

The **TEP** Exchange

# **TEP Exchange Group PLC**

## **Report and Financial Statements**

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for the year ended 31 December 2003

# Contents and company details

Page	
2	Chairman's statement
3	Corporate governance statement
5	Report of the Directors
11	Report of the independent auditors
12	Consolidated profit and loss account
12	Reconciliation of movements in shareholders' funds
13	Consolidated balance sheet
14	Company balance sheet
15	Consolidated cash flow statement
16	Notes forming part of the financial statements

## Directors

G Kynoch *Chairman (Non-Executive)*  
 A Weitz *Marketing Director*  
 M Kraus *Non-Executive Director*  
 P Sands *Non-Executive Director*  
 D Roxburgh *Non-Executive Director*

## Secretary and registered office

J Murphy  
 1-2 Grosvenor Court  
 Foregate Street  
 Chester  
 Cheshire CH1 1HG

## Company number

3877125

## Auditors

BDO Stoy Hayward LLP  
 8 Baker Street  
 London W1U 3LL

## Registrars

Capita IRG plc  
 The Registry  
 34 Beckenham Road  
 Beckenham  
 Kent BR3 4TU

## Nominated adviser

John East & Partners Limited  
 Crystal Gate  
 28-30 Worship Street  
 London EC2A 2AH

## Bankers

Bank of Scotland plc  
 Queen Square House  
 15 Queen Square  
 Brighton  
 East Sussex BN1 3FD

## Brokers

Insinger Townsley  
 44 Worship Street  
 London EC2A 2AH

## Chairman's statement

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I am pleased to report the results for the year ended 31 December 2003. Turnover reduced to £58,930 from £909,406 in 2002. The loss before tax was reduced to £601,848 (2002 – loss £699,216). The loss per share was 0.42 pence compared to a loss per share last year of 0.45 pence.

Whilst there was a slight improvement in market expectations towards the end of the year, trading continued to suffer due to uncertainty in the traded endowment policy market.

It will be recalled that the significantly changed trading position in 2002 prompted your Directors to raise additional funds through forming a strategic alliance with Surrenda-link Limited, which included outsourcing the operational management of the Exchange to Surrenda-link Limited together with a placing of new shares in which Surrenda-link limited was a significant participant. The effect of the new arrangements was to reduce significantly the Company's cost structure and to stabilise its financial position.

During 2003 several new products were identified and introduced on the Exchange with varying results and 2004 will see the introduction of new product services aimed at the Independent Financial Adviser Community.

More importantly, with the return of investor confidence, the Exchange is seeing a considerable increase in activity which has resulted in a rise in the number of accepted deals for traded endowment policies in recent months.

In late May 2004, we launched the TEP Exchange "public website" which will give members of the public the opportunity to receive on-line bids for their endowment policies from the panel of market makers on the Exchange. This new facility is designed to increase volume and to meet the growing demand for traded endowment policies in a fast growing market.

Your Board continues to focus on achieving financial viability in the short term and in creating shareholder value. Costs are closely controlled and product development will continue in a cost effective manner.

Your Board is not proposing a dividend for the year under review.

**G Kynoch**  
Chairman

29 June 2004

# Corporate governance statement

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TEP Exchange Group PLC is highly committed to high standards of corporate governance and the Company is supportive of the provisions set out in Section 1 of the Combined Code on Corporate Governance laid out in the Financial Services Authority Listing Rules.

Companies on the Alternative Investment Market of the London Stock Exchange are not required to comply with the Combined Code and, due to the size of the Company, TEP Exchange Group PLC is not in full compliance. The Company is, however, working towards full compliance with the Combined Code, together with other current draft corporate governance, and expects to be fully compliant in 2004.

## **The Board**

The Board of TEP Exchange Group PLC consists of one Executive Director and four Non-Executive Directors. The composition of the Board ensures no one individual or group of persons dominates the decision making process.

