Surgical Innovations Group plc
Annual report 2005

introduction

Surgical Innovations Group plc specialises in the design and manufacture of innovative devices for use in minimally invasive surgery and industrial markets.

Our vision is to be the world's leading supplier of high quality, cost-effective instrumentation, empowering surgeons to provide patients with an improved quality of life; and to create engineering solutions which truly focus on the user's needs.

innovative products which prove our dedication to design and development

Contents

si group

Profit before taxation
+102%
to £352,000
(2004: £174,000)

Operating Profit
+66%
to £401,000
(2004: 242,000)

Turnover
+33%
to £4.02m
(2004: 3.03m)

- **100% increase in earnings per share to 0.16p**
  (2004: 0.08p)
- **Increase in earnings before interest, taxation and depreciation ("EBITDA") to £617,000**
  (2004: £445,000)
- **7th successive year of sales growth**

Financial and Operational Review

I am delighted to report yet another year of increased sales and profit growth — the seventh in succession.

Group turnover increased to £4.02 million in 2005 (2004: £3.03 million), an increase of 33% which resulted in a doubling of pre-tax profit to £352,000, compared with £174,000 in the previous year.

Within the turnover figure there are product development fees of £535,000 (2004: £nil). These reflect our entry into an exciting new area of industrial design, where we have already applied our advanced surgical device technology to the aero engine maintenance field through a relationship with Rolls-Royce plc. We are very proud of this relationship where our design expertise has been recognised through a ten-year licensing agreement. Over the period of the agreement we will receive up to £800,000 for licensing fees and access to technology, of which £200,000 was received in the year. This is in addition to any ongoing product development fees that may arise through this collaboration. We have also written-off the total costs of negotiating and implementing the licensing arrangement which were £103,000.

The Group has increased its product development capability through the recruitment of highly talented young graduates. We have invested in leading edge technology, enabling the team to respond efficiently and effectively to future design projects.

Royalties from the licensing of *EndoFlex* to Cardinal Health improved to £281,000 from £231,000 in the previous year. This is a testament to the uniqueness of the design, with *EndoFlex* still widely regarded as the world's leading retraction and tissue mobilisation device.

We continue to invest in the development of new devices for Minimally Invasive Surgery (MIS) — our core competency. This has contributed to overall MIS sales of £2,677,000 and we are confident that we can build upon this performance at a substantially increased rate. Our investment in developing relationships with our strategic partners and international distributors provides a solid foundation for future growth in this area.

Doug Liversidge CBE
Chairman

Group Overview

Instruments Division

Surgical Innovations designs and manufactures creative solutions for minimally invasive surgery. Our pioneering products are user-oriented, with ergonomics at the core of our technology. We have a truly international presence with representation in all major markets through our OEM partners and global network of distributors.

- Logic Instrument System
- Logic Scissors
- Quick Range

- YelloPort
- FastClamp
- EndoFlex
  ('Diamond Flex' — manufactured and distributed by Cardinal Health)

"2005 saw our entry into the area of industrial design."

Our laparoscopic port access system, *YelloPort,* continues to gain acceptance with leading international surgeons. We firmly believe that our continuous product development programme will further increase our market share. In the current year our efforts to develop the US market for *YelloPort* have resulted in direct distribution to hospitals, in addition to increased sales through Equipment Managed Service companies.

Sales of our laparoscopic scissors have increased considerably over the past year and continue to do so. The quality of the product coupled with its innovative design is enabling us, through our relationships with Aesculap and Teleflex Medical, to make substantial inroads into this lucrative market.

Cash generation of £279,000 from all operating activities has enabled us to repay £68,000 of the 6.5% convertible loan notes and reduce our finance lease debt. However, based on our anticipated growth for 2006, our record order book of £745,000, and an increased leasing facility from our bankers, the Board has entered into a significant capital expenditure programme. This should result in improved production efficiencies and increased margins.

Outlook

We have made substantial progress during the year and are optimistic that the growth in sales and profitability will continue. We are determined to achieve full recognition of Surgical Innovations within the investment community and a valuation that genuinely reflects the development of the Group.

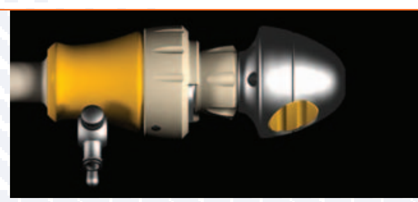
Finally I wish to thank, on your behalf, my Board colleagues and all employees for their dedication and commitment during a year in which we doubled the Group's pre-tax profits.

Doug Liversidge CBE
7 April 2006

Group Overview

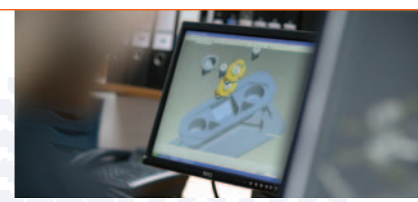
Product Development Division

Surgical Innovations is one of the world's leading surgical instrument companies but, fundamentally, we are precision engineers who are passionate about providing ideas, technology and surgical/engineering solutions that exceed our customers' expectations.



Surgical Innovations' Product Development Division specialises in the design and manufacture of innovative instrumentation and equipment for medical and industrial markets.

In a rapidly changing world, competitive advantage is founded upon innovative engineering design. Our Product Development Division provides creative engineering solutions which really focus on the user's needs.



Our multidisciplinary team of designers and engineers employ the latest computer aided three-dimensional modelling combined with traditional engineering, surgical and scientific instrument-making skills.

This unique blend of talent allows us to produce surgical devices and engineering solutions that are truly innovative and original.

2005 was our seventh consecutive year of growth in both turnover and operating profit. Importantly, it included our initial venture into the arena of industrial design with the signing of a ten-year agreement with Rolls-Royce plc. The Group continues to benefit from the strength of our medical devices and our design capabilities.

Business Restructuring

We have restructured the business to create two divisions: Instruments and Product Development, allowing us to deliver our energy and drive in a focused manner and providing a clear measure of profitability in the respective areas. The new structure is already yielding benefits, such as increased instrument sales and the rapid delivery of new products. We firmly believe that we have established a structure for growth that will result in enhanced profitability for the Group.

In 2005 we focused on improving the efficiency of our manufacturing facilities, analysing the flow of products around the site and eliminating waste from the production processes. This reorganisation has already delivered significant improvements in efficiency and in our overall manufacturing capacity.

Capital Investment Programme

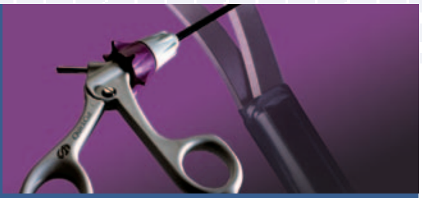
This manufacturing review has been coupled with a substantial investment programme. At Surgical Innovations, we firmly believe that the quality of our products is paramount: our investment programme is designed to ensure that our products maintain their respective positions in the market while continuing to be supplied at competitive prices.

A new clean room, associated packaging equipment, and the £140,000 year-end commitment to cutting-edge Computer Numerically Controlled (CNC) machine tools are part of this exciting capital investment programme. We have also increased our manufacturing floor space by using an off-site storage facility.

Furthermore, we have taken the opportunity to upgrade our IT systems by installing a new business management system, server, and the latest version of our industry-leading three-dimensional Computer Aided Design (CAD) system.

Graham Bowland *Finance Director*   **Stuart Moran** *Technical Director*

Our product range offers a variety of solutions to surgeons in three distinct groups.



High performance reusables featuring disposable accessories

56%

of MIS sales

Products include:
- YelloPort Single Use Accessories
- Logic Scissors

Optimum performance reusables

24%

of MIS sales

Products include:
- YelloPort
- Logic Instrument System
- FastClamp

Maximum performance disposables

20%

of MIS sales

Products include:
- Variglide
- Quick Range

"A strong second half performance . . . providing high expectations for 2006."

Instruments Division

Sales of our devices for Minimally Invasive Surgery (MIS), at £2,677,000, firmly establish MIS as our core business activity.

