business, but the inability of a unit to establish its growth potential will. Successful businesses will be supported, and will be encouraged to grow. We shall make decisions about our units on the basis of their potential under group ownership, and we will support what we expect to be our winners.

The impact of these developments will not be sudden. I must stress once again that, with our heavy reliance on selling our backlists (i.e. books and art prints first published in prior years), the turnaround must be incremental, and depends upon making good publishing decisions.

I am more comfortable now, than at any previous time, that we have a very strong team of people running and working in our businesses. Publishing is at its best when it is organized creatively on a small scale. This, of course,



requires having publishers who are creative and entrepreneurial – a difficult combination, when added to the need to work within the commercial disciplines of a group. We have those people now. I believe that they will continue to attract and nurture the people who join us.

It would be rash to say that the "threat" posed to book publishing by the digital revolution is over. But, the industry has recovered from its bout of nerves and, as when other new media, such as newspapers, magazines, serial publications, radio, movies, and television, previously challenged it, book publishing is redefining its purpose and uniqueness. CD-ROMs have largely come and gone, the downloadable book is perceived as a minority taste and, to date, the Internet revolution has not done to the industry much more than to rearrange the retail outlets.

Quarto has always tried to draw a distinction between data and information. Editing information is our real skill, and it remains where we define ourselves in publishing terms. The opportunities are vast and, accordingly, we have terminated group wide Internet initiatives in favor of letting each individual business develop its web activities in its own way.

As I write, it is still too soon to know whether the United States is entering a period of recession, or of slower growth. Much as there is ringing talk of the European economies taking over as the locomotive of growth, I remain a skeptic but, as with many things, the possible cloud of economic slowdown also has a silver lining. Historically, during periods of recession, book publishing has done well. Books offer relatively cheap information and entertainment, so I am hopeful that our business will continue its steady underlying improvement.

Our focus for 2001 is on sales, exciting publishing programs across the board, and strong cash generation. We are better poised, internally, to achieve this. January is a quiet month, but I am pleased to be able to report that sales for January 2001 are ahead of forecast. I want to take this opportunity to thank all of those who contributed to our many achievements in 2000. Our mission, in 2001, is to exceed these.

Sincerely,

Laurence F Orbach
Chairman and Chief Executive
February 16, 2001



OPERATIONAL REVIEW

A number of companies within the group trade with each other on an arm's-length basis. Because, at the consolidated group level, this inter-company trading is not properly reflected, the performance of individual units can be understated. In this operational review, performance references, turnover, and profit figures are on an unconsolidated basis.

The group is organized into two operating divisions: International Co-edition Book Publishing, and Publishing. The International Co-edition Book Publishing Division comprises those units that are active in co-edition publishing and have a major part of their sales outside the domestic markets in which the books are created. By contrast, group companies in the Publishing Division focus on individual markets, and trade mostly within their domestic territories.

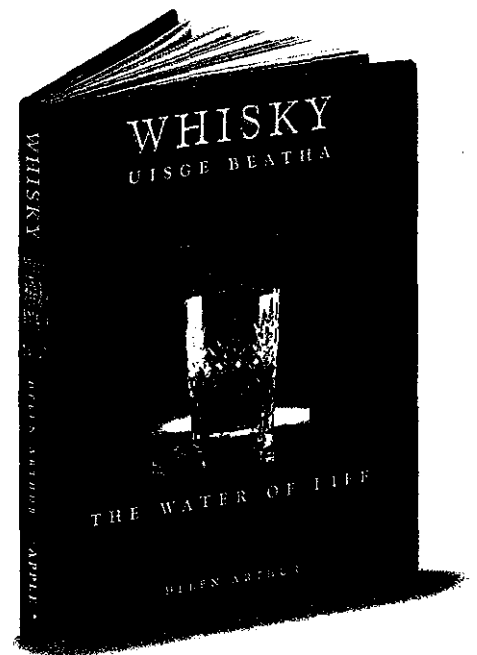
INTERNATIONAL CO-EDITION BOOK PUBLISHING DIVISION

Divisional Results: Sales were down by 8.1% at £47.8 million (1999: £52.0million) and operating profit by 7% at £5.4 million (1999: £5.8 million). The division generated £5.7million (1999: £6.8 million) in cash for the group.

QUARTO PUBLISHING: After a year of consolidation, 2000 was poised to be a year of good growth, but exchange rates held back sales in the euro-zone. Against this background, sales fell almost 9%, but the gross margin increased dramatically to 33% (1999: 28%), and sales on new titles increased on average by 11%. The 200,000th copy of *The Book of Spells* came off press in the same week as the book reached the top of the UK's New Age bestseller list. Operating profit was at a record level, and reflected careful control of overheads, judicious print buying, careful management of foreign exchange exposure, and vigorous leadership by Piers Spence, the Publisher.



QUINTET PUBLISHING: Rather more exposed than other units to the European markets, Quintet's turnover fell by 37%, and the gross margin declined to 22% (1999: 28%). Quintet's publisher left the company in the spring, and a suitable replacement has not yet been appointed. As mentioned at the interim stage, Quintet had also exhausted itself creatively. Several series came to the end of their lives. Quintet has traditionally produced many books in *ad hoc* series. No new series was launched during the year. Only 22 new titles were published (1999: 35) but, encouragingly, many of these were sold to new customers. *Whisky* was named the Best Drinks Book and Best Book Overall at the 2000 World Cookbook Fair, and Quintet's position as a publisher of cookbooks remained well established.

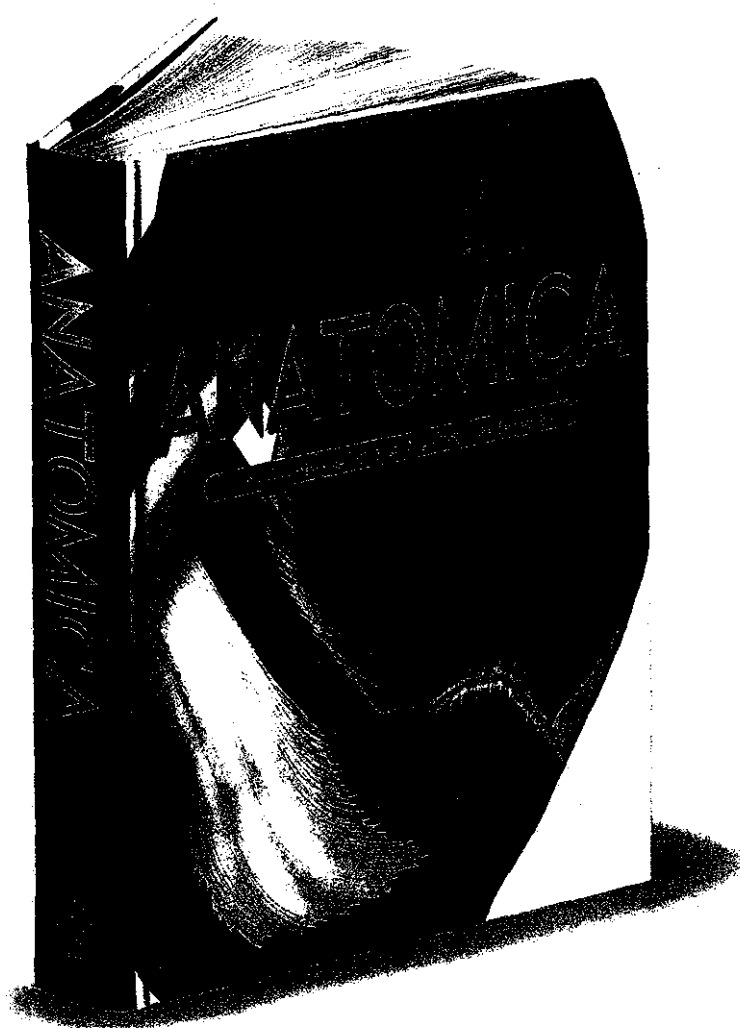
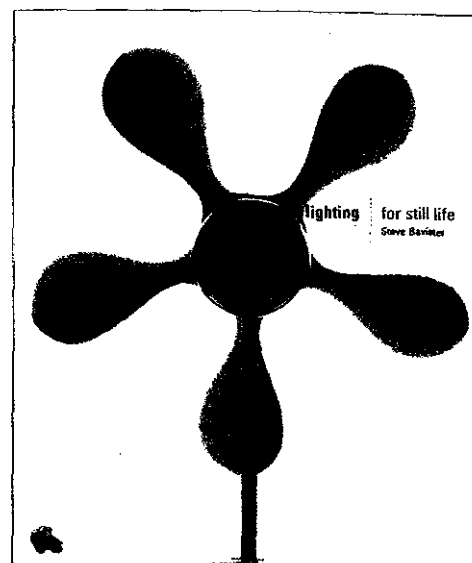


QUANTUM PUBLISHING recycles the group's older titles, selling them in tertiary and promotional markets internationally, and repurposing the contents into new titles and formats. It also produces some new books for promotional markets. In 1999 Quantum overextended itself with new titles. This largely unprofitable activity was reversed in 2000 and, on virtually unchanged turnover, Quantum's gross margin rose to 21% (1999: 14%). Overheads were reduced and Quantum recorded an operating profit of 10% on sales. Isabel Leao, the Publisher, did an excellent job in identifying and correcting the shortcomings of 1999.



ROCKPORT and **ROTOVISION** both came under the management of Ken Fund during the year and this consumed much of his time. Both companies publish books for specialists in the graphic and commercial arts, photography, architecture, interior design, and related areas. In 2000, declining sales in the euro-zone were largely offset by the strong rebound in Far Eastern sales. Overall, sales fell by almost 7%, the gross margin rose to 40% (1999: 36%), and operating profit rose to 7.9% (1999: 6.2%).