The Board is responsible to the shareholders for setting the direction of the Company through the establishment of strategic objectives and key policies. The Board meets on a regular basis and considers the strategic direction, approves major capital expenditure, appoints and monitors senior management and any other matters having a material effect on the Company. Presentations are made to the Board by senior management on the activities and both the Executive and Non-Executive Directors undertake regular visits to operations.

All Directors have access to management, including the Company Secretary, and to such information as is needed to carry out their duties and responsibilities fully and effectively.

Furthermore, all Directors are entitled to seek independent professional advice concerning the affairs of the Company at its expense. All Directors are subject to election by shareholders at the first annual general meeting following their appointment. In addition, Directors will retire and stand for re-election at least once every three years in accordance with the Company's Articles of Association.

The interests of the Directors in the shares and share options of the Company serve to align their interests with the shareholders generally and the Company does not consider this to have an adverse effect on their independence.

## **Nominations committee**

The Directors do not consider that, given the size of the Board, it is appropriate to have a Nominations Committee. The appropriateness of such a committee will, however, be kept under regular review by the Company.

## **Internal controls**

The Directors are responsible for the Group's systems of internal control and reviewing its effectiveness. Any such system is designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable assurance against material misstatement or loss.

Internal controls and business risks were monitored in the course of 2003 through regular Board meetings. A more formal review of internal controls is scheduled before the end of 2004.

# Corporate governance statement

continued

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## **Communication with shareholders**

The Board recognises that it is accountable to shareholders for the performance and activities of the Group.

The forthcoming Annual General Meeting of the Company will provide an opportunity for the Chairman to present to the shareholders a report on current operations and developments and enable the shareholders to express their views about the Company's business.

## **Remuneration Committee**

The Directors do not consider that, given the size of the Group, it is appropriate to have a Remuneration Committee. The appropriateness of such a committee will, however, be kept under regular review by the Board. At present, remuneration of Directors and senior management is determined at the Board meetings.

## **Audit committee**

The Audit Committee, comprising solely of independent Non-Executive Directors, meets not less than twice a year and considers the Company's financial reporting (including accounting policies) and internal financial controls.

Meetings are normally attended, by invitation, by a representative of the auditors.

The audit committee presently comprises G Kynoch, M Kraus and D Roxburgh.

## **Going concern**

The Board is required to assess whether the Group has adequate financial resources to continue in operation for the foreseeable future. The Directors' statement on the appropriateness of the going concern basis is set out on page 9.

# Report of the Directors

for the year ended 31 December 2003

The Directors present their report together with the audited financial statements for the year ended 31 December 2003.

## Principal activities and business review

The principal activity of the Group during the year was arranging the sale and purchase of with profit endowment policies on-line utilising its proprietary trading platform known as The TEP Exchange. The principle activity of the Group remained unchanged during the year.

A review of the business and future developments is given in the Chairman's statement on page 2.

## Results and dividends

The consolidated profit and loss account is on page 12 and shows the result for the year. The Directors do not recommend the payment of a dividend (2002 – nil).

## Research and development

The Group has a policy of continual product development and enhancement of the modules, systems and facilities that constitute The TEP Exchange trading platform.

## Directors and their interests

The Directors who served in office during the year and their interests in the Company's ordinary shares of 1p each are as follows:

Ordinary shares held at:	31 December 2003 (or date of resignation if earlier)		31 December 2002 (or date of appointment if earlier)	
	Number	%	Number	%
M Kraus	22,034,698*	15.33	22,034,698*	19.06
A Weitz	–	–	–	–
P Sands	–	–	–	–
G Kynoch	274,167	0.19	–	–
D Roxburgh (appointed 13 January 2003)	–	–	–	–
S Kay (resigned 13 January 2003)	1,900,000	1.32	1,900,000	1.64

\*Of these shares, M Kraus holds 3,125,000 ordinary shares. The remaining shares are held by the M Kraus Family Foundation pursuant to the terms of which M Kraus and members of his family are potential beneficiaries.

On 17 March 2004, G Kynoch acquired a further 50,000 ordinary shares of 1p each.