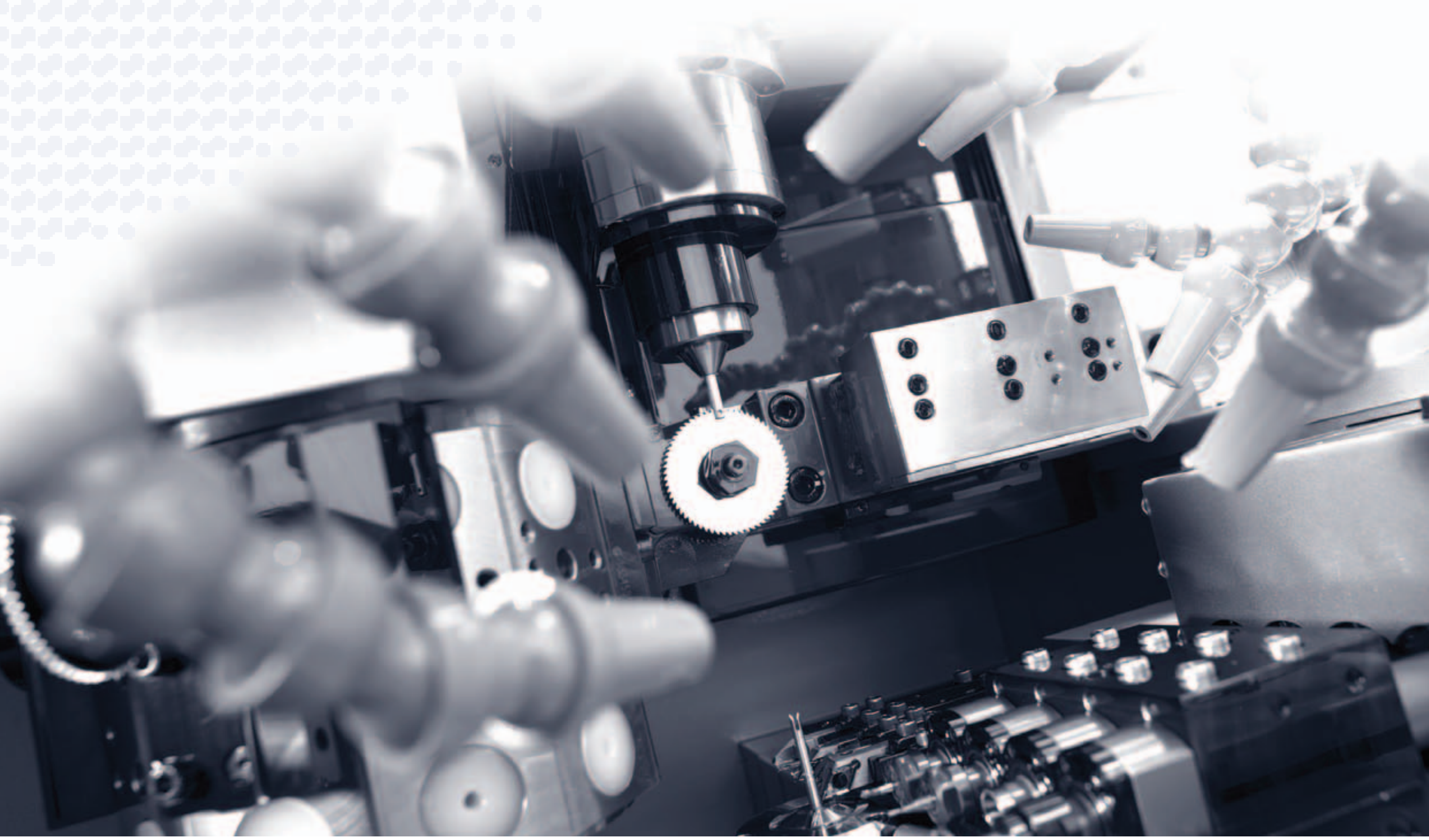
The second half of 2005 produced strong growth with sales in MIS of £1,684,000, a significant improvement on first half sales of £993,000. This sharp increase provides high expectations for 2006, as we anticipate added benefits from the continual investment in our product portfolio and international distributor network.

Sales of *YelloPort* totalled £572,000. Importantly, Rest of World sales increased by 45%. This is a creditable performance and we are delighted with our success in developing a new positioning of the product in the market. *YelloPort* is now promoted as a 'resposable' system: a mixture of both reusable and disposable items which offers a quality, innovative and cost-effective solution — ideal for the surgeon and hospital finance administrator alike.

YelloPort continues to gain popularity amongst leading, influential laparoscopic surgeons. This is an important phase in the development of the product amongst the surgical community: to achieve increased market share, it is vital that *YelloPort* gains credibility within this community as an equal against equivalent products from the dominant US medical device companies.

We are therefore delighted that we have been able to enter the US market in the current year through a combination of direct sales, distribution, and Equipment Managed Service business. The latter is based upon a business model whereby major healthcare companies provide hospitals with fully serviced procedure trays on a charge-by-use basis, which significantly reduces hospital overhead costs. *YelloPort* in its 'resposable' format is ideally suited to this marketing concept.

Within our *Logic* range of instrumentation, sales of single use scissors increased by 3% to £1,219,000 despite an increasing number of low-cost alternatives in the market. This performance can be attributed to our ever-strengthening relationships with our main



"Surgical Innovations is at the forefront of instrument development . . . well placed to meet future demands."

strategic partners, Aesculap and Teleflex Medical. Our investment in design, tooling and machinery has enabled us to maintain our exceptionally high standards at a competitive price, ensuring that in the current year, like-for-like sales of single use scissors are significantly higher than in 2005.

It is particularly satisfying to report that we have opened up new markets for our laparoscopic scissors in Australia, Iran and Israel following visits to these countries.

During 2005 we saw initial sales of our fully disposable *Quick* range of instruments. In the laparoscopic market it is always difficult to gain acceptance of a product line within a short period of time and so we are encouraged by the initial level of business and positive feedback received to date. Our intention is to focus our efforts on the UK market through direct sales, and elsewhere through our existing collaboration with Aesculap. We continue to review the product and have a planned strategy of improvement and broadening of the range during 2006 and 2007.

Our main brands of *YelloPort* and *Logic* are now well established and continue to attract critical acclaim. Building upon this, we are embarking on a major development initiative with *YelloPort* to strengthen the product's suitability for surgeons moving away from single use port access systems. This is extremely important if we are to make significant inroads into the US market, which annually undertakes in excess of 700,000 laparoscopic gall bladder procedures, worth approximately £100 million in predominately single use laparoscopic ports.

The US is naturally an important area for Surgical Innovations; however, our strategy is to also develop our presence in markets such as India and China where laparoscopic surgery is undertaken routinely. There is an opportunity for our instrumentation to be used in obesity surgery in these markets: in China, a quarter of all adults are obese and half of all new obesity-related diabetes cases result from India and China.

The demand for laparoscopic surgery is escalating with the majority of countries now undertaking this type of surgery on a routine basis. More and more procedures, previously confined to complex open surgery, are being performed laparoscopically in such areas as colorectal cancer surgery, urology — including kidney transplants — and paediatric surgery, where the benefits of minimally invasive techniques on children are self-evident.

With this continual rise in the annual number of performed cases and with Surgical Innovations at the forefront of instrumentation development, we are well placed to meet future demands.

Product Focus

YelloPort

__YelloPort__ is ergonomically designed to be strong and durable yet lightweight and easy to handle. A wide range of configurations is available to suit the surgeon's individual preference.

Fully reusable main elements combined with a choice of either single use or reusable accessories means __YelloPort__ can now be promoted as a 'resposable' system: a mixture of both reusable and disposable items which offers a highly cost-effective solution — ideal for the surgeon and hospital finance administrator alike.

__YelloPort__ is the perfect product range to support Surgical Innovations' position in the market as a provider of high quality 'resposable' surgical instrument systems.

“In the current year we have an ambitious product development programme.”

Product Development Division

2005 was an excellent year for the Group’s product development team. Finalising the collaboration agreement with Rolls-Royce plc was a major success. We will receive up to £800,000 over the ten-year period of the agreement for licensing fees and access to technology. During the year we received the first tranche of these fees, totalling £200,000, as well as successfully completing a number of development projects that generated design and manufacturing fees of £535,000. Completing the agreement and securing the subsequent business with Rolls-Royce plc required a substantial investment in management time and £103,000 of costs were attributed to this activity.

The adaptation of our world-class ‘keyhole’ surgical instrument technology, *EndoFlex*, to meet the demands of aero engine inspection was an exciting challenge. Based upon the experience gained in this area, we have established a new product offering, *EndoFlex Industrial*, which provides the user with *Paths to Precision*: a unique technology which helps to access challenging, complex spaces with the minimum of downtime. We are now rolling out this business model and are targeting the industrial gearbox, oil and gas, aerospace and nuclear industries.

Ever cognisant of the need to increase our presence in these competitive markets, we are honing our marketing strategies; for example, we are exhibiting at a number of highly focused trade congresses.