Rockport achieved targets set for it but RotoVision failed to deliver, on time, a number of planned titles. Ken Fund has put in place new creative teams to enhance and add to both lists, and the first fruits of this initiative will be felt in 2001. The United States is the largest market for Rockport and RotoVision books, and new arrangements in 2000 should improve sales to specialist audiences. At the end of the year, Brian Morris, the founder of RotoVision, retired from the company. We thank him for his inspiring leadership and for his skill as a book producer.



GLOBAL BOOKS: In its first full year, Global produced two huge tomes, *Wine* and *Anatomica*, a new road atlas of Australia and a number of smaller titles. Owning all the material in its books, and able to exploit it in many ways, Global already has an archive of 22,000 transparencies and approximately 1,000 illustrations. The material has already been licensed by a number of internet sites, producing profitable revenue in 2000. Global's specialty is producing encyclopedic reference works for consumer audiences. Investment in individual titles is huge, and 4 big books are scheduled for publication in 2001. Global is based in Sydney, and favorable exchange rates mean that it operates very competitively. The gross margin, at 31%, is in line with expectations, and the company made a very useful contribution to group profits.

DESIGN EYE and QUARTO CHILDREN'S BOOKS were, as I have written above, substantially reorganized in 2000. Design Eye was relocated to London and has been put under the management of Sally Gritten, who also has responsibility for

Quarto Children's Books. Quarto Childrens' sales rose marginally, but Design Eye was more affected by

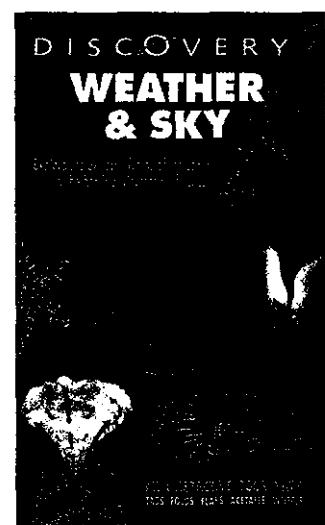
the move and reorganization. These factors, coupled with currency issues, led to a 21% decline in their combined sales. The gross margin, at 29% overall, was unchanged, and the operating profit margin was 9.7%. Design Eye neglected new product development, and became overly dependent on key titles, particularly its best-selling *Let's Start!* series, sales of which were severely impacted by price issues in the euro-zone. The effects of relocation mean that comparisons with the prior year, of

overhead and development costs, are not possible. Quarto Children's sales were down by

29% in the euro-zone, and this led to sales 10% down on budget. But, new title sales rose strongly by 51%

and costs were kept under control, with both overheads and development costs down on 1999. Both Design Eye and Quarto Children's Books publish interactive activity books for children. Production of these involves a great deal of manual assembly and, provided that we can keep costs under control and revitalize the creative side, the new children's division should rebound and resume its growth.

The Division also includes Regent Publishing Services and ProVision, both of which operate in the Far East, and provide pre-press and print production services to group and, predominantly, third-party customers around the world. Only 19% of their sales were intergroup in 2000 (1999: 21%), and they surmounted the impact of a strong dollar, to increase their



sales by 7%. Very stiff price competition led to a small decline in the operating profit margin to 8.7% (1999: 8.9%). Under the very able direction of George Tai, Regent is working to grow sales by adding more regional sales offices.

PUBLISHING DIVISION

Divisional revenues increased by 2% to £30.3 million (1999: 29.7 million). The gross margin improved slightly to 34% (1999: 33%), and the operating profit advanced by 58% to £1.9 million (1999: £1.2 million) largely thanks to a much improved profit at Book Sales, and a sharp reduction in losses at the art publishing businesses. The companies in this division operate largely within their domestic territories, in either the US or the UK. Two-thirds of the Division's sales revenues arise in the United States. The division generated £2.4 million cash (1999: £2.7 million).

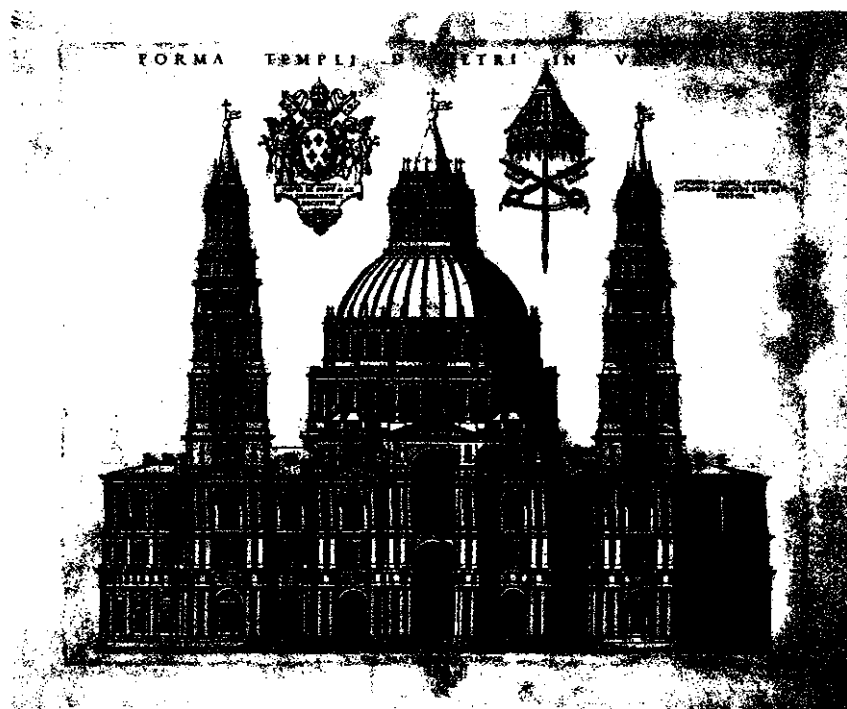
Book Sales: Despite a decline in exports, explained by the strength of the dollar, sales increased in dollar terms by 6%, gross margins by 2% to 24% (1999: 22%), and operating profit by 193%. Book Sales has three lines of activity: selling overstocks that it acquires from other publishers; publishing original titles, largely illustrated books, that it acquires from overseas publishers, including other group entities; and publishing reprints of previously published titles, and compilations of out-of-print material that are produced in-house. All these lines were successful in 2000. Book Sales operates in a low margin area, amid fierce competition. Its operating profit, at 9.4% of sales, exceeded expectations, and is at the upper end of what can be achieved.



WALTER FOSTER: For many decades, Walter Foster has been the leading American publisher of art instruction books sold in art and craft supply stores. Sales to this traditional market improved in 2000, following several disappointing years, when the consolidation of retailers in the market inhibited sales growth. For several years Walter Foster has been expanding its distribution channels outside the specialist retailers, in response to their consolidation. Sales into the gift trade increased markedly, but the inability to repeat a large one-off 1999 order to a warehouse club chain left sales, in

currency terms, down for the year by 8%, and reduced operating profits by 21%. Most excitingly, Walter Foster launched a line of journals, addressed to a mainly young, female audience, and published under the *My Chaotic Life* imprint. Considerable investment went into the new range. Initial sales, mostly through the gift and apparel markets, have been very encouraging, but the range must get into general bookstores as well. Sales efforts in 2001 will focus on this without, of course, neglecting the traditional, core markets and publishing activity.

ART PUBLISHING: The group publishes art prints from its subsidiaries in the US and Australia. Until the last few years, this was an extremely profitable and cash generative part of the group's business. We fell short of our expectations



THE VATICAN LIBRARY COLLECTION
ETCHING OF THE PROMISED FACADE OF SAINT PETER'S, 1546 ANTONIO TAMBURINI: CIRCA 1600 AFTER ANTONIO DA SANALESSO THE YOUNGER (1562-1601)

of breaking even for the year as a whole. The US and Australian units operated independently during 2000, but both took the first steps towards a reorganization that put them under common management in 2001. In the United States, operations were consolidated in the New York area, and in

Australia, they were brought together in Melbourne. After several years of mediocre publishing prior to 2000, both units faced declining backlist sales, and the need to manage excess inventory of slow-moving items. As I have explained elsewhere, sales of new images generate only a small part of the revenue mix and it will take time for the benefits of the current publishing programs to work their way to the bottom line. In the meantime, we have continued to publish, and secured the exclusive worldwide license to publish art prints from the vast archive of materials in the Vatican Library. The first collection was launched towards the end of the year. At the same time as re-invigorating the publishing programs, we cut overhead sharply, and disposed of unprofitable inventory lines. In currency terms, sales were down overall by 15%, gross margins improved to 47% (1999: 44%) and operating losses halved. We have now to concentrate on driving up sales, reducing inventory levels, managing inventory better, improving operational efficiencies generally, and continuing to publish better.

UK PUBLISHING: Apple Press and the Artist's and Illustrator's Magazine are small businesses, publishing books and magazines respectively. Their combined performance deteriorated slightly in 2000, and both businesses have been given new direction.

PUBLISHING AND MARKETING SUPPORT SERVICES: Both AP Screenprinters and the Image Factory produce material for retailers and manufacturers in support of marketing campaigns. Combined sales increased by almost 9% but strong price competition led to a small decline in gross margin to 39% (1999: 40%). Coming off a very successful year in 1999, when we installed a new two-colour printing press at AP, we invested in an expanded sales effort in 2000. The extra personnel costs increased overheads during the year, with the consequence that the combined operating profits declined by 8%. The sales push yielded results, and we installed our second two-colour printing press at the Image Factory in January of this year. Both Rod Pearce, of AP, and Geoff Banks, of the Image Factory, are to be commended on their performances, and on the smooth implementation of their expansion plans.



FINANCIAL REVIEW

Chief Financial Officer's Report

TURNOVER AND OPERATING PROFIT BEFORE AMORTISATION OF GOODWILL AND EXCEPTIONAL ITEMS

Turnover fell 4% from £76.5m to £73.6m due to a shortfall in European sales which were down £5.3m. Improved gross profit margins, up from 33.9% to 35.2%, together with lower overheads, which were down 1%, led to an advance in operating profit before amortisation of goodwill and exceptional items from £5.8m to £6.1m. Operating profit before amortisation of goodwill and exceptional items represented 8.3% of sales compared to 7.6% in 1999.