A Weitz retires by rotation in accordance with the Articles of Association and being eligible offers himself for re-election. The terms of the Directors' service contracts or terms of engagement are set out below.

M Kraus, G Kynoch and D Roxburgh consider themselves to be independent Non-Executive Directors. M Kraus has been nominated as Senior Non-Executive Director.

# Report of the Directors

continued

## Directors and their interests continued

### Share options

The Directors' interests in share options are set out below:

Interest held at:	31 December 2003 (or date of resignation if earlier)	31 December 2002 (or date of appointment if earlier)
M Kraus	287,273	287,273
A Weitz	295,545	295,545
P Sands	200,000	200,000
G Kynoch	–	–
D Roxburgh (appointed 13 January 2003)	–	–
S Kay (resigned 13 January 2003)	2,100,000	2,100,000

Share options were granted to M Kraus and A Weitz on 16 February 2001 pursuant to the rules of the Enterprise Management Incentive Scheme (“the EMI Rules”). The subscription price payable under the terms of the share options granted to M Kraus and A Weitz were 10 pence per share. Share options were granted to S Kay on 6 September 2001 pursuant to the EMI Rules. The subscription price payable under the terms of the share options were in respect of 600,000 shares, 8 pence per share and in respect of 1,500,000 shares, 12 pence per share. The terms of the share options granted under the EMI Rules permit exercise after the expiry of three years from the date of grant and before ten years after date of grant. There are no other restrictions preventing exercise under the terms of the share options or EMI Rules. Share options were granted to P Sands on 24 August 2001 pursuant to the rules of the Unapproved Share Option Scheme 2000. The subscription price payable under the share option was 8 pence per share. The terms of the Unapproved Share Option Plan permit exercise after the expiry of three years from the date of grant and before ten years after date of grant. There are no other restrictions preventing exercise under the terms of the share option or pursuant to the rules of the Unapproved Share Option Plan.

P Sands entered into a letter of engagement with the Company for his services as a Non-Executive Director of the Company. The agreement was deemed to commence on 7 June 2000 and is terminable on six months' written notice given by either party at any time. Pursuant to a letter agreement dated 29 August 2001 with Drumduan Associates the Company secured the services of G Kynoch as Non-Executive Chairman. The agreement with Drumduan Associates is terminable on six months' written notice given by either party at any time. S Kay entered into a service agreement dated 29 August 2001 for his services as a Chief Executive Officer of the Company for an initial term of 12 months and thereafter to continue until terminated by either party giving not less than three months' written notice. S Kay resigned on 13 January 2003 and had an interest in share options over 2,100,000 ordinary shares at 31 December 2002 and the date of his resignation.

M Kraus and D Roxburgh do not have service agreements with the Company.

A Weitz has entered into a service agreement dated 29 August 2001 providing an annual salary of £72,000 per annum. The service agreement is for an initial term of 12 months, and, thereafter, continues until terminated by either party giving not less than 12 months written notice. The agreement provides that Mr Weitz will work full time for the Company being such number of hours as agreed between him and the Company. For a period of 9 months after termination Mr Weitz is prohibited from being interested in any matter or other entity which competes with the business of the Company other than as the holder of shares which confer not more than three per cent of the voting rights in a company listed on a Recognised Investment Exchange and for a period of 12 months after termination Mr Weitz is prohibited from soliciting or enticing Directors or senior employees, clients or customers of the Company.

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# Report of the Directors

continued

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## Directors profile

**George Kynoch (Non-Executive Chairman)**, aged 57, has over 20 years' experience in industry and was Chief Executive of G & G Kynoch plc (the predecessor of Kynoch Group plc, now called Bioquell PLC, the Officially Listed designer and manufacturer of healthcare equipment for use in contamination control). He was Grampian Industrialist of the Year in 1988 and received the Highland Business Award. Mr Kynoch was the Scottish Office Industry and Local Government Minister from 1995 to 1997, while serving as a Member of Parliament for Kincardine and Deeside between 1992 and 1997. He is also a director of Talent Group Plc.