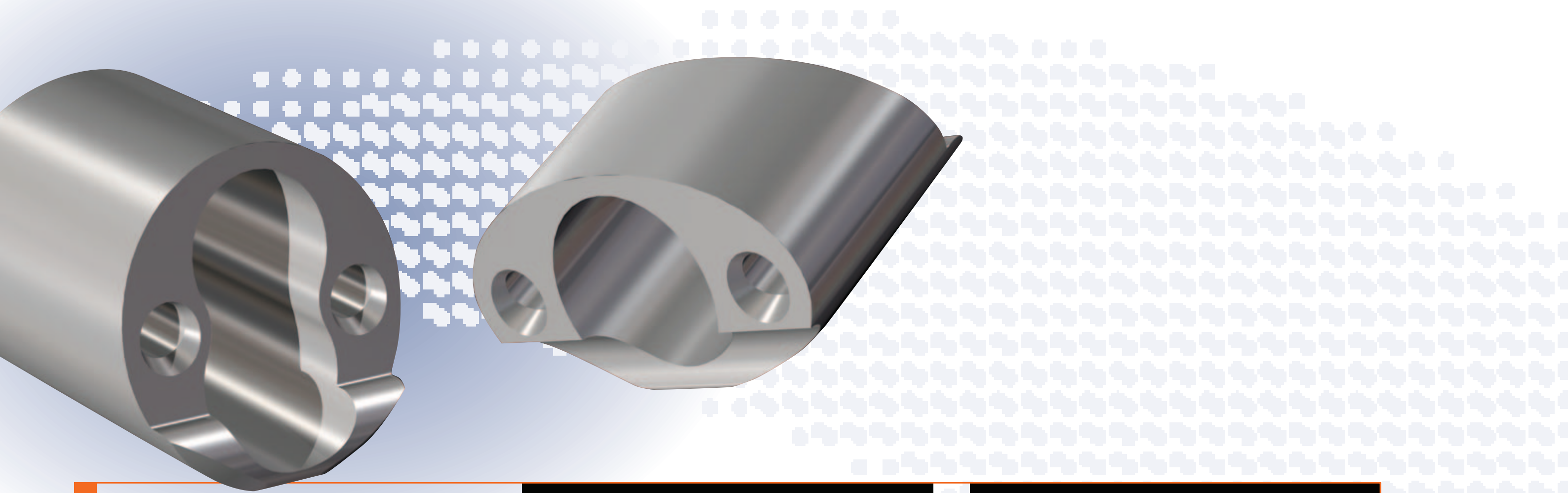
Vhairi Maxwell
Design Engineer

“EndoFlex Industrial . . . ‘keyhole’ technology for accessing complex spaces.”

The technology transfer into these new markets has been profitable and exciting, but this has not been at the expense of our core business: MIS instrumentation. The team has developed a number of new products plus several significant improvements to our existing product ranges. In the current year we have mapped out an ambitious product development programme, including the development of a second-generation *YelloPort* port access system. This new product range is aimed at the lucrative US market, where our competitors primarily supply high performance, single use devices.

The new divisional structure has brought a new degree of focus which is now allowing us to look further ahead. We are examining longer term development projects with much larger sales potential and, in order to fund such development activities, we are fully exploring the research and development funding opportunities available to us through our Regional Development Agency, Yorkshire Forward.

During this current year we will see developments in a number of new markets as well as significant additions to our MIS portfolio. The Group’s Product Development division is poised for successful growth.



EndoFlex Industrial

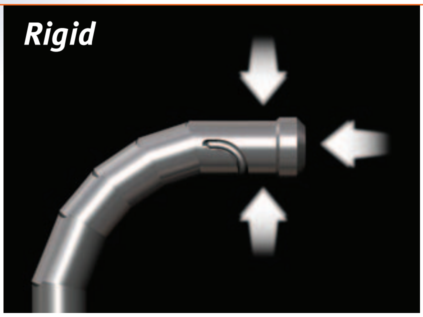
EndoFlex Industrial *is adapted from our unique, patented articulating segment technology and is designed to deliver tools, devices, sensors and probes precisely and repeatedly to the target zone. Designed to meet the rigours of the aerospace, nuclear and other industrial markets, it minimises the need to disassemble complicated equipment and systems, as it can be introduced in a straight, semi-rigid condition and then actuated into a rigid, pre-defined shape, thereby helping the user to access challenging, complex spaces with the minimum of downtime.*

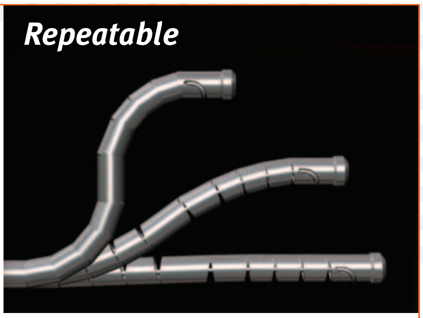
Rigid
EndoFlex Industrial *offers significantly greater rigidity than other cable controlled multi-segmented devices, thereby allowing the user to deliver considerable force at the target site.*

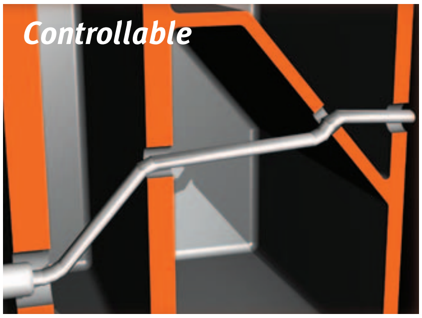
Repeatable
Manufactured to exacting tolerances, EndoFlex Industrial *delivers a high degree of precision and, therefore, a high degree of repeatability.*

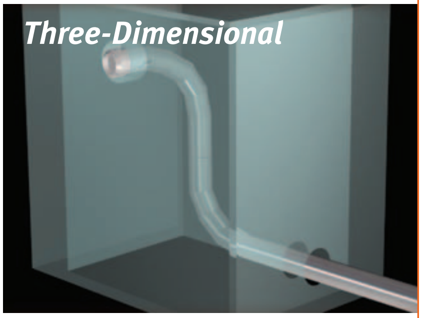
Controllable
Patented actuation mechanisms facilitate varying degrees and combinations of actuation and advancement into the target body.

Three-Dimensional
Our innovative segment technology allows the creation of full, three-dimensional shapes which are useful where contact normal to the target surface is desirable.









"Our outstanding progress could not have been achieved without the dedication of our work colleagues."

Licensing

Royalty income from sales of *EndoFlex* amounted to £281,000. Cardinal Health, which acquired the licence in April 2004, has taken an aggressive view on defending its licensed intellectual property and together we were successful in an action against an infringement of the *EndoFlex* patent, at a cost of £53,000. We continue to develop our relationship with Cardinal Health and are confident that this will lead to further product development and international market opportunities.

Autologous Blood Transfusion

We have continued to concentrate our efforts on the UK post-operative market. We continue to see gains in our market share with a 55% increase in turnover to £172,000. The opportunities for growth will be further enhanced as we begin to experience planned cost savings in the manufacturing process of the product.

People

The progress of Surgical Innovations has been outstanding and could not have been achieved without the total involvement and dedication of our work colleagues. In 2005 and the current year we have made significant investments in ensuring that the creativity of our staff is harnessed, that they are well trained, and that the culture of the business is appropriate to meet our growth expectations, leading to this year's improved performance. We remain committed to this focus on training and personal development as part of our strategy for success.

Summary

The trading year was a remarkable one for Surgical Innovations, with an operating profit increase of 66%.

With the restructuring of the Company and the growth plans in place for both divisions, we believe we are well placed to achieve our objectives of once again delivering improved profitability and enhanced shareholder value.

N Graham Bowland
7 April 2006

Stuart S Moran
7 April 2006

Group Results
The year to 31 December 2005 has been another year of growth for the Group.

The major financial headlines from the year ended 31 December 2005 are as follows:

	2005 £'000	2004 £'000	Increase
Group turnover	**4,018**	3,032	33%
EBITDA	**617**	445	39%
EBIT	**401**	242	66%
Profit before taxation	**352**	174	102%
EPS	**0.16p**	0.08p	100%

EBITDA is defined as:

	2005 £000	2004 £000
Operating profit (EBIT)	**401**	242
Depreciation	**216**	203
Earnings before interest, taxation and depreciation	**617**	445

As in previous years we continue to place emphasis on our margins and this is highlighted in the following statistics:

	2005	2004	2003
Net profit margin	**8.76%**	5.74%	4.95%
EBIT margin	**9.98%**	7.98%	6.65%

"We continue to benefit from the government's initiatives for research and development."
Graham Bowland
Finance Director

Net profit margin
8.76%
(2004: 5.74%)

Net cash inflow from operating activities
£279,000
(2004: £130,000)

Reduction in net debt
£199,000
(2004: £1,000)

Taxation

We continue to benefit from the government's initiatives for expenditure in the field of research and development. As we are creating taxable profits, we are able to utilise the expenditure to gain enhanced reductions against the profits.

In recognition of projected taxable profits, the Group has also recognised a deferred taxation asset in accordance with FRS19, which has given rise to a tax credit of £50,000 in the year.

Cash Flow and Net Debt

The net cash inflow from operating activities was £279,000 (2004: £130,000). With capital investment in the year at £64,000, cash inflow before financing was £166,000 (2004: £59,000). This enabled the Group to reduce borrowings to end the year with net debt of £440,000 (2004: £639,000).

We continue to review our borrowing facilities in line with our continuing growth and have recently negotiated £725,000 of asset finance to assist with our capital investment programme.

Shareholders' Funds

1,136,294 shares were issued during the year as detailed in note 17 to the financial statements. Shareholders' funds increased from £1.650 million to £2.094 million. This increase is principally due to the retained profit for the financial year of £402,000.