INTEREST

The net interest charge increased from £1.7m to £2.0m due to higher interest rates and currency translation. Interest cover was 3.0 times (1999: 3.4) based on operating profit before amortisation of goodwill and exceptional items. Our objective is to improve interest cover to 5 times.

TAXATION

The taxation charge on profit before amortisation of goodwill and exceptional items was 7.7% [1999: 9.5%]. The Group's tax charge benefits from taxable losses brought forward, together with low tax rates in Hong Kong and Switzerland.

MINORITY INTERESTS

The Group now has three trading subsidiaries in which there are minority interests. During the year, the Group acquired the minority shareholding in Design Eye Holdings Limited.

SHAREHOLDER RETURN

Underlying earnings per share rose 2% to 16.1p [1999: 15.8p].

The proposed final dividend of 2.3p is unchanged as is the total dividend for the year at 4.5p. The dividend is 3.6 times covered [1999: 3.5 times] by underlying earnings per share.

The market price of the shares of common stock on December 31, 2000 was 87.0p [1999: 108.5p].

GOODWILL

Goodwill arising on acquisitions is now carried in the balance sheet under the category of intangible fixed assets in accordance with the accounting standard FRS 10. The goodwill arising during the year relates to the purchase of the 12.5% minority interest in Design Eye Holdings Limited.

WORKING CAPITAL

Working capital at the balance sheet dates is summarised below:

	2000	1999
	£m	£m
Stock and work in progress	18.7	16.9
Trade debtors	24.7	24.4
Trade creditors	(21.0)	(20.2)
Other net liabilities	(1.9)	(2.7)
	<u>20.5</u>	<u>18.4</u>

Working capital is up £2.1m compared to 1999. Of the increase £1.4m is attributable to currency.

Stock and work in progress levels are up £1.8m. Of the increase £1.1m is attributable to currency and £0.6m is attributable to Global Publishing, a new initiative.

Trade debtors represent 3.2 months sales compared to 3.1 months at the end of 1999.

CASH FLOW AND NET DEBT

Net cash inflow from operating activities was £6.4m [1999: £8.3m]; this represents a good return on operating profit of 115% [1999: 142%].

Our principal operating currency is the US dollar and over 90% of our borrowings are in this currency. At the year end our net debt was US\$34.3m (£23.0m), the same as a year ago [US\$34.3m (£20.9m)]. There was no cash generated during the year because we spent £1.5m on acquisitions. Our total banking facilities at the year end were US\$68.9m (£46.2m) and of this US\$59.5m (£39.9m) was committed.

TREASURY

The Group's borrowings, liquidity, interest rate and foreign exchange exposures and banking relationships are managed at Group level. The following policies have been applied during the year to manage the financial risks faced by the Group with regard to funding and liquidity, interest rate exposure and currency rate exposures:

- **Liquidity risk;** the Group prepares an annual cash flow forecast which is reviewed by the Board covering the next twelve months. This forecast is reviewed in the light of the facilities available to the Group to ensure that we have adequate liquidity. Some US\$59.5m (£39.9m) of our total banking facilities is committed until 2002.
- **Interest rate risk;** most of the Group's borrowings are at floating rates. The Group does not enter into interest rate swaps.
- **Currency rate exposure;** the Group's principal operating currency is the US dollar. At Group level our annual US dollar receipts and payments are approximately the same and as a consequence we have a natural hedge in place to help protect our results from exchange rate fluctuations with regard to the US dollar.

In August 1997 we signed a five year, US\$55 million multi-currency revolving credit agreement with a syndicate of banks on both sides of the Atlantic. This facility gives us a very secure basis on which to finance our plans for the future. In addition it reduces our cost of funds. Most of our borrowings are in US dollars

The following table sets out the average exchange rates used in translating the results of our overseas subsidiaries:

	2000	1999
US Dollar	1.52	1.62
Hong Kong Dollar	11.82	12.57
Swiss Franc	2.56	2.43
Australian Dollar	2.61	2.51
Singapore Dollar	2.61	2.74

FINANCIAL REPORTING

We have very tight reporting deadlines as we believe that this enables a greater degree of focus to be placed on running the business. It requires a lot of hard work and commitment and I take this opportunity to thank my staff for their continued loyalty and support.

MICHAEL J MOUSLEY
Chief Financial Officer

February 16, 2001

Directors and Advisers

DIRECTORS

Laurence Francis Orbach
(Chairman and Chief Executive) (USA)
Robert John Morley
Michael John Mousley, ACA
George Tai (Hong Kong)
Peter Campbell (Non-executive)
Peter Waine (Non-executive)
Leigh Collins (Non-executive)

SECRETARY

Cyrus Homi Bhote, FCA, MCSE

PRINCIPAL PLACE OF BUSINESS

The Old Brewery,
6 Blundell Street,
London, N7 9BH
Tel: +44 (0) 20 7700 6700

WEBSITE

www.quarto.com

STOCKBROKERS

Collins Stewart Limited
21 New Street,
London, EC2M 4HR

AUDITORS

KPMG Audit Plc
8 Salisbury Square, London, EC4Y 8BB

SOLICITORS

Travers Smith Braithwaite, 6 Snow Hill, London, EC1A 2AL

REGISTRARS AND TRANSFER OFFICE

IRG plc
Bourne House, 34 Beckenham Road, Beckenham, Kent, BR3 4TU

PRINCIPAL BANKERS

AIB Bank / AllFirst Bank
11-12 Old Jewry, London EC2R 8DP

Barclays Bank plc
50 Pall Mall, London, SW1A 1QA

Fleet Bank
100 Federal Street, Boston, MA 02110, USA

National Westminster Bank plc
65 Piccadilly, London, W1A 2PP

REGISTERED NUMBER

FCO 13814

Directors' Report

The Directors present their report and the audited financial statements of The Quarto Group, Inc., for the year ended December 31, 2000.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The Group conducts an international business whose principal activity is as a publisher of illustrated non-fiction books in co-edition and under its own imprint, for both adults and children. A detailed review of the development of the business of the Group is given in the Chairman's Letter and Operational Review on pages 4 to 18.

RESULTS AND DIVIDENDS

The profit for the year after taxation and minority interests amounted to £2,823,000 [1999: loss: £(1,963,000)]. The Directors propose a final ordinary dividend of 2.3p [1999: 2.3p] per share subject to approval at the Annual General Meeting. The retained profit for the year was £1,561,000 [1999 deficit: £(3,225,000)] which has been transferred to (1999: deducted from) reserves.

DIRECTORS

The Directors of the Company, who served as Directors during the year, were as follows:

L. F. Orbach
R. J. Morley
M. J. Mousley
T. Hancock (Resigned November 3, 2000)
G. T. Y. Tai
P. Campbell (Non-executive)
P. Waine (Non-executive)
L. Collins (Non-executive)

Educated at Eton College, Peter Campbell started his business career with the Booker Group, holding a number of marketing positions in their United Rum Merchants subsidiary. From 1972 to 1989 he was with the Ocean Group, initially on the sales and marketing side, and from 1987 to 1989, he was the General Manager, UK Operations, for the MSAS subsidiary, with responsibility for 27 locations and 800 staff. Since 1989 he has been involved in management training and development, and is currently a Director of Catalyst Development, a member of the Blueprint Group.

Peter Waine has a wide corporate experience gained as a result of holding executive and non-executive Directorships in a variety of different sectors and with companies both public and private, up to £1 billion turnover. The organisations he has worked for include GEC, Coopers & Lybrand, W.R. Royle, and the CBI. He is the co-founder of Hanson Green, the principal source for non-executive appointments in the UK.

Leigh Collins has been a stockbroker since 1970 and was a director of Collins Stewart Limited, of which he was a founding director in 1991, until 2000.

None of the Directors has a service contract of more than one year's duration.

Save as disclosed in Note 23, no Director has had a material interest in any contract of significance with the Company or its subsidiaries during the year.

DIRECTORS' INTERESTS IN SHARES

The Directors who held office at December 31, 2000 had the following interests in the share capital of the Company.

Shareholding	Number of US\$0.10 shares of common stock	
	December 31, 2000	January 1, 2000
L. F. Orbach*	2,913,413	2,878,413
R. J. Morley	1,539,424	1,504,424
M. J. Mousley	42,000	37,000
G. T. Y. Tai	25,477	25,477
L. Collins	337,650	337,650
P. Campbell	1,000	1,000
P. Waine	-	-
Options		
L.F. Orbach:	Exercisable between April 10, 1995 - April 9, 2002 at £1.30424	50,000
	Exercisable between Feb 22, 2003 - Feb 21, 2010 at £1.115	10,000
R.J. Morley:	Exercisable between Feb 22, 2003 - Feb 21, 2010 at £1.115	5,000
M. J. Mousley:	Exercisable between Feb 22, 2003 - Feb 21, 2010 at £1.115	10,000
	Exercisable between March 31, 2001 - March 31, 2008 at £0.685	5,000
G. T. Y. Tai	Exercisable between Feb 22, 2003 - Feb 21, 2010 at £1.115	5,000

The options which are exercisable between February 22, 2003 and February 21, 2010 were granted on February 22, 2000. In addition, 90,000 options were granted to T. Hancock on February 22, 2000 at £1.50 per share; these and a further 90,000 options which were granted to T. Hancock on February 19, 1999 at an exercise price of 62.5p have lapsed. There were no other movements during the year.

*2,678,413 shares in which L. F. Orbach is interested are owned through his family trusts. The remaining 235,000 are held by the Quarto Publishing plc pension scheme, which is for the benefit of both L. F. Orbach and R. J. Morley.

235,000 of the shares in which R. J. Morley is interested are owned through the Quarto Publishing plc pension scheme, which is for the benefit of both L. F. Orbach and R. J. Morley.