**A Weitz (Marketing Director)**, aged 39, has many years of experience in the property industry, having joined Highdorn Co. Limited, a property management company, in early 1992. Mr Weitz has for some time had an interest in merging the new e-commerce ideas with more traditional business and is joint founder of the Company.

**M Kraus (Non-Executive Director)**, aged 46, has been an active participant in the TEP market for several years. After finishing Rabbinical and Talmudic studies in 1980, Mr Kraus was a teacher in a religious school in Zurich between 1981 and 1985. In 1983 he trained as a life insurance salesman, in his spare time, with Winterthur Insurance in Zurich, where he was first exposed to the endowment policy market. In 1984 he became a significant shareholder in Caruso AG, which was formed in 1983 to sell life insurance and associated products. It currently holds endowment policies with a value of approximately CHF 200 million in its clients' portfolios. Mr Kraus' shareholding in Caruso AG has now reduced to less than 10 per cent and he has no executive role in that company. He moved from Switzerland to the United Kingdom in 1994 with residential status of "Person of Independent Means" which prevented him from working as an employee or engaging in business in the United Kingdom until he obtained indefinite residence in March 1999. He founded TEP Exchange Group PLC in November 1999.

**David Roxburgh (Non-Executive Director)**, aged 40, a member of the Institute of Certified Public Accountants in Ireland and is Managing Director of the Fitzwilton Group of Companies. One of Fitzwilton's investments is a 36% shareholding in Portfolio Design Group International Limited (the parent company of Surrenda-link Limited). The business of Portfolio Design Group International Limited comprises the purchase, sale and valuation of with profit endowment policies in the secondary market and management of portfolios of with profit endowment policies. Outside of the Fitzwilton Group, Mr. Roxburgh is a Non-Executive Director of Arcon International Resources Plc (a publicly quoted zinc mining company), Hart Marketing Services Limited (a financial services company) and Waterford Crystal Limited (the world renowned luxury branded company).

**P Sands (Non-Executive Director)**, aged 60, has nearly 20 years experience in the UK Life Assurance and Financial Services market. He is Chief Executive of Surrenda-link Limited, which he established in 1990 and under his direction the company has grown to a position of considerable prominence in the market for traded endowment policies (TEPs). Mr Sands is a Director of various TEP related funds, designed and created by Surrenda-link Limited, and is a former Chairman of the Association of Policy Market Makers (APMM). Mr Sands is also the non-executive Chairman of Hart Marketing Services Limited (a financial services company).

# Report of the Directors

continued

## Substantial shareholdings

Excluding Directors whose shareholdings are set out above, the following had declared an interest of 3% or more in the Company's issued ordinary share capital at 31 December 2003. Following the share issue on 17 March 2004, Surrenda-link Limited and Surrenda-link (IOM) Limited declared an interest of 39.26 per cent of the enlarged issued share capital of the Company. No other shareholder had declared an interest of 3% or more in the Company's issued ordinary share capital by 27 June 2004.

Name	Ordinary Shares	Percentage of Ordinary Shares
Surrenda-link Limited	67,692,579	35.34%
Urs Kranz	18,909,698	9.87%
Zwi Holles Transcontex AG	18,606,858	9.71%
Surrenda-link (IOM) Limited	7,500,000	3.92%
Pershing Keen Nominees Limited	5,974,190	3.12%
Eli Brandelis	5,750,000	3.00%

None of the Directors are aware of any interest, apart from those listed above which represents 3% or more of the issued share capital of the Company or which directly or indirectly, jointly or severally, exercises or could exercise control of the Company.

The market price of the Company's shares at the end of the financial year was 0.875p; the highest and lowest share prices during the year were 2.25p and 0.875p respectively.

## Post balance sheet events

In March 2004, the Company issued 47,867,579 Ordinary Shares of 1p each at par. These shares were issued and allotted in satisfaction of the following:

- 47,692,579 shares in relation to invoices totalling approximately £476,926 from Surrenda-link Limited in respect of management and commission fees for the 12 months ended 31st December 2003.
- 50,000 shares in relation to the consultancy fees of Mr G Kynoch for the amount of £500
- 125,000 shares in relation to an invoice totalling £1,250 rendered to the Company by a provider of services.