Foreign Currency

The Group maintains foreign currency bank accounts and, wherever possible, supplier payments are made in euros or dollars to utilise currency receipts. The Group has considered the use of forward exchange contracts and will continue to do so as international business increases.

International Financial Reporting Standards ("IFRS")

The Group will be required to report under IFRS for the year ending 31 December 2007. We continue to plan for adoption and implementation of IFRS at this time. The principal areas where there may be a significant impact on the reported results of the Group are:

i) Intangible assets (IAS38)

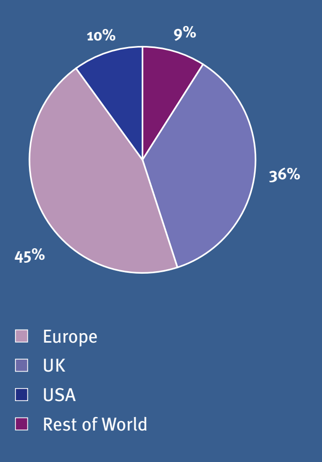
Certain development expenditure is required to be capitalised. Current Group policy is to write off such expenditure as it is incurred.

ii) Share-based payment (IFRS2)

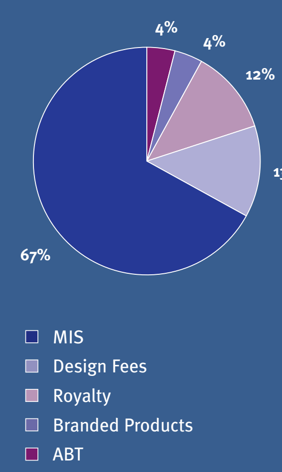
The fair value of share options issued will be required to be charged to the profit and loss account over the relevant measurement period. The UK standard FRS20 captures the same requirements and the Group will be required to report under this standard for the year ending 31 December 2006.

N Graham Bowland ACA
Finance Director
7 April 2006

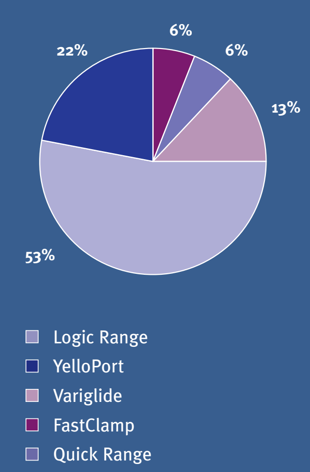
Geographical Analysis of Turnover 2005



Product Sales by Sector 2005



MIS Sales by Product Classification 2005



directors

Douglas B Liversidge CBE
(Non-executive Chairman)

Doug (age 69) was previously Chief Executive of G W Thornton during its flotation on the LSE in March 1987.

Until recently he was Chairman of the Yorkshire and Humber Medilink and held the office of Master Cutler in Hallamshire in 1998–99.

He is non-executive chairman of Biofusion PLC which was floated on AIM last year and is a director of a number of private companies.

Colin Glass
(Non-executive)

Colin (age 62) is a Chartered Accountant and a partner in Winburn Glass Norfolk. He is a founder Director of Surgical Innovations Limited and was instrumental in securing early funding and in the reverse takeover of Haemocell plc in 1998 which resulted in the quotation of the Company on AIM.

He is a non-executive director of several companies, including Coe Group PLC, Straight PLC and Getech Group PLC, which are quoted on AIM.

Apart from his own expertise in financial and corporate advisory matters, he has built up a wide range of contacts from many different industries and organisations which has added considerably to his general business experience and which can be used to the benefit of the companies with which he is involved.

Ray Simkins
(Non-executive)

Ray (age 62) is a mechanical engineer by training. He has worked for Getz since 1966 where he has represented their business interests in the US, Japan, Thailand, Malaysia and Singapore.

He is currently President of the Getz Group with interests throughout the Asia/Pacific region.

Ray has been a non-executive Director since 1996 and was instrumental in securing investment from Getz prior to the reverse takeover of Haemocell plc in 1998.

He has a wealth of experience in international distribution management.

N Graham Bowland
(Finance Director)

Graham (age 44) qualified as a Chartered Accountant in 1987 and joined Surgical Innovations in 1999. He has responsibility for finance matters at Group level and is also responsible for sales and the expansion of the international distribution network.

Stuart S Moran
(Technical Director)

Stuart (age 42), one of the founders of the Company, joined the Surgical Innovations Limited Board in 1992 as Engineering Director, having previously worked for BP Research.

In 2000 he was promoted to the Group Board as Technical Director and was appointed Joint Managing Director of the operating business. Stuart oversees all major design, manufacturing and product development decisions, and has overall commercial responsibility for external projects.

advisers

Company Secretary and Registered Office
N Graham Bowland
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Registered Number 2298163

Nominated Adviser
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Solicitors
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Auditors
Grant Thornton UK LLP
St Johns Centre
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Leeds LS2 8LA

Broker
Westhouse Securities LLP
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London
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Registrars
Capita Registrars (proxies)
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Licence Number MB122

Bankers
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Leeds LS1 1PA

Public Relations
Abchurch Communications Ltd
West One
Wellington Street
Leeds
LS1 1BA

financial calendar

Annual General Meeting
27 June 2006

Announcement of interim results
September 2006

Announcement of final results
April 2007

report of the directors

The Directors present their annual report, together with the audited financial statements for the year ended 31 December 2005.

Principal Activities and Business Review
The Company is the holding company of a Group whose principal activities in the year involved the design, development and manufacture of devices for use in minimally invasive surgery and industrial markets. Surgical devices are targeted at the operating theatre environment in both public and private hospitals. In international markets, the Group sells through independent healthcare distributors and through OEM and licensing contracts with major suppliers of medical equipment. A review of the Group's activities during the period is included within the Chairman's Statement and Executive and Financial Reviews on pages 2 to 11.

Results and Dividends
The consolidated profit and loss account for the year is set out on page 22.

The Directors cannot recommend the payment of a dividend.

Research and Development
The Group's activities in this area have focused principally on the continuing development of innovative instruments for use in the field of minimally invasive surgery.

Employees
The commitment and ability of our employees are key factors in achieving the Group's objectives.

Employment policies are based on the provision of appropriate training, whilst annual personal appraisals support skill and career development.

The Board encourages management feedback at all levels to facilitate the development of the Group's business. The Group seeks to keep its employees informed on all matters affecting them by regular management and departmental meetings. The Company operates a Save As You Earn (SAYE) share option scheme.

Directors
The names of the current Directors of the Company and their biographical details are set out on pages 12 and 13. All Directors served throughout the year.

Directors' Interests
The interests in the share capital of the Company of those Directors in office at the end of the year were as follows:

Ordinary Shares of 1p each

	31 December 2005 Beneficial	1 January 2005 Beneficial
D B Liversidge	**2,786,107**	2,786,107
S S Moran	**3,199,005**	3,199,005
N G Bowland	**115,892**	115,892
C Glass	**2,495,888**	2,495,888
R Simkins	**983,747**	983,747

Apart from the interests disclosed above and the options referred to on page 19, no Directors were interested at any time during the year in the share capital of the Company or other Group companies. There have been no changes in Directors' interests between the year end and 3 April 2006.

Otherwise than as disclosed in note 24, no Director has an interest in any material contract, other than contracts of service and employment, to which the Group was a party.

Copies of the Directors' service contracts are available for inspection at the registered office of the Company, Clayton Park, Clayton Wood Rise, Leeds LS16 6RF and will be available at this year's Annual General Meeting for 15 minutes prior to, and during the whole course of, the meeting.

Substantial Shareholdings

Other than Directors' own holdings, the Board has been notified that as at 21 March 2006 the following are interested in 3 per cent or more of the issued Ordinary Share capital of the Company:

	No. of shares	%
Getz Bros. Co., Ltd.	49,248,810	19.0
M J McMahon	8,886,507	3.4

Share issues

During the year 1,136,294 shares were issued, details of which can be found in note 17 to the financial statements.

Creditor Payment Policy

The Group's current policy concerning the payment of suppliers is to:

(a) settle the terms of payment with those suppliers when agreeing the terms of each transaction;

(b) ensure that those suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and

(c) pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services without exception. The Company has no trade creditors.

Directors' Responsibilities Statement

The Directors are required by the Companies Act 1985 to prepare financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) for each financial year which give a true and fair view of the state of affairs of the Company and the Group for that period. The Directors are required to prepare the Directors' Report and other information in the Annual Report. It is also the Directors' responsibility to ensure that the Company and the Group maintain proper accounting records. The Directors have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

The Directors consider that appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the financial statements and that all accounting standards which they consider to be applicable have been followed.

The maintenance and integrity of the Surgical Innovations Group plc website is the responsibility of the Directors: the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

Financial Risk Management Objectives and Policies

The Directors are confident that the banking facilities currently in place are more than adequate for the Company's working capital requirements.

Some of the Company's sales and purchases are made in currencies other than sterling and consideration is given to the use of forward currency contracts to reduce the exposure.