M. J. Mousley held 5,000 convertible cumulative redeemable shares of preferred stock of par value US\$0.10 each at December 31, 2000 (At January 1, 2000: 5,000).

During the year the market price of the shares of common stock ranged between 62.5p and 160.0p. The market price at December 31, 2000 was 87.0p.

Between December 31, 2000 and February 16, 2001 there have been no changes in the interests of the Directors.

SUBSTANTIAL SHAREHOLDERS

As at February 16, 2001, the latest practicable date prior to the publication of this report, the Directors have been advised of the following shareholders who have an interest of 3% or more in the shares of common stock of the Company:

	Number of US\$0.10	
	Shares of common stock	Percentage
Aerion Fund Management	618,026	3.3%
Clerical Medical Investment Group	716,132	3.8%
Goldman Sachs Securities	1,495,000	8.0%
Herald Investment Trust	632,690	3.4%
Bank of Bermuda	937,500	5.0%
UBS Asset Management Limited	1,891,623	10.1%
M & G Investment Management Limited	645,524	3.5%
Schroder Investment Management Limited	1,700,000	9.1%
L.F.Orbach	2,913,413	15.6%
R.J.Morley	1,539,424	8.2%
The Quarto Group, Inc.	750,000	4.0%

CORPORATE GOVERNANCE

The Directors have reviewed the governance arrangements of The Quarto Group, Inc. in the context of the Combined Code, issued in June 1998. The principles of the Code have been applied as follows:

- a) The Board of Directors represents the shareholders' interests in maintaining and growing a successful business including optimising consistent long-term financial returns.
- b) The Board comprises four executive Directors and three non-executive Directors. The non-executive Directors, P. Campbell, P. Waine and L. Collins are considered by the Board to be independent.
- c) The Board meets eight times a year. A formal agenda is prepared for each meeting and all board papers and information are circulated to the Board forty-eight hours before the meetings.
- d) All of the Directors are subject to re-election by the shareholders at the Annual General Meeting.
- e) The remuneration of the executive Directors is recommended by the Remuneration Committee. A separate report with respect to Directors' remuneration is included below.
- f) The Chairman and the Finance Director are responsible for investor relations. Shareholders are invited to attend the AGM at least twenty working days in advance of that meeting.
- g) The Audit Committee, comprising P. Campbell, P. Waine and L. Collins, meet with the auditors as necessary.

The Group has complied throughout the year with the provisions set out in Section 1 of the Combined Code appended to the Listing Rules of the London Stock Exchange, apart from those listed below. Where non-compliance is reported, this is because, in the opinion of the Board, it is not appropriate to change current practice due to the size and constitution of the Board. The provisions of the Combined Code not complied with are as follows:

- a) The Chairman of the Company is also the Chief Executive. Due to the size of the Group the Board sees no commercial benefit in splitting the roles of Chairman and Chief Executive.
- b) A formal schedule of matters specifically reserved for the Board is not required, since the Board forms the executive management of the Group.
- c) The Company does not have any formal arrangements for Directors, in the furtherance of their duties, to take independent professional advice.
- d) The Remuneration Committee does not consist exclusively of non-executive Directors. The Chairman, P. Campbell, P. Waine and L. Collins fulfil the role of the Remuneration Committee for Directors.
- e) Performance related bonuses are not given.
- f) There is no nominated senior non-executive Director.
- g) The Company does not have a Nominations Committee. The Board as a whole is responsible for the appointment of its own members.

GOING CONCERN

The Directors, having made enquiries, consider that the Group has adequate resources to continue in operational existence for the foreseeable future, and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

INTERNAL CONTROLS

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

The main elements of the internal control system are:

- a) The results of individual operating units are reported monthly and reviewed by the Board at its eight board meetings a year.
- b) The management reports of each operating unit are tailored to suit the business and management needs of local management. Each operating unit has its own performance indicators and these are regularly reviewed and assessed.
- c) In addition to the monthly reporting, individual operating units report certain management information more frequently where it is considered appropriate.
- d) All operating units report their bank balances twice weekly and a report is produced summarising the Group position.
- e) The Board and the finance department make frequent visits to all operating units. These visits include a review of the internal control system.
- f) All operating units prepare annual budgets and cash flow forecasts which are reviewed by the Board.

The Combined Code introduced a requirement that the directors review the effectiveness of the group's system of internal controls. This extends the existing requirement in respect of internal financial controls to cover all controls including financial, operational, compliance, and risk management. Following publication of guidance for the directors - *Internal Control: Guidance for Directors on the Combined Code* (the Turnbull guidance), the Board confirm that there is an ongoing process for, and an annual review covering, the identification, evaluation and management of the significant risks faced by the Group, that has been in place for the year under review and up to the date of approval of the annual report and accounts and that this process is regularly reviewed by the Board and accords with the guidance. The process is carried out through, inter alia:

- a) Group Board meetings.
- b) Quarterly subsidiary board meetings.
- c) Quarterly strategy meetings.
- d) Presentations by subsidiary Chief Executive officers to the Board.
- e) Discussion and review by the Executive Board and the finance department during the several visits per year to individual operating units.
- f) Discussions with professional advisers where appropriate.

The Board has considered the need for an internal audit function, but has resolved that, due to the size of the Group, this cannot be justified on the grounds of cost effectiveness at present.

DIRECTORS' REMUNERATION

The remuneration committee advises the Board on the remuneration and other terms of employment of executive Directors. With respect to Directors' remuneration the Board report that:

- a) Remuneration levels are set by reference to individual performance, experience and market conditions with a view to providing a package which is appropriate for the responsibilities involved.
- b) Performance related bonuses are not given.
- c) Each Director has a defined contribution personal pension plan.
- d) No Director has a service contract of more than one year's duration.
- e) Full details of Directors' remuneration and benefits are given in note 2 to the financial statements on page 37.

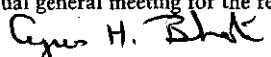
The remuneration committee is constituted in accordance with relevant provisions of Section B of the Combined Code, save that it does not consist exclusively of non-executive Directors and its terms of reference are not formally documented. The remuneration committee has given full consideration to Section B of the Combined Code Provisions in framing its remuneration policy.

SUPPLIER PAYMENT POLICIES

The Group agrees terms and conditions for its business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to when making payments, subject to the terms and conditions being met by the supplier. At December 31, 2000, Group creditor days amounted to 102 days [1999: 99 days]. The holding company does not have any trade creditors.

AUDITOR

Our auditor, KPMG Audit Plc, is willing to continue in office and, accordingly, a resolution is to be proposed at the annual general meeting for the reappointment of KPMG Audit Plc as auditor to the Company.


C. H. Blöte

Secretary

February 16, 2001

Statement of Directors' Responsibilities

The Company is incorporated in the State of Delaware, United States and is subject to the law of that state which places no requirement for annual reporting to shareholders upon the directors. However, since the Company has a listing on the London Stock Exchange and a place of business in the UK, the Directors are required to prepare financial statements which comply with certain provisions which are contained within the Listing Rules of the UK Financial Services Authority (the Listing Rules) and UK company law for overseas companies. In complying with these provisions, the Directors are required to prepare financial statements in accordance with the terms of chapter 17 of the Listing Rules (including compliance with approved Generally Accepted Accounting Principles, for which they have adopted UK GAAP) and the requirements of UK company law, and have assumed responsibility for making disclosures in accordance with Schedules 4 and 6 of the Companies Act 1985.

The Directors are responsible for preparing 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 or loss for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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 maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the relevant requirements of UK company law. They have assumed general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Auditor's Report

to the members of The Quarto Group, Inc.

We have audited the financial statements on pages 29 to 47.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Directors are responsible for preparing the financial statements. As described on page 27 of the financial statements, the Company is incorporated in the United States but the Directors are responsible for preparing financial statements in accordance with the terms of chapter 17 of the Listing Rules (including compliance with UK Generally Accepted Accounting Principles) and the requirements of UK company law appropriate to an overseas company, and have assumed responsibility for making disclosures in accordance with schedules 4 and 6 of the Companies Act 1985. Our responsibilities, as independent auditors, are established in the United Kingdom by the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the requirements of the Companies Act 1985 appropriate to an overseas company. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by Schedule 6 of the Companies Act 1985 or chapter 17 of the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

In addition to our audit of the financial statements, the Directors have instructed us to review their corporate governance statement as if the Company were required to comply with the Listing Rules of the Financial Services Authority in relation to these matters. We review whether the statement on pages 25 and 26 reflects the Company's compliance with the seven provisions of the Combined Code specified for audit review by those rules, 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 form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

BASIS OF 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. 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 Group's circumstances, consistently applied and adequately disclosed.

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

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at December 31, 2000 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the requirements of the Companies Act 1985 appropriate to an overseas company.