Following the issue of the above shares Surrenda-link Limited (together with Surrenda Link (IOM) Limited, which is deemed to be acting in concert with Surrenda-link Limited) holds 75,192,579 ordinary shares representing 39.26 per cent of the enlarged issued share capital of the Company, respectively.

# Report of the Directors

continued

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## Going concern

During the year ended 31 December 2003 the Group incurred a loss of £601,848 (2002 – £516,421) and at 31 December 2003 had net liabilities of £694,138 (2002 – £373,540).

The Group meets its day to day working capital requirements through an overdraft facility which is repayable on demand, and is currently due for renewal by the bank in December 2004. The Directors anticipate improved trading results for the forthcoming year have and prepared projected cash flow information.

The Group also relies on support from one of its major shareholders, Surrenda-link Limited, in order to meet its obligations as they fall due. Since the year end, the Company has issued to Surrenda-link Limited 47,692,579 ordinary shares of 1p each by way of capitalisation of the £476,926 of the year end creditor.

The Directors have received assurances from Surrenda-link Limited that it will provide the following continuing financial support:

- settlement of fees payable under the outsourcing agreement through the issuance of shares up to a number which does not exceed 48.22% of the entire issued share capital of the Company;
- deferment of fees payable under the outsourcing agreement for 9 months from the date at which the 48.22% holding is reached up to an amount of £250,000 for 9 months; and
- support of £40,000 to April 2005.

On the basis of the above, and all other available information, the Directors consider that the Group will become profitable and continue to operate within the facilities currently agreed and those likely to be agreed in the future and therefore that it is appropriate to prepare the financial statements on the going concern basis.

During the year ended 31 December 2003 the Group incurred a loss of £601,848 (2002 – £516,421) and at 31 December 2003 had net liabilities of £694,138 (2002 – £373,540).

The Group meets its day to day working capital requirements through an overdraft facility which is repayable on demand, and is currently due for renewal by the bank in December 2004. The Directors have prepared projected cash flow information for the next year and on the basis of these consider that the Group will continue to operate within the facilities currently agreed and those likely to be agreed in the future.

# Report of the Directors

continued

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## **Directors' responsibilities**

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

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

## **Group policy on payment of creditors**

It is the Group's policy to agree terms of payment prior to commencing business with suppliers. The average creditor payment period for the Company at 31 December 2003 was 113 days (2002 – 122 days).

## **Auditors**

On 31 December 2003, BDO Stoy Hayward, the Company's auditors, transferred its business to BDO Stoy Hayward LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. Accordingly BDO Stoy Hayward resigned as auditors on that date and the Directors appointed BDO Stoy Hayward LLP as its successor. A resolution to re-appoint BDO Stoy Hayward LLP as auditors will be proposed at the next annual general meeting.

By order of the Board

**J Murphy**  
Secretary

29 June 2004

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# Report of the independent auditors

## to the shareholders of TEP Exchange Group PLC

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We have audited the financial statements of TEP Exchange Group PLC for the year ended 31 December 2003 on pages 12 to 22. These financial statements have been prepared under the accounting policies set out on pages 16 and 17.

### **Respective responsibilities of Directors and auditors**

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards 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 United Kingdom Auditing Standards.