The Directors are satisfied that credit risk is adequately managed, and the level of bad debts is consistent with the nature of the industry.

Annual General Meeting

The notice convening the Annual General Meeting (AGM) of the Company is set out on page 35, together with an explanation of the items of business on page 36.

The AGM will be held at the Weetwood Hall Hotel & Conference Centre, Otley Road, Far Headingley, LS16 5PS on 27 June 2006 at 1.00 p.m.

Auditors

Grant Thornton UK LLP have indicated their willingness to continue in office. In accordance with section 385 of the Companies Act 1985, a resolution for their reappointment as Independent Auditors will be proposed at the Annual General Meeting.

By Order of the Board
N G Bowland ACA
Company Secretary
7 April 2006

Directors' Remuneration

The Board recognises that Directors' remuneration is of legitimate concern to the shareholders. The Group operates within an innovative and competitive arena that places constant demands on the technical abilities of the Group. Its performance depends on the individual contributions of the Directors and employees and it believes in rewarding all those who have made a positive contribution in the development of the Group.

The Board has, in accordance with best practice, decided to present this remuneration report for shareholders' approval so that shareholders can approve the policy detailed in this report.

Remuneration Committee

The Remuneration Committee, which meets as required, is made up of the following Directors:
D B Liversidge (Chairman)
C Glass
R Simkins

Remuneration Policy

The principal objective is to develop policies and recommend proposals appropriate to facilitating the recruitment, retention and motivation of executive Directors and in so doing to avoid the Group bearing more than a reasonable and necessary cost. Where practical and appropriate, the remuneration of executive Directors (and other senior management) is aligned with the interests of shareholders.

The Remuneration Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Group's business environment and in remuneration practice. Any changes to policy for years after 2005 will be described in future Directors' remuneration reports, which will continue to be subject to shareholder approval.

The remuneration of the executive Directors comprises four main elements:

- Basic salary: to remain competitive in the marketplace, reflecting the experience, level of competence of the individual and comparative base salaries elsewhere within the Group.
- Annual bonus payment: to provide additional short-term remuneration which directly reflects Group and individual performance.
- Share options: through the regular grant of options to reward achievements of target and outstanding business performance over the longer term.
- Pension arrangements: to enable Directors to make appropriate provision for retirement.

It is Group policy that a significant proportion of the remuneration of the executive Directors should be performance related, with an annual bonus of up to 25% of basic salary.

Contracts of Service

No Director has a service contract with a notice period in excess of one year.

Directors' emoluments

Details of individual Directors' emoluments for the year are as follows:

	Salary & Fees £	Annual Bonus £	Benefits £	Pension Contributions £	**2005 Total £**	2004 Total £
Executive:						
N G Bowland	66,350	6,750	7,688	3,033	**83,821**	76,729
S S Moran	66,350	6,750	7,688	3,033	**83,821**	76,729
Non-executive:						
D B Liversidge (1)	18,000	—	—	—	**18,000**	18,000
C Glass (2)	12,000	—	—	—	**12,000**	12,000
R Simkins (3)	12,000	—	—	—	**12,000**	12,000
	174,700	13,500	15,376	6,066	**209,642**	195,458

(1) Payable to Quest Investments Limited, a company of which D B Liversidge is a director.
(2) Payable to Winburn Glass Norfolk, a firm of which C Glass is a partner.
(3) Payable to Getz Bros & Co. (BVI) Inc., a company of which R Simkins is an employee.

Remuneration of the non-executive Directors is determined by the Board.

Where a pension is payable under the terms of the service contract, it is calculated by reference to basic salary. All employer's contributions in relation to Directors are shown above.

Directors' Share Options

Details of the share options held by Directors are as follows:

	At 1 January and 31 December 2005	Option price	Date granted
D B Liversidge	1,000,000	3.00p	Nov 2000
	1,000,000	2.00p	Apr 2001
S S Moran	1,000,000	3.00p	Nov 2000
	1,000,000	2.00p	July 2001
N G Bowland	1,000,000	3.00p	Nov 2000
	1,000,000	2.00p	July 2001
C Glass	1,000,000	3.00p	Nov 2000
	1,000,000	2.00p	Apr 2001
R Simkins	2,000,000	2.00p	May 2001

Share Options are exercisable between 3 and 10 years from the date of the grant.

The market price of the Company's shares at the end of the financial year was 2.13p and the range of market prices during the period was between 1.63p and 2.63p.

On behalf of the Board

D B Liversidge CBE
Chairman
7 April 2006

Principles of Good Governance

The Board continues to support the principles of good governance as contained in the Combined Code (2003). The Board has adopted such procedures as it considers practical and appropriate for a company of its size so as to effect good governance.

Application of Principles

i) Directors
The Company supports the concept of an effective Board leading and controlling the Company. The Board is responsible for approving Company policy and strategy. It meets regularly and has a schedule of matters specifically reserved to it for decision. Management supply the Board with appropriate and timely information and the Directors are free to seek any further information they consider necessary. All Directors have access to advice from the Company Secretary and independent professionals at the Company's expense. Training is available for new Directors and other Directors as necessary.

The Board members are:

D B Liversidge	—	Non-executive Chairman
S S Moran	—	Technical Director
N G Bowland	—	Finance Director
C Glass	—	Non-executive Director
R Simkins	—	Non-executive Director

All Directors are subject to re-election every three years and at the first Annual General Meeting after appointment.

This year Messrs C Glass and R Simkins retire by rotation and, being eligible, offer themselves for re-election.

ii) Accountability and audit
The Board is responsible for maintaining a sound system of internal control to safeguard shareholders' investments and the Company's assets.

The audit committee comprises D B Liversidge, R Simkins, and C Glass who are all non-executive Directors.

The Committee considers the appointment and terms of engagement of the external auditor and assesses the independence of the external auditor and reviews the auditor's policy for the rotation of audit partners.

The terms of reference of the committee include reviewing the scope and results of the external audit and its effectiveness.

Communication with Shareholders

The Board is committed to effective communication between the Group and its shareholders.

It regards the Annual General Meeting as a means of communicating directly with private investors and encourages their participation. All Directors normally attend the Annual General Meeting and private investors have the opportunity to meet the Directors and discuss any issues on an informal basis. Separate resolutions are passed on each issue so that they can be given proper consideration and there is a resolution to approve the annual report and accounts.

The shareholders can gain access to information on the Group, as well as to the annual report, through the website, www.sigroupplc.com

Internal Controls

The Board of Directors is ultimately responsible for the Group's management and internal control systems. During the financial period and to the date of approval of the financial statements, they have reviewed the operation and effectiveness of the Group's systems of internal control, which can provide only a reasonable but not absolute assurance against material misstatement or loss.

The Board discharges its responsibility for internal financial control through the following key procedures:

- the establishment of an organisational structure appropriate to the size of the business, with clearly defined levels of authority and division of responsibilities for approval of external payments, and receipt and dispatch of goods;
- a comprehensive budgeting and financial reporting system which compares actual performance with budget on a monthly basis;
- the formulation by the Board of policies and of approval procedures in a number of key areas such as credit control, expenditure authorisation, stock ordering and Quality Assurance.

Going Concern

On the basis of the budget for 2006 and forecasts prepared by the Directors, the Board has a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

On behalf of the Board
D B Liversidge CBE
Chairman
7 April 2006

report of the independent auditors to the shareholders of Surgical Innovations Group plc

We have audited the Group and parent company financial statements (the "financial statements") of Surgical Innovations Group plc for the year ended 31 December 2005 which comprise the Group profit and loss account, the Group and Company balance sheets, the Group cash flow statement and notes 1 to 25. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Statement, the Executive Review, the Financial Review, Directors, the Report of the Directors, the Report on Remuneration and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent company's affairs as at 31 December 2005 and of the Group's profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

Grant Thornton UK LLP
Registered Auditors
Chartered Accountants
Leeds
7 April 2006

consolidated profit and loss account

For the year ended 31 December	*Notes*	**2005 £'000**	2004 £'000
Turnover	*2*	**4,018**	3,032
Cost of sales		**(2,295)**	(1,432)
Gross profit		**1,723**	1,600
Administrative expenses		**(1,322)**	(1,358)
Operating profit	*3*	**401**	242
Interest payable	*5*	**(49)**	(68)
Profit on ordinary activities before taxation		**352**	174
Tax on profit on ordinary activities	*6*	**50**	38
Retained profit	*7,18*	**402**	212
Earnings per ordinary share	*7*	**0.16p**	0.08p

As permitted by section 230 of the Companies Act 1985, the holding company's profit and loss account has not been included in these financial statements (Note 8).

The consolidated profit and loss account above relates to continuing operations.

The Group has no material recognised gains and losses other than the profits above and therefore no separate statement of total recognised gains and losses has been presented.