KPMG Audit Plc
KPMG Audit Plc
Chartered Accountants
London
February 16, 2001


Consolidated profit and loss account for the year ended December 31 2000

		GROUP	
	Notes	2000 £000	1999 £000
TURNOVER	1	73,564	76,456
Cost of sales		(47,639)	(50,524)
GROSS PROFIT		25,925	25,932
Distribution costs		(2,502)	(2,376)
Administration expenses			
-Before exceptional items and goodwill amortisation		(17,389)	(17,809)
-Exceptional items	2	(457)	-
-Goodwill amortisation		(58)	(12)
Total administrative expenses		(17,904)	(17,821)
Other operating income		54	78
GROUP OPERATING PROFIT		5,573	5,813
Loss on discontinued operations	2	-	(5,230)
		5,573	583
Net interest payable and similar charges	3	(2,023)	(1,716)
PROFIT (LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	2	3,550	(1,133)
Tax on profit on ordinary activities	4	(314)	(390)
PROFIT (LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION		3,236	(1,523)
Minority interests – equity		(413)	(440)
PROFIT (LOSS) FOR THE YEAR		2,823	(1,963)
Dividends (including non-equity)	5	(1,262)	(1,262)
RETAINED PROFIT (DEFICIT) FOR THE YEAR		1,561	(3,225)
EARNINGS (LOSS) PER SHARE	6	13.2p	(13.5)p
UNDERLYING EARNINGS PER SHARE	6	16.1p	15.8p
DILUTED EARNINGS (LOSS) PER SHARE	6	13.2p	(9.3)p
DILUTED UNDERLYING EARNINGS PER SHARE	6	15.8p	15.6p

Balance Sheets at December 31 2000

	Notes	GROUP		COMPANY	
		2000 £000	1999 £000	2000 £000	1999 £000
FIXED ASSETS					
Intangible assets	7	1,201	792	-	-
Tangible assets	7	6,141	6,341	-	-
Investments	8	-	-	12,925	14,847
		<u>7,342</u>	<u>7,133</u>	<u>12,925</u>	<u>14,847</u>
CURRENT ASSETS					
Stocks and work in progress	9	18,709	16,849	-	-
Debtors	10	26,503	26,243	-	-
Investments	11	1	1	-	-
Cash and deposits	12	9,691	9,567	-	-
		<u>54,904</u>	<u>52,660</u>	<u>-</u>	<u>-</u>
CREDITORS: Amounts falling due within one year	13	(26,642)	(26,362)	(697)	(1,325)
NET CURRENT ASSETS/(LIABILITIES)		<u>28,262</u>	<u>26,298</u>	<u>(697)</u>	<u>(1,325)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>35,604</u>	<u>33,431</u>	<u>12,228</u>	<u>13,522</u>
CREDITORS: Amounts falling due after more than one year	14	(31,337)	(29,833)	-	-
PROVISION FOR LIABILITIES AND CHARGES					
Deferred taxation	15	(1,202)	(1,151)	-	-
NET ASSETS		<u>3,065</u>	<u>2,447</u>	<u>12,228</u>	<u>13,522</u>
CAPITAL AND RESERVES					
Called up share capital	16	1,341	1,341	1,341	1,341
Treasury stock	17	(461)	(461)	(461)	(461)
Reserves – Paid in surplus	18	23,891	23,891	23,891	23,891
– Revaluation		1,018	1,018	-	-
– Profit and loss	19	(25,852)	(26,097)	(12,543)	(11,249)
SHAREHOLDERS' (DEFICIT) FUNDS		<u>(63)</u>	<u>(308)</u>	<u>12,228</u>	<u>13,522</u>
Equity		(5,267)	(5,512)	7,024	8,318
Non-equity		<u>5,204</u>	<u>5,204</u>	<u>5,204</u>	<u>5,204</u>
		<u>(63)</u>	<u>(308)</u>	<u>12,228</u>	<u>13,522</u>
MINORITY INTERESTS – EQUITY		<u>3,128</u>	<u>2,755</u>	<u>-</u>	<u>-</u>
		<u>3,065</u>	<u>2,447</u>	<u>12,228</u>	<u>13,522</u>

The financial statements on pages 29 to 47 were approved by the Board of Directors on February 16, 2001 and were signed on its behalf by :


M. J. MOUSLEY
Director

Consolidated Statement of Total Recognised Gains and Losses for the Year Ended December 31 2000

	GROUP	
	2000	1999
	£000	£000
PROFIT (LOSS) FOR THE FINANCIAL YEAR	2,823	(1,963)
Currency translation differences		
on foreign currency net investments	(1,316)	(531)
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR	1,507	(2,494)

Reconciliation of consolidated movement in shareholders' funds for the Year Ended December 31 2000

	2000	1999
	£000	£000
PROFIT (LOSS) FOR THE FINANCIAL YEAR	2,823	(1,963)
Dividends	(1,262)	(1,262)
Retained profit (deficit) for the financial year	1,561	(3,225)
Other recognised gains and losses relating to the year	(1,316)	(531)
Goodwill on closure of operations written back to reserves	-	4,937
Net movement in shareholders' funds	245	1,181
Shareholders' deficit at December 31, 1999	(308)	(1,489)
SHAREHOLDERS' DEFICIT AT December 31, 2000	(63)	(308)

Consolidated Cash Flow Statement for the Year Ended December 31 2000

	GROUP	
	2000	1999
	£000	£000
NET CASH INFLOW FROM OPERATING ACTIVITIES	<u>6,409</u>	<u>8,259</u>
RETURN ON INVESTMENT AND SERVICING OF FINANCE		
Interest received	485	338
Interest paid	(2,464)	(2,029)
Interest element of hire purchase payments	(44)	(45)
Preference dividend paid	<u>(455)</u>	<u>(455)</u>
NET CASH OUTFLOW FROM RETURN ON INVESTMENT AND SERVICING OF FINANCE	<u>(2,478)</u>	<u>(2,191)</u>
TAXATION		
UK and overseas corporation tax paid	<u>(627)</u>	<u>(594)</u>
CAPITAL EXPENDITURE		
Purchase of tangible fixed assets	(487)	(690)
Sale of tangible fixed assets	37	225
	<u>(450)</u>	<u>(465)</u>
ACQUISITIONS AND DISPOSALS		
Purchase of businesses/subsidiaries	<u>(1,471)</u>	<u>(67)</u>
EQUITY DIVIDENDS PAID		
Dividends paid	<u>(877)</u>	<u>(928)</u>
MANAGEMENT OF LIQUID RESOURCES		
Movement in short term deposits	<u>(115)</u>	<u>(1,418)</u>
FINANCING		
Capital element of finance leases	(408)	(521)
(Decrease) increase in debt	<u>(980)</u>	<u>999</u>
NET CASH (OUTFLOW) INFLOW FROM FINANCING	<u>(1,388)</u>	<u>478</u>
(DECREASE) INCREASE IN CASH	<u>(997)</u>	<u>3,074</u>
RECONCILIATION OF NET CASHFLOW TO MOVEMENT IN NET DEBT		
(Decrease) increase in cash	(997)	3,074
Decrease (increase) in debt and lease financing	1,388	(478)
Management of liquid resources	115	1,418
	<u>506</u>	<u>4,014</u>
New finance leases	(324)	(726)
Translation differences	<u>(2,286)</u>	<u>(364)</u>
	<u>(2,104)</u>	<u>2,924</u>
MOVEMENT IN DEBT FOR YEAR		
Net debt at beginning of year	<u>(20,894)</u>	<u>(23,818)</u>
Net debt at end of year	<u>(22,998)</u>	<u>(20,894)</u>

See note 22 for an analysis of certain of the items included above.

Accounting Policies

BASIS OF PREPARATION

The significant accounting policies that have been adopted in the financial statements, which are presented under the historical cost basis of accounting, as modified by the revaluation of freehold property, are as set out below and comply with applicable accounting standards. The Company is an "oversea company" within the meaning of the Companies Act 1985; it therefore complies with the company laws of the state of Delaware, United States, which are different in certain respects from the Companies Act 1985, in particular in relation to distributable reserves and the arrangements with directors. The financial statements have been prepared in accordance with the terms of chapter 17 of the Listing Rules of the UK Financial Services Authority (in complying with which the Directors have elected to adopt UK Generally Accepted Accounting Principles) and the requirements of UK company law appropriate to an oversea company, and in addition include disclosures in accordance with Schedules 4 and 6 of the Companies Act 1985 with the exception of accounting for treasury stock as explained in note 17.

BASIS OF CONSOLIDATION

The consolidated financial statements represent a consolidation of the audited accounts of The Quarto Group, Inc. and its subsidiaries, all of which have been made up to December 31.

The results of subsidiaries acquired during the year and requiring to be acquisition accounted are included from the date on which control passes. On the acquisition of a business, fair values, reflecting conditions at the date of acquisition, are attributed to the net tangible assets. Where the fair value of the purchase consideration exceeds the values attributable to the Group's share of such net assets, the difference is treated as purchased goodwill and for accounting periods up to December 31, 1997 this was written off directly to reserves in the year of acquisition. Goodwill on acquisitions subsequent to December 31, 1997 is capitalised as an intangible fixed asset and written off over its useful economic life (not more than 20 years). Reorganisation and integration costs resulting from the acquisition are charged to the profit and loss account. The profit or loss on the disposal or discontinuation of a previously acquired business is calculated taking account of the attributable amount of purchased goodwill relating to that business.

In accordance with the exemptions allowed by Section 230 of the Companies Act 1985, the Company has not presented its own profit and loss account.

CHANGE IN ACCOUNTING POLICY

FRS15 "tangible fixed assets" has been adopted in the year and requires freehold buildings to be depreciated. Under previous accounting standards, such depreciation was not provided on the basis that the economic lives and residual values of freehold buildings were such that depreciation was not material.

As permitted by the transitional arrangements of FRS15, the Group has chosen to hold freehold properties at previous valuations. Depreciation has been provided on freehold buildings at 2% per annum with effect from January 2000. No depreciation will be provided on freehold land.

In accordance with the provisions of FRS15, the depreciation arising from the introduction of the standard will be dealt with prospectively and, therefore, no prior year adjustment has been made.

FOREIGN CURRENCY

Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the respective balance sheet dates. Profit and loss accounts in foreign currencies are translated at average rates for the respective accounting periods. Exchange differences arising on the translation of the net assets and profit and loss accounts of non-UK companies together with exchange differences on related borrowings are accounted for through reserves. All other exchange differences are recorded as ordinary trading items.

TURNOVER

Turnover represents the invoiced value of goods and services supplied to third parties, excluding Value Added Tax.

Accounting Policies

DEPRECIATION

Depreciation is calculated to write off the cost less estimated residual value of fixed assets by annual instalments over their estimated economic lives at the following annual rates:

Freehold Buildings / Long leasehold	: 2% straight line
Short leaseholds	: over the period of the lease
Plant, equipment and motor vehicles	: 10-25% straight line
Fixtures and fittings	: 15-20% straight line

No depreciation is provided on freehold land.