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 transactions with the Company and other members of the Group 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 Directors' Report, the Chairman's Statement 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. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

### **Basis of audit opinion**

We conducted our audit in accordance with United Kingdom 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 the Group's and the Company's affairs as at 31 December 2003 and of the Group's loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**BDO Stoy Hayward LLP**  
Chartered Accountants  
and Registered Auditors

London

29 June 2004

## Consolidated profit and loss account

for the year ended 31 December 2003

	Note	2003 £	2002 £
<b>Turnover</b>	2	58,930	909,406
Cost of sales		(15,614)	(649,690)
<b>Gross profit</b>		43,316	259,716
Administrative expenses		(963,667)	(1,048,334)
Other operating income	4	313,802	119,596
<b>Operating loss</b>	5	(606,549)	(669,022)
Interest receivable		258	3,553
Interest payable	6	4,443	(33,747)
<b>Loss on ordinary activities before taxation</b>		(601,848)	(699,216)
Tax on loss on ordinary activities	8	–	182,795
<b>Loss on ordinary activities after taxation</b>		(601,848)	(516,421)
Retained loss brought forward		(5,197,162)	(4,680,741)
<b>Retained loss carried forward</b>		(5,799,010)	(5,197,162)
<b>Loss per share</b>			
Basic and diluted loss per share	10	(0.42)p	(0.45)p

All amounts relate to continuing activities.

All recognised gains and losses are included in the profit and loss account.

The notes on pages 16 to 22 form part of these financial statements.

## Reconciliation of movements in shareholders funds

for the year ended 31 December 2003

	2003 £	2002 £
Loss for the year	(601,848)	(516,421)
New share capital subscribed and issued	281,250	–
	(320,598)	(516,421)
Opening shareholders' funds	(373,540)	142,881
<b>Closing shareholders' funds</b>	(694,138)	(373,540)

# Consolidated balance sheet

at 31 December 2003

	Note	2003 £	2003 £	2002 £	2002 £
<b>Fixed assets</b>					
Tangible assets	11		21,901		59,996
<b>Current assets</b>					
Stock	13	2,591		12,540	
Debtors	14	207,667		164,023	
Cash at bank and in hand		1,494		19,050	
		<u>211,752</u>		<u>195,613</u>	
<b>Creditors: amounts falling due within one year</b>					
	15	<u>927,791</u>		<u>629,149</u>	
<b>Net current liabilities</b>			<u>(716,039)</u>		<u>(433,536)</u>
<b>Net liabilities</b>			<u>(694,138)</u>		<u>(373,540)</u>
<b>Capital and reserves</b>					
Called up share capital	16		1,436,971		1,156,250
Share premium account	17		3,667,901		3,667,372
Profit and loss account	17		<u>(5,799,010)</u>		<u>(5,197,162)</u>
<b>Shareholders' funds – equity</b>			<u>(694,138)</u>		<u>(373,540)</u>

The financial statements were approved by the Board on 29 June 2004

**G Kynoch**  
Chairman

**D Roxburgh**  
Director

The notes on pages 16 to 22 form part of these financial statements.

# Company balance sheet

at 31 December 2003

	Note	2003 £	2003 £	2002 £	2002 £
<b>Fixed assets</b>					
Tangible assets	11		21,901		59,996
Investments	12		100,006		100,006
			<u>121,907</u>		<u>160,002</u>
<b>Current assets</b>					
Debtors – due within one year	14	370,886		334,969	
Cash at bank and in hand		149		1,994	
		<u>371,035</u>		<u>336,963</u>	
<b>Creditors: amounts falling due within one year</b>					
	15	<u>1,240,210</u>		<u>897,036</u>	
<b>Net current liabilities</b>			<u>(869,175)</u>		<u>(560,073)</u>
<b>Net liabilities</b>			<u>(747,268)</u>		<u>(400,071)</u>
<b>Capital and reserves</b>					
Called up share capital	16		1,436,971		1,156,250
Share premium account	17		3,667,901		3,667,372
Profit and loss account	17		<u>(5,852,140)</u>		<u>(5,223,693)</u>
<b>Shareholders' funds – equity</b>			<u>(747,268)</u>		<u>(400,071)</u>

The financial statements were approved by the Board on 29 June 2004

**G Kynoch**  
Chairman

**D Roxburgh**  
Director

The notes on pages 16 to 22 form part of these financial statements.