The notes on pages 26 to 34 form part of these financial statements.

consolidated balance sheet

As at 31 December		2005		2004	
	Notes	**£'000**	**£'000**	£'000	£'000
Fixed assets					
Tangible assets	*9*		**668**		811
Current assets					
Stocks	*11*	**852**		881	
Debtors	*12*	**1,605**		1,215	
Cash at bank		**25**		1	
		2,482		2,097	
Creditors: amounts falling due within one year	*13*	**(940)**		(1,043)	
Net current assets			**1,542**		1,054
Total assets less current liabilities			**2,210**		1,865
Creditors: amounts falling due after more than one year	*14*		**(116)**		(215)
Net assets			**2,094**		1,650
Capital and reserves					
Called up share capital	*17*		**2,591**		2,580
Share premium account	*18*	**16,101**		16,070	
Capital reserve	*18*	**329**		329	
Accumulated losses	*18*	**(16,927)**		(17,329)	
			(497)		(930)
Shareholders' funds	*19*		**2,094**		1,650

The financial statements on pages 22 to 34 were approved by the Board of Directors on 7 April 2006 and were signed on its behalf by:

D B Liversidge CBE
Director

The notes on pages 26 to 34 form part of these financial statements.

company balance sheet

As at 31 December	*Notes*	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Fixed assets					
Investments	*10*		**1,018**		1,018
Current assets					
Debtors	*12*	**2,199**		2,295	
Cash at bank		**1**		1	
		2,200		2,296	
Creditors: amounts falling due within one year	*13*	**(44)**		(183)	
Net current assets			**2,156**		2,113
Net assets			**3,174**		3,131
Capital and reserves					
Called up share capital	*17*		**2,591**		2,580
Share premium account	*18*	**16,101**		16,070	
Accumulated losses	*18*	**(15,518)**		(15,519)	
			583		551
Shareholders' funds			**3,174**		3,131

The financial statements on pages 22 to 34 were approved by the Board of Directors on 7 April 2006 and were signed on its behalf by:

D B Liversidge CBE
Director

The notes on pages 26 to 34 form part of these financial statements.

consolidated cash flow statement

For the year ended 31 December	*Notes*	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Net cash inflow from operating activities	*21*		**279**		130
Returns on investments and servicing of finance					
Interest payable on finance leases		**(22)**		(29)	
Interest payable on bank overdrafts		**(24)**		(32)	
Interest payable on convertible loan notes		**(3)**		(7)	
Net cash outflow from returns on investments and servicing of finance			**(49)**		(68)
Taxation			**–**		18
Capital expenditure: purchases of tangible fixed assets			**(64)**		(21)
Net cash inflow before financing			**166**		59
Financing					
Issue of share capital		**–**		21	
Receipts from borrowings		**–**		22	
Capital repayments under bank loans		**(9)**		(7)	
Capital repayments under finance leases		**(109)**		(96)	
Redemption repayments of convertible loan notes		**(68)**		–	
Net cash outflow from financing			**(186)**		(60)
Decrease in cash	*22*		**(20)**		(1)

The notes on pages 26 to 34 form part of these financial statements.

1. Accounting Policies

The principal accounting policies, which remain unchanged from the previous year, are as follows:

(a) Basis of accounting
The financial statements have been prepared under the historical cost basis of accounting and under United Kingdom Generally Accepted Accounting Practice.

(b) Basis of consolidation
The Group financial statements consolidate those of the Company and of its subsidiary undertakings drawn up to 31 December 2005. The results of subsidiaries accounted for under the acquisition accounting method are included in the consolidated profit and loss account from the date of their acquisition. The results of subsidiaries, accounted for under the merger accounting method, are included in the consolidated profit and loss account as if they had always been part of the Group. Intra-Group sales and results are eliminated on consolidation and all sales and results relate to external transactions only.

(c) Tangible fixed assets
Tangible fixed assets are stated at cost less depreciation. Depreciation is charged so as to write off the cost of tangible fixed assets less estimated residual value over their estimated useful economic lives at the following rates:

Office & computer equipment	20% per annum on cost
Plant & machinery	10–25% per annum on cost
Tooling	20% per annum on cost

Tooling developed for the Group's own products is only depreciated when brought into use.

(d) Stocks and work in progress
Stocks and work in progress are stated at the lower of cost and net realisable value.

(e) Finance and operating leases
Costs in respect of operating leases are charged on a straight-line basis over the lease term. Leasing agreements which transfer to the Group substantially all the benefits and risks of ownership of an asset are treated as if the asset had been purchased outright. The assets are included in fixed assets and the capital element of the leasing commitments is shown as obligations under finance leases.

The lease rentals are treated as consisting of capital and interest elements. The capital element is applied to reduce the outstanding obligations and the interest element is charged against profit so as to give a constant periodic rate of charge on the remaining balance outstanding at each accounting period end. Assets held under finance leases are depreciated over the shorter of the lease terms and the useful economic lives of equivalent owned assets.

(f) Pensions
The Group operates a group defined contribution personal pension scheme covering all of of its employees. Contributions are charged against revenue as they are made.

(g) Turnover
Turnover is the total amount receivable by the Group for the supply of goods and services, excluding VAT and trade discounts. It also includes Royalty Income derived from agreements with other parties for them to manufacture and distribute products. Such Royalty Income is recognised in the same period as the licensee makes the related sale. Design and manufacturing fees are recognised in the period in which client approval and formal sign-off is received.

(h) Foreign currency translation
Transactions denominated in foreign currencies are recorded at exchange rates ruling at the date of the transaction. Monetary assets and liabilities are translated at rates ruling at the balance sheet date. Exchange differences are dealt with through the profit and loss account.

Assets and liabilities of Haemocell Inc. are translated into sterling at the rate of exchange ruling at the end of the financial year. The results of Haemocell Inc. are translated at the average rate of exchange for the year. Differences on exchange arising from the retranslation of the opening net investment in Haemocell Inc. and from the translation of the results of Haemocell Inc. at average rate are taken to reserves.

(i) Research and development
Development costs incurred on specific projects are capitalised when recoverability can be assessed with reasonable certainty and amortised in line with the expected sales arising from the projects. All other development costs are written off in the year of expenditure.

(j) Deferred Taxation
Deferred tax is recognised in respect of all timing differences that have originated but which have not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more or a right to pay less or to receive more tax.

Deferred tax assets are recognised to the extent that they are regarded as recoverable. Assets are regarded as recoverable when it is regarded as more likely than not there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

(k) Financial Instruments
Income and expenditure arising on financial instruments is recognised on the accruals basis, and credited or charged to the profit and loss account in the financial period to which it relates.

2. Turnover

Analysis by class of business

	2005 £'000	2004 £'000
Minimally Invasive Surgery	**2,677**	2,487
Branded Products	**153**	203
Autologous Blood Transfusion	**172**	111
Royalties and Licence Fees	**481**	231
Design Fees	**535**	—
	4,018	3,032

Analysis by geographical area, excluding royalties and licence fees

	2005 £'000	2004 £'000
United Kingdom	**1,287**	610
Europe	**1,585**	1,182
USA	**359**	864
Rest of World	**306**	145
	3,537	2,801

Operating profit and net assets are not disclosed by class of business, as this is prejudicial to the Group's interests.

3. Operating profit

	2005 £'000	2004 £'000
The profit for the year is stated after charging:		
Depreciation of owned tangible fixed assets	**125**	123
Depreciation of tangible fixed assets held under finance lease	**91**	80
Auditors' remuneration — Audit Fees	**17**	13
— Tax Compliance Fees	**5**	5
Operating lease rentals:		
Land and buildings	**63**	57
Research and development — current year expenditure	**248**	330

4. Employees

The average monthly number of persons employed by the Group was:

	2005 Number	2004 Number
Production	**28**	24
Development	**8**	7
Sales	**2**	2
Administration	**6**	6
	44	39

The costs incurred in respect of the employees were:

	£'000	£'000
Wages and salaries	**916**	812
Social security costs	**88**	80
Pension costs	**28**	23
	1,032	915

A detailed analysis of Directors' emoluments is shown in the table on page 18.

5. Interest payable

	2005 £'000	2004 £'000
On finance leases	**22**	29
On bank overdrafts	**24**	32
On convertible loan notes	**3**	7
	49	68

6. Taxation

Tax on profit on ordinary activities

	2005 £'000	2004 £'000
Current tax charge	**—**	—
Deferred tax credit recognised in year	**50**	38
Tax credit on profit on ordinary activities	**50**	38

The taxation assessed for the year is lower than the standard rate of corporation tax in the UK at 30% (2004: 30%). The differences are explained as follows:

	2005 £'000	2004 £'000
Factors affecting the tax charge for the year:		
Profit on ordinary activities before taxation	**352**	174
Corporation tax at standard rate of 30% (2004: 30%)	**106**	52
Effects of:		
Research and development enhanced expenditure	**(55)**	(43)
Expenses not tax deductible	**5**	4
Capital allowances for the year in excess of depreciation	**10**	5
Increase in provisions not tax deductible	**21**	10
Losses utilised	**(100)**	(26)
Losses not utilised	**14**	—
Income taxable at less than standard rate of corporation tax	**(1)**	(2)
Current tax charge for the year	**—**	—

Deferred Taxation

The movement in the deferred taxation account during the year was:

	2005 £'000	2004 £'000
Balance brought forward	**38**	—
P&L account movement arising during the year	**50**	38
Balance carried forward	**88**	38

The deferred taxation recognised in the financial statements at 19% is set out below:

	2005 £'000	2004 £'000
Trade losses	**88**	38

The recoverability of the deferred tax asset is dependent on future taxable profits in excess of those arising from the reversal of deferred tax liabilities. The recognition of the deferred tax assets is based upon profit forecasts for the year ended 31 December 2006.