STOCKS AND WORK IN PROGRESS

Stocks and work in progress are valued at the lower of cost, including an appropriate portion of overheads, and net realisable value. Production costs (excluding unit print costs), including an appropriate proportion of overheads, in respect of a book are charged against the first printing of a book.

DEFERRED TAXATION

Provision is made, using the liability method, for deferred taxation on all material timing differences which are expected to crystallise.

COPYRIGHTS

Predominately the Group owns the copyright in its titles. No value is attributed to these rights.

LEASE AND HIRE PURCHASE CONTRACTS

Where assets are acquired under finance leases (including hire purchase contracts) the amount representing the outright purchase price of such assets is included in tangible fixed assets. Depreciation is provided in accordance with the accounting policy above. The capital element of future finance lease payments is included in creditors and the interest element is charged to the profit and loss account over the period of the lease in proportion to the capital element outstanding. Expenditure on operating leases is charged to the profit and loss account on a straight line basis.

PENSIONS

Substantially all of the Group's pension costs relate to individual pension plans and are charged to the profit and loss account as they arise.

FINANCIAL INSTRUMENTS

Page 21 of the Financial Review provides an explanation of the role that financial instruments have had during the period in creating or changing the risks the Group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts and the strategies for achieving those objectives that have been followed during the period.

As permitted by FRS 13, short-term debtors and creditors have been excluded from the disclosures, other than currency disclosures.

Notes to the Financial Statements

GROUP

2000
£000

1999
£000

I SEGMENTAL ANALYSIS

GEOGRAPHICAL ANALYSIS OF TURNOVER BY DESTINATION

United Kingdom	14,189	15,177
United States of America	39,783	36,605
Canada	1,838	1,988
Europe	9,319	14,576
Australasia and the Far East	6,383	5,628
Rest of the World	2,052	2,482
	<u>73,564</u>	<u>76,456</u>

	TURNOVER		PROFIT BEFORE TAX		NET OPERATING ASSETS	
	2000 £000	1999 £000	2000 £000	1999 £000	2000 £000	1999 £000
CLASS OF BUSINESS						
Co-edition Publishing	43,472	47,106	5,429	5,810	14,000	12,148
Publishing	30,092	29,350	1,902	1,208	13,885	13,336
	<u>73,564</u>	<u>76,456</u>	<u>7,331</u>	<u>7,018</u>	<u>27,885</u>	<u>25,484</u>

Amortisation of goodwill: Co-edition Publishing	(58)	(12)
Group overheads	(1,243)	(1,193)
Exceptional items: Co-edition Publishing	(457)	-
Loss on discontinued operations: Publishing	-	(5,230)
Net interest payable	(2,023)	(1,716)
	<u>3,550</u>	<u>(1,133)</u>

The group interest expense is arranged centrally and is not attributed to individual activities or geographical areas.

ANALYSIS BY GEOGRAPHICAL AREA OF ORIGIN

	TURNOVER		OPERATING PROFIT		NET OPERATING ASSETS	
	2000 £000	1999 £000	2000 £000	1999 £000	2000 £000	1999 £000
United Kingdom	29,250	36,825	2,793	4,192	7,744	6,275
United States of America	28,520	25,925	3,157	1,872	12,944	12,337
Rest of the World	15,794	13,706	1,381	954	7,197	6,872
	<u>73,564</u>	<u>76,456</u>	<u>7,331</u>	<u>7,018</u>	<u>27,885</u>	<u>25,484</u>

Notes to the Financial Statements

	GROUP	
	2000 £000	1999 £000
1 SEGMENTAL ANALYSIS (CONTINUED)		
The net operating assets can be reconciled to the consolidated balance sheet as follows:		
Net operating assets	27,885	25,484
Total bank loans and other borrowings	(32,689)	(30,461)
Cash at bank and in hand	9,691	9,567
Corporation tax and deferred tax	(1,410)	(1,656)
Dividends payable	(412)	(487)
Net assets	3,065	2,447

2 PROFIT (LOSS) ON ORDINARY ACTIVITIES
BEFORE TAXATION IS STATED AFTER CHARGING:

Depreciation	1,118	1,056
Auditors' remuneration : audit	182	171
: other	5	7
Operating lease rentals in respect of:		
Plant and machinery	71	54
Other assets	1,087	1,019
Exceptional items: restructuring costs	457	-
Loss on discontinued operations:		
Closure costs with respect to the Broughton Hall business	-	293
Goodwill written back	-	4,937
	-	5,230

Restructuring costs primarily relate to the relocation and operational mergers of co-edition businesses.

Included under auditors' remuneration are audit fees in respect of the Company, amounting to £39,000 [1999: £38,000]. The fees have been dealt with through the financial statements of Quarto Publishing plc.

A loss of £1,294,000 [1999: £899,000] has been dealt with in the accounts of the Company.

EMPLOYEES

STAFF COSTS INCLUDING DIRECTORS' EMOLUMENTS COMPRISE:

Wages and salaries	11,089	10,472
Social security costs	895	833
Pension costs	348	317
	12,332	11,622

	2000 Number	1999 Number
--	----------------	----------------

**THE AVERAGE MONTHLY NUMBER OF PERSONS
EMPLOYED BY THE GROUP DURING THE YEAR WAS:**

Co-edition Publishing	188	193
Publishing	234	225
Group administration	15	15
	437	433

Notes to the Financial Statements

	GROUP	
	2000 £000	1999 £000
2 PROFIT (LOSS) ON ORDINARY ACTIVITIES (CONTINUED)		
DIRECTORS' REMUNERATION		
EMOLUMENTS:		
Fees to non-executive Directors	51	43
Executive Directors – remuneration including benefits in kind in respect of		
motor vehicles and health insurance	765	669
– pension contributions	103	96
– compensation for loss of office	100	-
	<u>1,019</u>	<u>808</u>

The Directors' remuneration disclosed above included the following amounts paid in respect of the Chairman, who was also the highest paid Director:

Remuneration	253	195
Pension contributions	38	38
	<u>291</u>	<u>233</u>

Details of Directors' share options are given in the Directors' report. During the year certain of the Directors maintained current accounts with the Company. The balance on these current accounts can be found under note 23 on page 47.

The remuneration of the Directors was as follows:

	SALARY/ FEES £000	BENEFITS £000	PENSION CONTRIBUTION £000	COMPENSATION FOR LOSS OF OFFICE £000	2000 TOTAL £000	1999 TOTAL £000
L. F. Orbach	250	3	38	-	291	233
R. J. Morley	171	3	26	-	200	176
M. J. Mousley	125	2	19	-	146	128
T. Hancock	115	3	17	100	235	133
G. T. Y. Tai	75	18	3	-	96	95
P. Campbell	17	-	-	-	17	15
P. Waine	17	-	-	-	17	15
L. Collins	17	-	-	-	17	13
	<u>787</u>	<u>29</u>	<u>103</u>	<u>100</u>	<u>1,019</u>	<u>808</u>

Notes to the Financial Statements

	GROUP	
	2000	1999
	£000	£000
3 NET INTEREST PAYABLE AND SIMILAR CHARGES		
Interest payable:		
On bank overdrafts and other loans repayable within 5 years by instalments	2,464	2,010
Hire purchase	44	45
	<u>2,508</u>	<u>2,055</u>
Interest receivable	(485)	(339)
	<u>2,023</u>	<u>1,716</u>

4 TAXATION

On profit for the year:		
United Kingdom corporation tax at 30%	-	-
Deferred taxation - UK	41	123
~ Overseas	(57)	(115)
Overseas tax	<u>330</u>	<u>382</u>
	<u>314</u>	<u>390</u>

The Group's low taxation charge reflects the benefit of tax losses in the UK, tax relief on the write-off of intangible assets in the US and low tax rates in Hong Kong and Switzerland.

5 DIVIDENDS

Equity: Ordinary: Interim paid of 2.2p per share		
[1999: 2.2p per share]	395	395
Ordinary: Final proposed of 2.3p per share		
[1999: 2.3p per share]	<u>412</u>	<u>412</u>
	807	807
Non-equity: Preference	<u>455</u>	<u>455</u>
	<u>1,262</u>	<u>1,262</u>

6 EARNINGS PER SHARE

The calculation of earnings per share is based on 17,925,306 shares, the number of issued shares less the shares held as treasury stock, (1999: 17,925,306) and a profit, after minority interests and preference dividends of £2,368,000 (1999: loss of £2,418,000). The calculation of underlying earnings per share is based on earnings of £2,883,000 (1999: £2,824,000) calculated as follows:

	2000	1999
	£000	£000
Earnings after minority interests and preference dividends	2,368	(2,418)
Exceptional items	457	-
Loss on discontinued operations	-	5,230
Amortisation of goodwill	<u>58</u>	<u>12</u>
	<u>2,883</u>	<u>2,824</u>

Diluted earnings per share is based on 17,972,702 shares (1999: 21,063,732) and earnings of £2,368,000 (1999: loss of £1,963,000). The number of shares for 2000 incorporates 47,396 with regard to dilutive options (1999: 3,122,414 with regard to the conversion of the preference shares and 16,012 with regard to dilutive options). Diluted underlying earnings per share is based on 21,095,116 shares (incorporating 3,122,414 with regard to the conversion of the preference shares and 47,396 with regard to dilutive options) and earnings of £3,338,000 being the underlying earnings calculated above plus the preference dividend of £455,000 (1999: 21,063,732 shares and earnings of £3,279,000).