# Consolidated cash flow statement

for the year ended 31 December 2003

	Note	2003 £	2003 £	2002 £	2002 £
<b>Net cash outflow from operating activities</b>	21		(428,754)		(691,620)
<b>Returns on investments and servicing of finance</b>					
Interest received		258		3,553	
Interest paid		4,443		(13,826)	
<b>New cash inflow/(outflow) from returns on investment and servicing of finance</b>			4,701		(10,273)
<b>Taxation</b>					
Corporation tax received			–		182,795
<b>Capital expenditure and financial investment</b>					
Purchase of tangible fixed assets		–		(5,143)	
Proceeds on sale of tangible fixed assets		1,482		6,331	
<b>Net cash inflow from capital expenditure and financial investment</b>			1,482		1,188
<b>Financing</b>					
Issue of ordinary share capital		281,250		–	
<b>Cash inflow from financing</b>			281,250		–
<b>Movement in net debt</b>	22		(141,321)		(517,910)

The notes on pages 16 to 22 form part of these financial statements.

# Notes forming part of the financial statements

for the year ended 31 December 2003

## 1 Accounting policies

The financial statements have been prepared under the historical cost convention and are in accordance with applicable United Kingdom accounting standards. The following principal accounting policies have been applied consistently in dealing with items that are considered material to the Group's financial statements.

### Going concern

During the year ended 31 December 2003 the Group incurred a loss of £601,848 (2002 – £516,421) and at 31 December 2003 had net liabilities of £694,138 (2002 – £373,540).

The Group meets its day to day working capital requirements through an overdraft facility which is repayable on demand, and is currently due for renewal by the bank in December 2004. The Directors anticipate improved trading results for the forthcoming year have and prepared projected cash flow information.

The Group also relies on support from one of its major shareholders, Surrenda-link Limited, in order to meet its obligations as they fall due. Since the year end, the Company has issued to Surrenda-link Limited 47,692,579 ordinary shares of 1p each by way of capitalisation of the £476,926 of the year end creditor.

The Directors have received assurances from Surrenda-link Limited that it will provide the following continuing financial support:

- settlement of fees payable under the outsourcing agreement through the issuance of shares up to a number which does not exceed 48.22% of the entire issued share capital of the Company;
- deferment of fees payable under the outsourcing agreement for 9 months from the date at which the 48.22% holding is reached up to an amount of £250,000 for 9 months; and
- support of £40,000 to April 2005.

On the basis of the above, and all other available information, the Directors consider that the Group will become profitable and continue to operate within the facilities currently agreed and those likely to be agreed in the future and therefore that it is appropriate to prepare the financial statements on the going concern basis.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of TEP Exchange Group PLC and all of its subsidiary undertakings made up to 31 December 2003. Uniform accounting policies are adopted by all companies in the Group. The acquisition method of accounting is used to consolidate the results of subsidiary undertakings in the Group financial statements.

### Turnover

Turnover represents sales to outside customers at invoiced amounts less value added tax. Fee and commission income is recognised when due.

### Research and development costs

All research and development costs are charged to the profit and loss account in the year in which the expenditure is incurred.

### Depreciation

Depreciation is provided to write off the cost, less estimated residual values, of all fixed assets over their expected useful lives. It is calculated at the following rates:

Fixtures, fittings and equipment	–	4 years
Computer equipment	–	3 years

### Investments

Investments held as fixed assets are stated at cost less provision for impairment in value.

# Notes forming part of the financial statements

continued

## 1 Accounting policies continued

### Stocks

Stocks of endowment policies are valued at the lower of cost and net realisable value. Cost is based on the cost of purchase. Net realisable value is based on surrender value less additional costs to completion and disposal.

### Operating leases

Annual rentals are charged to the profit and loss account on a straight line basis over the term of the lease.

### Financial instruments

The Group does not use derivative financial instruments for trading purposes or to manage risk.

### Deferred tax

Deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date except for deferred tax assets which are only recognised to the extent that the Company anticipates making sufficient taxable profits in the future to absorb the reversal of the underlying timing differences.

## 2 Turnover

Turnover is wholly attributable to the principal activity of the Group and arises solely within the United Kingdom.