Deferred tax assets at 19% of £2,934,000 (2004: £3,029,000) in respect of trading losses carried forward, £23,000 (2004: £12,000) in respect of short-term timing differences and £6,000 (2004: £6,000) in respect of accelerated capital allowances have not been recognised on the grounds that there is insufficient evidence that these assets will be recoverable in the foreseeable future.

7. Earnings per Ordinary Share

The earnings per Ordinary Share has been calculated by dividing the profit attributable to ordinary shareholders for the year ended 31 December 2005 of £402,000 (2004: £212,000) by the weighted average number of Ordinary Shares in issue during the year of 258,612,616 (2004: 256,955,941) and amounted to 0.16p per share (2004: 0.08p per share).

The Group has one category of dilutive potential ordinary shares, those share options granted where the exercise price is less than the average price of the Company's ordinary shares during the year. The dilution has no effect on basic earnings per share.

8. Profit for the financial year of Surgical Innovations Group plc

The profit for the financial year dealt with in the financial statements of the holding company, Surgical Innovations Group plc, was £885 (2004: £8,075).

9. Tangible fixed assets

Group	Office & computer equipment £'000	Tooling £'000	Plant & machinery £'000	Total £'000
Cost:				
At 1 January 2005	356	1,131	409	1,896
Additions	51	11	11	73
At 31 December 2005	**407**	**1,142**	**420**	**1,969**
Depreciation:				
At 1 January 2005	244	627	214	1,085
Charge for period	29	159	28	216
At 31 December 2005	**273**	**786**	**242**	**1,301**
Net book value:				
At 31 December 2005	**134**	**356**	**178**	**668**
At 1 January 2005	112	504	195	811
The net book value of assets held under finance leases:				
At 31 December 2005	32	161	138	331
Depreciation of assets held under finance leases:	5	68	18	91

10. Investments

Company	£'000
Cost	
At 31 December 2005 and 1 January 2005	1,551
Provisions for diminution in value	
At 31 December 2005 and 1 January 2005	533
Net book value at 31 December 2005 (2004: £1,018,000)	**1,018**

The principal subsidiaries of the Group comprise:

	Description of shares held	Nature of business	Country of incorporation and operation	Proportion held Group	Proportion held Company
Surgical Innovations Limited	Ordinary £1 shares	Design and manufacture of surgical instruments	Great Britain	100%	100%
B & P Biotechnology Limited	Ordinary £1A shares Ordinary £1B shares	Intermediate Holding Company	Great Britain	100%	100%
Bellhouse Technology Limited	Ordinary £1 shares Deferred £1 shares	Holder of patents and intellectual property	Great Britain	100%	—
Haemocell Inc.	Common $1 shares	Import/export vehicle	USA	100%	100%

11. Stocks

	Group		Company	
	2005 £'000	2004 £'000	**2005 £'000**	2004 £'000
Raw materials	**518**	608	**—**	—
Finished goods	**334**	273	**—**	—
	852	881	**—**	—

12. Debtors

	Group		Company	
	2005 £'000	2004 £'000	**2005 £'000**	2004 £'000
Trade debtors	**1,322**	947	**—**	—
Prepayments and accrued income	**141**	140	**2**	21
Corporation tax	**3**	3	**—**	—
Deferred tax asset	**88**	38	**—**	—
Other debtors	**51**	87	**8**	8
Amounts due from subsidiary undertakings	**—**	—	**2,189**	2,266
	1,605	1,215	**2,199**	2,295

Included in Group Trade debtors is an amount of £67,000 (2004: £Nil), which is due after more than one year.

13. Creditors: amounts falling due within one year

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Bank loans and overdrafts	**228**	186	**–**	–
Convertible debt	**–**	110	**–**	110
Trade creditors	**395**	466	**–**	–
Obligations under finance leases	**121**	129	**–**	–
Social security and other taxes	**44**	64	**–**	–
Accruals and deferred income	**131**	28	**27**	16
Other creditors	**21**	60	**17**	57
	940	1,043	**44**	183

The Group's borrowing facilities are in the form of a multi-currency overdraft facility provided by Barclays Bank PLC. The facility is secured by a fixed and floating charge over the assets of the Group and inter-company guarantees.

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

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Bank loans	**2**	9	**–**	–
Obligations under finance leases	**114**	206	**–**	–
	116	215	**–**	–

15. Borrowings

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Bank loans and overdrafts	**230**	195	**–**	–
Obligations under finance leases	**235**	335	**–**	–
Convertible debt	**–**	110	**–**	110
	465	640	**–**	110
Borrowings are repayable as follows:				
Due within one year				
Bank loans and overdrafts	**228**	186	**–**	–
Obligations under finance leases	**121**	129	**–**	–
Convertible debt	**–**	110	**–**	110
Due after one year and within two years				
Bank loans	**2**	9	**–**	–
Obligations under finance leases	**82**	117	**–**	–
Due after two years and within five years				
Obligations under finance leases	**32**	89	**–**	–
	465	640	**–**	110

16. Financial instruments

The Group's policy is to maintain an appropriate balance between variable and fixed rate interest rate borrowings.

The Group uses financial instruments, other than derivatives, comprising borrowings, cash and various items, such as trade debtors, trade creditors, etc. that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

The main risks arising from the Group financial instruments are interest rate risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged from previous years.

It is and has been throughout the year under review, the Group policy that no trading in financial instruments or derivatives shall be undertaken.

The fair values of financial instruments are not materially different from book values.

Short-term debtors and creditors

Short-term debtors and creditors have been excluded from the interest rate risk disclosure.

Interest rate risk

The Group finances its operations through a mixture of bank borrowings, finance leases and convertible debt. The Group exposure to interest rate fluctuations on its borrowings is managed by the use of both fixed and floating rate facilities. At the year end 53 per cent (2004: 73 per cent) of the total borrowings as noted in note 15 were at fixed rates.

The floating rate financial liabilities mainly comprise bank borrowings and overdrafts bearing interest at commercial rates.

Currency risk

The Group is exposed to translation and transaction foreign exchange risk. The Group does, as appropriate, use derivative instruments to hedge against this risk. The Group maintains US Dollar and Euro bank accounts as follows:

US Dollar — £9,000 (2004: £900)
Euro — £14,000 (2004: £6,000)

In addition, the Group has short-term foreign currency debtors and creditors with a net exposure as follows:

US Dollar — £72,171 (2004: £233,817)
Euro — £248,088 (2004: £147,121)

Foreign exchange differences on retranslation of these assets and liabilities are taken to the profit and loss account of the Group.

17. Share capital

	2005 £'000	2004 £'000
Authorised 325,000,000 (2004: 325,000,000) Ordinary Shares of 1p each	**3,250**	3,250
Allotted, called up and fully paid 259,151,188 (2004: 258,014,894) Ordinary Shares of 1p each	**2,591**	2,580

During the period the Company issued 1,136,294 ordinary 1p shares, on conversion of £42,611 convertible loan notes.

Of the unissued ordinary share capital, 14,605,000 are reserved for allotment under the savings related, executive and non-executive share option schemes. These are exercisable as follows:

	Number	Exercise Price	Exercise Period
Savings related	405,000	2.00	August 2004 to August 2006
Executive	2,000,000	3.00	November 2003 to November 2010
Non-Executive Unapproved Scheme	2,000,000	3.00	November 2003 to November 2010
Non-Executive Unapproved Scheme	4,000,000	2.00	April 2004 to May 2011
Enterprise Management Scheme	3,200,000	2.00	July 2004 to July 2011
Unapproved Schemes	2,000,000	2.00	April 2004 to June 2011
Unapproved Schemes	1,000,000	3.00	November 2003 to November 2010

18. Reserves

(a) Group	Share premium £'000	Accumulated losses £'000	Capital reserve £'000
At 1 January 2005	16,070	(17,329)	329
Premium on shares issued	31	—	—
Profit for the year	—	402	—
At 31 December 2005	**16,101**	**(16,927)**	**329**

(b) Company	Share premium £'000	Accumulated losses £'000
At 1 January 2005	16,070	(15,519)
Premium on shares issued	31	—
Profit for the year	—	1
At 31 December 2005	**16,101**	**(15,518)**

19. Reconciliation of Movements in Shareholders' Funds

	2005 £'000	2004 £'000
Profit for the financial year	**402**	212
Issue of shares	**42**	43
Net increase in Shareholders' Funds	**444**	255
Opening Shareholders' Funds	**1,650**	1,395
Closing Shareholders' Funds	**2,094**	1,650

20. Contingent liabilities and financial commitments

These are as follows:

(a) Contingent liabilities
The Company guarantees the rent of £25,000 per annum until 1 October 2006 under the terms of the assignment of its former lease at Warrington.