Notes to the Financial Statements

	GROUP				
	FREEHOLD PROPERTY £000	LEASEHOLD PROPERTY £000	PLANT EQUIPMENT AND MOTOR VEHICLES		TOTAL £000
			AND	FIXTURES	
				AND FITTINGS £000	
7 FIXED ASSETS					
TANGIBLE FIXED ASSETS					
Group					
Cost or valuation:					
At January 1, 2000	2,880	979	5,546	1,102	10,507
Exchange differences	34	54	178	60	326
Additions	-	14	723	74	811
Disposals	-	(27)	(657)	(132)	(816)
At December 31, 2000	2,914	1,020	5,790	1,104	10,828
Depreciation:					
At January 1, 2000	30	372	3,001	763	4,166
Exchange differences	-	20	116	42	178
Charge for the year	32	93	839	154	1,118
Disposals	-	(27)	(625)	(123)	(775)
At December 31, 2000	62	458	3,331	836	4,687
Net book value:					
At December 31, 2000	2,852	562	2,459	268	6,141
At December 31, 1999	2,850	607	2,545	339	6,341

The net book value of plant, equipment and motor vehicles included £796,000 [1999: £830,000] in respect of assets held under hire purchase contracts. The depreciation charged on these assets during the year was £133,000 [1999: £144,000]. Included in leasehold property at cost is £376,000 [1999: £344,000] in respect of a long leasehold property; the net book value was £311,000 [1999: £293,000].

Freehold property at valuation comprises buildings £1,593,000 and land £1,321,000. The principal freehold property in the UK, with a historic cost of £382,000, was revalued on the basis of an open market value for existing use at December 31, 1989 by Conway Kersh, Professional Valuers. The valuation was £1.7 million but the Directors ascribed a value of £1.4 million, on the grounds of prudence. The valuation was in accordance with RICS Statements of Asset Valuation Practice and Guidance Notes.

As stated in the accounting policy note on page 33, the Directors have chosen to hold freehold properties at these valuations under the transitional arrangements of FRS15.

INTANGIBLE FIXED ASSETS

Intangible fixed assets comprises goodwill on acquisition at a cost of £1,271,000 less amortisation of £70,000. The goodwill arising during the year (£467,000) relates to the acquisition of the remaining 12.5% interest in Design Eye Holdings Limited. No fair value adjustments were made as the effect is not material. The amortisation during the year amounted to £58,000.

Notes to the Financial Statements

	COMPANY		
	SHARES		
	AT COST	LOANS	TOTAL
	£000	£000	£000
8 FIXED ASSET INVESTMENT			
At January 1, 2000	9,841	5,006	14,847
Additions (repaid)	630	(2,552)	(1,922)
At December 31, 2000	10,471	2,454	12,925

The Company has the following principal trading subsidiaries (*Directly held by The Quarto Group, Inc.), all of which operate in their country of incorporation.

NAME	PLACE AND DATE OF INCORPORATION	ISSUED AND FULLY PAID SHARE CAPITAL	PERCENTAGE HELD	BUSINESS
Quarto Publishing plc	England April 1, 1976	100,000 shares of £1 each	100*	Co-edition Publishing
Quarto Inc.	Delaware, USA October 16, 1986	60 shares of no par value	100*	Co-edition Publishing
Western Screen and Sign Limited	England November 24, 1961	1,500 shares of £1 each	100*	Publishing
Quarto Magazines Limited	England May 20, 1986	1,000 shares of £1 each	100	Publishing
Regent Publishing Services Limited	Hong Kong October 23, 1985	1,000 shares of HK\$10 each	75	Co-edition Publishing
Apple Press Limited	England June 5, 1984	100 shares of £1 each	100	Publishing
Quarto Australia Pty Ltd.	Australia September 14, 1981	8 redeemable preference shares of A\$1 each and 103 ordinary shares of A\$1 each	100*	Publishing
AP Screenprinters Limited	England September 30, 1980	1,000 shares of £1 each	100	Publishing
RotoVision S.A.	Switzerland July 18, 1977	1,500 shares of SFr500 each	100*	Co-edition Publishing
Rockport Publishers Inc.	Massachusetts, USA December 4, 1985	4,000 shares of no par value	100	Co-edition Publishing
Book Sales Inc.	Delaware, USA December 13, 1972	85 shares of no par value	80	Publishing
Quarto Children's Books Limited	England January 6, 1976	2 shares of £1 each	100	Co-edition Publishing
Scafa-Tornabene Art Publishing Co., Inc.	Delaware, USA June 29, 1987	1,210 shares of no par value	100	Publishing
Front Line Graphics, Inc.	Delaware, USA April 29, 1994	1,000 shares of US\$1 each	100	Publishing
Walter Foster Publishing, Inc.	Delaware, USA February 10, 1988	19,625 shares of US\$0.01 each	100	Publishing
Design Eye Holdings Limited	England June 22, 1992	200 shares of £1 each	100*	Co-edition Publishing
Global Book Publishing Pty. Limited	Australia November 4, 1999	1,000 shares of A\$1 each	100*	Co-edition Publishing

Notes to the Financial Statements

	GROUP		COMPANY	
	2000	1999	2000	1999
	£000	£000	£000	£000
9 STOCKS AND WORK IN PROGRESS				
Finished goods	13,224	12,437	-	-
Work in progress	5,405	4,143	-	-
Raw materials	264	439	-	-
Less: Payments on account	(184)	(170)	-	-
	<u>18,709</u>	<u>16,849</u>	<u>-</u>	<u>-</u>
10 DEBTORS				
Trade debtors	24,670	24,381	-	-
Prepayments and accrued income	1,589	1,554	-	-
Other debtors	244	308	-	-
	<u>26,503</u>	<u>26,243</u>	<u>-</u>	<u>-</u>
11 CURRENT ASSET INVESTMENTS				
Listed investments at cost (market value £1,000)				
{1999: £1,000} Listed other than on The				
International Stock Exchange in London	<u>1</u>	<u>1</u>	<u>-</u>	<u>-</u>
12 CASH AND DEPOSITS				
Cash at bank	6,875	6,969	-	-
Short term deposits	<u>2,816</u>	<u>2,598</u>	<u>-</u>	<u>-</u>
	<u>9,691</u>	<u>9,567</u>	<u>-</u>	<u>-</u>
13 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR				
Bank overdrafts	1,198	631	-	-
Current loan instalments	148	138	-	-
Hire purchase creditors	<u>280</u>	<u>278</u>	<u>-</u>	<u>-</u>
Total borrowings	1,626	1,047	-	-
Trade creditors	20,959	20,293	-	-
Other creditors including taxation and social security:				
Corporation tax	208	505	-	-
Dividend payable	412	412	412	412
Dividend payable to minority shareholders	-	75	-	-
Social security	479	416	-	-
Other creditors	939	1,481	285	913
Accruals and deferred income	<u>2,019</u>	<u>2,133</u>	<u>-</u>	<u>-</u>
	<u>26,642</u>	<u>26,362</u>	<u>697</u>	<u>1,325</u>

Notes to the Financial Statements

	GROUP		COMPANY	
	2000	1999	2000	1999
	£000	£000	£000	£000
14 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Bank and other loans	30,899	29,164	-	-
Hire purchase liabilities	164	250	-	-
Total borrowings	31,063	29,414	-	-
Other creditors	274	419	-	-
	<u>31,337</u>	<u>29,833</u>	<u>-</u>	<u>-</u>
 Total borrowings are repayable as follows:				
Bank loans and overdrafts:				
In one year or less, or on demand	1,346	769	-	-
Between one and two years	30,817	116	-	-
Between two and five years	82	29,048	-	-
	<u>32,245</u>	<u>29,933</u>	<u>-</u>	<u>-</u>
 Other borrowings (hire purchase liabilities):				
In one year or less, or on demand	280	278	-	-
Between one and two years	138	198	-	-
Between two and five years	26	52	-	-
	<u>444</u>	<u>528</u>	<u>-</u>	<u>-</u>
 Total loans and other borrowings:				
In one year or less, or on demand	1,626	1,047	-	-
Between one and two years	30,955	314	-	-
Between two and five years	108	29,100	-	-
	<u>32,689</u>	<u>30,461</u>	<u>-</u>	<u>-</u>

The above borrowings carry interest at commercial rates ranging from 1.2% to 8.1%. Of the total borrowings £29,225,000 (1999: £28,091,000) was denominated in US dollars, the remainder being denominated in a variety of currencies.

Notes to the Financial Statements

GROUP			
AMOUNT PROVIDED		POTENTIAL LIABILITY	
2000	1999	2000	1999
£000	£000	£000	£000
143	144	143	144
(76)	21	(76)	21
1,135	986	1,189	1,121
-	-	305	305
1,202	1,151	1,561	1,591

The movement on the provision for deferred taxation is as follows:

	£000	£000
Provision at January 1, 2000	1,151	1,188
Exchange difference	67	(45)
Transfer to profit and loss account	(16)	8
Provision at December 31, 2000	<u>1,202</u>	<u>1,151</u>

16 SHARE CAPITAL

Authorised:

28,000,000 [1999: 28,000,000] shares of common stock of par value US\$0.10 each ("shares of common stock") with an aggregate nominal value of US\$2,800,000 [1999: US\$2,800,000].

5,212,587 [1999: 5,212,587] 8.75p (net) convertible cumulative redeemable shares of preferred stock of US\$0.10 each ("shares of preferred stock") with an aggregate nominal value of US\$521,258 [1999: US\$521,258].

	2000	1999
	£000	£000
Equity share capital		
Allotted, called up and fully paid:		
18,675,306 shares of common stock of par value US\$0.10 each		
[1999: 18,675,306]	1,063	1,063
Non-equity share capital		
Allotted, called up and fully paid:		
5,204,024 shares of preferred stock of US\$0.10 each		
[1999: 5,204,024]	278	278
	<u>1,341</u>	<u>1,341</u>

Notes to the Financial Statements

At December 31, 2000, the following options over shares of common stock were outstanding under the Company's Executive Share Option Schemes.

NUMBER OF SHARES	DATE EXERCISABLE	OPTION PRICE PER SHARE
65,000	April 10, 1995 – April 9, 2002	£1.30424
34,000	October 26, 1996 – October 25, 2003	£2.82
40,000	March 31, 2001 – March 30, 2008	£0.685
5,000	August 18, 2001 – August 17, 2008	£0.84
10,000	March 29, 2002 – March 28, 2009	£0.76
81,000	February 22, 2003 – February 21, 2010	£1.115

The movement in outstanding options from December 31, 1999 comprises (a) 15,500 shares exercisable between March 31, 2001 and March 30, 2008 lapsed (b) 90,000 shares exercisable between February 19, 2002 and February 18, 2009 lapsed, (c) 81,000 shares exercisable between February 22, 2003 and February 21, 2010 were granted and (d) 90,000 shares were granted to T. Hancock on February 22, 2000 at £1.50 per share and these options have lapsed.

The shares of preferred stock are convertible into shares of common stock on June 1, 1990 and annually thereafter at a rate of 60 shares of common stock for every 100 shares of preferred stock. The Company may at any time purchase shares of preferred stock in accordance with the rights attaching to such shares. The Company is obliged to redeem all outstanding shares of preferred stock in 2005 at a price of £1. The holders of the preferred stock are not entitled to vote at any meeting of shareholders unless their dividend payment is more than six months overdue or the meeting is being held to consider a resolution for liquidation, dissolution, winding up or the appointment of a receiver. On liquidation, dissolution or other winding up the holders of the preferred stock are entitled to be paid out of the available assets of the Company the sum of £1 per share and the amount of all accrued dividends payable in priority to any payment being made to the holders of common stock. There are no special rights to dividends in respect of holders of common stock.

17 TREASURY STOCK

At January 1, 2000 and December 31, 2000

GROUP		COMPANY	
2000	1999	2000	1999
£000	£000	£000	£000
<u>461</u>	<u>461</u>	<u>461</u>	<u>461</u>

The Company purchased 750,000 of its own shares during 1998. As a US company, it is permitted to hold these shares as treasury stock, without cancelling them, and to reissue them. Companies are not permitted to own their own shares in the same way under UK law and therefore the directors consider that the presentation of own shares as fixed asset investments that is required by paragraph 8 of Schedule 4 to the Companies Act 1985 would not give a true and fair view in the case of this company. In accordance with section 226 of that Act, the directors have overridden the detailed requirement and adopted the presentation normally used by US companies in order to show a true and fair view. The effect is to reduce fixed asset investments and shareholders' funds in the balance sheets of the Group and of Company by £461,000.

Notes to the Financial Statements

	GROUP		COMPANY	
	2000	1999	2000	1999
	£000	£000	£000	£000
18 RESERVES – PAID IN SURPLUS				
At January 1, 2000	<u>23,891</u>	<u>23,891</u>	<u>23,891</u>	<u>23,891</u>
At December 31, 2000	<u>23,891</u>	<u>23,891</u>	<u>23,891</u>	<u>23,891</u>
19 RESERVES – PROFIT AND LOSS ACCOUNT				
At January 1, 2000	(26,097)	(27,278)	(11,249)	(10,350)
Retained profit (deficit) for the year	1,561	(3,225)	(1,294)	(899)
Goodwill relating to closure of operations written back to reserves	-	4,937	-	-
Difference on translation of net assets and profit and loss accounts of non-UK companies	<u>(1,316)</u>	<u>(531)</u>	<u>-</u>	<u>-</u>
At December 31, 2000	<u>(25,852)</u>	<u>(26,097)</u>	<u>(12,543)</u>	<u>(11,249)</u>
 This is analysed as follows:				
Profit and loss account	(1,138)	(1,383)	(12,543)	(11,249)
Goodwill	<u>(24,714)</u>	<u>(24,714)</u>	<u>-</u>	<u>-</u>
	<u>(25,852)</u>	<u>(26,097)</u>	<u>(12,543)</u>	<u>(11,249)</u>

Notes to the Financial Statements

	GROUP			
	LAND AND		LAND AND	
	BUILDINGS	OTHER	BUILDINGS	OTHER
	2000	2000	1999	1999
	£000	£000	£000	£000
20 FINANCIAL COMMITMENTS				
At December 31, 2000, the Group had annual commitments to make payments under operating leases during the next year as follows for leases expiring:				
Within one year	493	4	131	18
Between two and five years	461	73	776	61
Over five years	117	-	116	-
	<u>1,071</u>	<u>77</u>	<u>1,023</u>	<u>79</u>

The land and buildings leases are subject to rent reviews.

Capital commitments at the end of the year for which no provision had been made amounted to £335,000 [1999: £24,000]. This expenditure was authorised and contracted for.

21 CONTINGENT COMMITMENTS AND LIABILITIES

Quarto Inc has an agreement to purchase the common stock from the minority shareholder in Book Sales Inc at the end of a five year period, which was October 1996. The purchase price shall be based on the shareholders' investment in Book Sales Inc, adjusted for subsequent earnings. At December 31, 2000 there was a potential liability, based on Book Sales Inc's financial statements, of approximately US \$2,213,000. No provision has been made because the minority shareholder has not exercised his option. At December 31, 2000 the minority interest in the consolidated financial statements of The Quarto Group Inc was US\$1,526,000.

The Quarto Group Inc. has issued guarantees in respect of £1,198,000 of overdrafts of subsidiaries [1999: £631,000] and bank loans of £30,775,000 [1999: £28,867,000].

The Group has also issued guarantees in respect of £444,000 of hire purchase creditors of subsidiaries [1999: £528,000].

There are other contingent liabilities, arising in the ordinary course of business, in respect of litigation, which the Directors believe will not have a significant effect on the financial position of the Group.

Notes to the Financial Statements

	GROUP	
	2000	1999
	£000	£000
22 NOTES ON THE CONSOLIDATED CASH FLOW STATEMENT		
RECONCILIATION OF OPERATING PROFIT		
TO NET CASH INFLOWS FROM OPERATING ACTIVITIES		
Operating profit	5,573	5,813
Discontinued Operations	-	(291)
Depreciation and amortisation charge	1,176	1,068
Loss on sale of fixed assets	4	149
Decrease (increase) in stocks and work in progress	(792)	984
Decrease in creditors	(1,037)	(2,470)
Decrease in debtors	1,485	3,006
Net cash inflow from operating activities	6,409	8,259

	AS AT JAN 1, 00 £000	CASH FLOW £000	EXCHANGE DIFFERENCE £000	NEW HIRE PURCHASE £000	AS AT DEC 31, 00 £000
ANALYSIS OF NET DEBT					
Cash at bank and in hand	6,969	(466)	372	-	6,875
Bank overdrafts < 1 year	(631)	(531)	(36)	-	(1,198)
	6,338	(997)	336	-	5,677
HP creditors	(528)	408	-	(324)	(444)
Current loan instalments < 1 year	(138)	(10)	-	-	(148)
Bank loans > 1 year	(29,004)	955	(2,725)	-	(30,774)
Mortgages	(160)	35	-	-	(125)
	(29,830)	1,388	(2,725)	(324)	(31,491)
Management of liquid resources	2,598	115	103	-	2,816
Net Debt	(20,894)	506	(2,286)	(324)	(22,998)

23 RELATED PARTY TRANSACTIONS

During the year L. F. Orbach and R. J. Morley maintained current accounts with the Group. The balances on these accounts were less than £5,000 throughout the year.

Historical cost five-year summary

	GROUP				
	1996	1997	1998	1999	2000
	£000	£000	£000	£000	£000
PROFIT AND LOSS ACCOUNT					
Turnover	80,619	81,820	79,156	76,456	73,564
Operating profit before exceptional charges	7,162	4,585	4,994	5,813	5,573
Net interest	(1,329)	(1,941)	(1,931)	(1,716)	(2,023)
Profit before exceptional charges and taxation	5,833	2,644	3,063	4,097	3,550
LOSS ON CLOSURE OF OPERATIONS	-	(1,160)	(580)	(5,230)	-
PROFIT (LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION	5,833	1,484	2,483	(1,133)	3,550
Taxation	(1,906)	(636)	(849)	(390)	(314)
PROFIT (LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION	3,927	848	1,634	(1,523)	3,236
Minority interests	(528)	(500)	(555)	(440)	(413)
PROFIT (LOSS) FOR THE FINANCIAL YEAR	3,399	348	1,079	(1,963)	2,823
Dividends	(1,944)	(1,296)	(1,278)	(1,262)	(1,262)
RETAINED PROFIT (LOSS)	1,455	(948)	(199)	(3,225)	1,561
EARNINGS PER SHARE					
Underlying	13.5p	3.9p	4.9p	15.8p	16.1p
Basic	15.8p	(0.6p)	3.3p	(13.5p)	13.2p
DIVIDENDS PER SHARE	8.0p	4.5p	4.5p	4.5p	4.5p
BALANCE SHEET					
Fixed assets	7,392	6,759	6,408	7,133	7,342
Other net assets	17,712	19,362	18,516	16,208	18,721
	25,104	26,121	24,924	23,341	26,063
NET BORROWINGS	(22,444)	(24,448)	(23,818)	(20,894)	(22,998)
NET ASSETS	2,660	1,673	1,106	2,447	3,065
CASH FLOW					
Net cash inflow from operating activities	1,807	4,903	5,907	8,259	6,409
Return on investment and servicing of finance	(1,691)	(2,427)	(2,417)	(2,191)	(2,478)
Taxation	(996)	(1,453)	(678)	(594)	(627)
Capital expenditure and financial investment	(1,009)	(28)	(878)	(465)	(450)
Acquisition and disposals	(7,552)	(565)	30	(67)	(1,471)
Equity dividends paid	(1,386)	(1,587)	(955)	(928)	(877)
Other	880	(847)	(379)	(1,090)	(2,610)
Movement in (debt) funds for year	(9,947)	(2,004)	630	2,924	(2,104)
Net debt at beginning of year	(12,497)	(22,444)	(24,448)	(23,818)	(20,894)
Net debt at end of year	(22,444)	(24,448)	(23,818)	(20,894)	(22,998)

The figures have been restated to reflect the accounting policy change in 1999.