(b) Operating leases
At 31 December 2005 the Group had annual commitments under non-cancellable operating leases as follows:

	2005 Land and Buildings £'000	2004 Land and Buildings £'000
Within two to five years	**61**	57

(c) Capital commitments
At 31 December 2005 the Group had capital commitments of £142,000 (December 2004: £Nil).

21. Reconciliation of operating profit to net cash inflow from operating activities

	2005 £'000	2004 £'000
Operating profit	**401**	242
Depreciation of tangible fixed assets	**216**	203
Decrease/(increase) in stocks	**29**	(160)
(Increase)/decrease in debtors	**(340)**	50
Decrease in creditors	**(27)**	(205)
Net cash inflow from operating activities	**279**	130

22. Reconciliation of net cash flow to movement in net debt

	2005 £'000	2004 £'000
Decrease in cash in the year	**(20)**	(1)
Cash outflow from finance leases and loans	**118**	103
Cash outflow from loan note redemption	**68**	—
Change in net debt resulting from cash flows	**166**	102
New finance leases and loans	**(9)**	(101)
Issue of shares on conversion of loan notes	**42**	—
Movement in net debt	**199**	1
Net debt at beginning of year	**(639)**	(640)
Net debt at end of year	**(440)**	(639)

23. Analysis of changes in net debt

	At 1 January 2005 £'000	Cash flow £'000	Non-cash changes £'000	At 31 December 2005 £'000
Cash at bank and in hand	1	24	—	**25**
Bank overdrafts	(175)	(44)	—	**(219)**
		(20)		
Bank loan	(20)	9	—	**(11)**
Finance leases	(335)	109	(9)	**(235)**
		118		
Convertible loan notes	(110)	68	42	**—**
	(639)	166	33	**(440)**

24. Transactions with related parties

As disclosed in the Report on Remuneration:

(1) Director's fees for D B Liversidge are paid to Quest Investments Limited, a company of which he is a director.
(2) Director's fees and advisory fees for C Glass are paid to Winburn Glass Norfolk, a firm of which he is a partner.
(3) Director's fees and advisory fees for R Simkins are paid to Getz Bros & Co. (BVI) Inc., a company of which he is an employee.

A summary of transactions during the year and outstanding amounts at the balance sheet date is as follows:

	Amounts invoiced to the Group £'000	Amounts payable at 31 December 2005 £'000
Quest Investments Limited (1)	18	**2**
Winburn Glass Norfolk (2)	12	**1**
Getz Bros & Co. (BVI) Inc. (3)	8	**—**

25. Pensions

The Company currently operates a Group personal pension plan for the benefit of employees.

NOTICE IS HEREBY GIVEN THAT the Annual General Meeting of the Company will be held at the Weetwood Hall Hotel & Conference Centre, Otley Road, Far Headingley, Leeds, LS16 5PS at 1.00 p.m. on Tuesday, 27 June 2006 for the transaction of the following business.

Ordinary Business

To consider and, if thought fit, to pass the following resolutions as ordinary resolutions of the Company:

1. To receive and adopt the audited Accounts for the twelve months ended 31 December 2005 and the Reports of the Directors and auditors thereon.
2. To re-elect Mr C Glass as a Director who retires by rotation in accordance with the Articles of Association of the Company and, being eligible, offers himself for re-election.
3. To re-elect Mr R Simkins as a Director who retires by rotation in accordance with the Articles of Association of the Company and, being eligible, offers himself for re-election.
4. To reappoint Grant Thornton UK LLP as auditors of the Company and to authorise the Directors to determine their remuneration.
5. To approve the Report on Remuneration set out on pages 18 and 19.

Special Business

As special business to consider and, if thought fit, to pass the following resolution numbered 6 as an ordinary resolution and the following resolution numbered 7 as a special resolution.

6. That the Directors be and they are hereby generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 to allot relevant securities (within the meaning of section 80(2) of the Companies Act 1985) up to a maximum nominal amount of £658,488.12 provided that this authority shall expire on the earlier of the date falling 15 months after the date of this resolution and the conclusion of the next Annual General Meeting of the Company unless previously renewed, varied or revoked by the Company in general meeting save that the Company before such expiry date make an offer or agreement which would or might require relevant securities to be allotted in pursuance of such offer or agreement as if the authority conferred hereby had not expired.
7. That the Directors be and they are hereby empowered until the earlier of the date falling 15 months after the date of this resolution and the conclusion of the next Annual General Meeting of the Company to allot equity securities (as defined in section 94(2) of the Companies Act 1985) of the Company for cash pursuant to the authority conferred by resolution 6 above as if section 89 of the said Act did not apply to any such allotment, provided that such power shall be limited to:

   (i) the allotment of equity securities in connection with an issue or offer in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders on a fixed record date are proportionate (as nearly as may be) to the ordinary shares held by them but including in connection with such an issue or offer, the making of such arrangements as the Directors may deem necessary or expedient to deal with problems under the laws of any territory or the requirements of any regulatory body or any stock exchange in connection with fractional entitlements or otherwise;

   (ii) the allotment (otherwise than pursuant to the power referred to in (i) above) of equity securities up to an aggregate nominal amount of £129,575.59 provided that the Company may, before such expiry, make an offer or arrangement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities pursuant to any such offer or agreement as if such authority had not expired.

Dated 7 April 2006

Registered office:
Clayton Park
Clayton Wood Rise
Leeds LS16 6RF

Notes:

1 All holders of Ordinary Shares are entitled to attend and vote at the above meeting. A member entitled to attend and vote at the above meeting may appoint one or more proxies to attend and, on a poll, vote on his behalf. A proxy need not be a member.

2 To be valid, a form of proxy must be completed and lodged (together with the power of attorney or other authority, if any, under which it is signed) with the Company's Registrars, Capita Registrars, PO Box 25, Beckenham, Kent, BR3 4BR not less than 48 hours before the time appointed for the meeting. The completion and return of a form of proxy will not prevent a member who wishes to do so from attending and voting in person.

These notes are intended to explain the business to be transacted at the Annual General Meeting.

Resolution 1 — Report and Accounts
The Directors of the Company are required under company law to present the audited Accounts, the Directors' Report and the Auditors' Report on the audited Accounts to shareholders at the Annual General Meeting.

Resolution 2 and 3 — Reappointment of C Glass and R Simkins.
In accordance with the Company's Articles of Association, no Director can hold office for more than three years and, in addition, one-third of the Company's Directors are required to retire as Directors, at the meeting. Accordingly, Messrs C Glass and R Simkins are eligible for re-election at the meeting and have chosen to submit themselves for re-election. The biographical details of each Director are given on page 12 in the Annual Report.

Resolution 4 — Reappointment and remuneration of Auditors
Under company law auditors are required to be reappointed at every Annual General Meeting.

Resolution 5 — Approval of the Report of the Board on Remuneration
In accordance with Best Practice, the Board of Directors of the Company has determined that the shareholders should be invited to approve the policies set out in the Report on Remuneration.

Resolution 6 — Authority to allot shares
Resolution 6 will allow the Directors to allot unissued shares of the Company up to a maximum aggregate nominal value of £658,488.12 which represents the lower of the unissued share capital or approximately one-third of the issued share capital. The authority will last from the date of the passing of the resolution until the next Annual General Meeting of the Company or for 15 months, whichever is the earlier.

Resolution 7 — Authority to allot shares for cash
Resolution 7 will allow the Directors to allot unissued shares of the Company for cash, other than to existing shareholders in proportion to their holdings. The aggregate nominal value of relevant securities which can be allotted under the authority is limited to £129,575.59, being approximately 5 per cent of the nominal value of the issued share capital of the Company at the date of the Directors' Report. The authority will last from the date of the passing of the resolution until the next Annual General meeting of the Company or for 15 months, whichever is the earlier.

five year summary

	2005	2004	2003	2002	2001
	£'000	£'000	£'000	£'000	£'000
Turnover (including licence fees and royalties)	**4,018**	3,032	2,750	2,224	1,847
Cost of sales	**(2,295)**	(1,432)	(1,312)	(1,048)	(846)
Gross profit	**1,723**	1,600	1,438	1,176	1,001
Administrative expenses	**(1,322)**	(1,358)	(1,255)	(1,098)	(900)
Exceptional items	**—**	—	—	—	(72)
Operating profit	**401**	242	183	78	29
Interest receivable	**—**	—	—	1	13
Interest payable	**(49)**	(68)	(47)	(19)	(6)
Profit on ordinary activities for the year before taxation	**352**	174	136	60	36
Tax on profit on ordinary activities	**50**	38	3	18	48
Retained profit for the year	**402**	212	139	78	84
Earnings per ordinary share	**0.16p**	0.08p	0.05p	0.03p	0.03p

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