## 3 Employees

Staff costs, including Directors, consist of:

	2003 £	2002 £
Wages and salaries	109,216	612,691
Social security costs	12,129	56,867
	<u>121,345</u>	<u>669,558</u>

The average number of employees, including Directors, during the year was as follows:

	Number	Number
Full time	<u>5</u>	<u>14</u>

## 4 Other operating income

	2003 £	2002 £
Rent receivable	159,450	119,596
Expenses recharged	154,352	–
	<u>313,802</u>	<u>119,596</u>

## 5 Operating loss

	2003 £	2002 £
Operating loss is stated after charging/(crediting):		
Depreciation	36,613	73,612
Profit on disposal of tangible fixed assets	–	(899)
Auditors' remuneration – audit services	13,000	17,000
– non-audit services	6,000	5,000
Operating lease rentals – equipment	1,700	2,643
– land and buildings	140,900	140,900
	<u>140,900</u>	<u>140,900</u>

The audit fees of the Company are £10,000 (2002 – £10,000).

# Notes forming part of the financial statements

continued

<b>6 Interest payable</b>	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
Bank interest	8,796	14,526
Interest on overdue taxation	(13,239)	19,221
	<u>(4,443)</u>	<u>33,747</u>

<b>7 Directors</b>	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
Directors' emoluments consist of:		
Fees and remuneration for management services	109,216	248,054
Compensation for loss of office	–	43,500
	<u>109,216</u>	<u>291,554</u>

No pension contributions were made in respect of the Directors (2002 – nil).

<b>8 Taxation on loss ordinary activities</b>	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
Research and development tax credit	–	182,795

The tax assessed for the year varies from the standard rate of corporation tax in the UK. The differences are explained below:

	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
Loss on ordinary activities before taxation	<u>(601,848)</u>	<u>(699,216)</u>
Loss on ordinary activities before taxation multiplied by the standard rate of UK corporation tax of 30% (2002 – 30%)	(180,554)	(209,765)
Expenses not deductible for tax purposes	–	4,500
Timing differences relating to capital allowances and depreciation	–	(637)
Tax losses not recognised as a deferred tax asset	180,554	205,902
Research and development tax credit	–	(182,795)
Current year tax credit	<u>–</u>	<u>(182,795)</u>

At 31 December 2003 the Group had a deferred tax asset of £1,442,874 (2002 – £1,262,320) in respect of losses which have not been recognised in these financial statements.

<b>9 Loss for the year attributable to the members of TEP Exchange Group PLC</b>	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
Dealt with in financial statements of the Parent Company	<u>628,447</u>	<u>633,248</u>

The Company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own profit and loss account in these financial statements.

## 10 Loss per share

The calculation of the basic loss per share is based on the loss after tax of £601,848 (2002 – £516,421) and on 142,544,945 (2002 – 115,625,000) ordinary shares, being the weighted average number of ordinary shares in issue. The options in issue at the 31 December 2002 and 31 December 2003 are antidilutive.

# Notes forming part of the financial statements

continued

## 11 Tangible assets

Group and Company	Computer equipment £	Fixtures, fittings and equipment £	Total £
<b>Cost</b>			
At 1 January 2003	173,684	66,724	240,408
Disposals	(238)	(1,244)	(1,482)
At 31 December 2003	<u>173,446</u>	<u>65,480</u>	<u>238,926</u>
<b>Depreciation</b>			
At 1 January 2003	147,693	32,719	180,412
Charge for the year	25,753	10,860	36,613
At 31 December 2003	<u>173,446</u>	<u>43,579</u>	<u>217,025</u>
<b>Net book value</b>			
At 31 December 2003	<u>–</u>	<u>21,901</u>	<u>21,901</u>
At 31 December 2002	<u>25,991</u>	<u>34,005</u>	<u>59,996</u>

## 12 Investments

	Company 2003 £	Company 2002 £
Subsidiary undertaking – shares at cost and net book value	<u>100,006</u>	<u>100,006</u>

The following were subsidiary undertakings held directly by Company at the end of the year:

Name	Country of incorporation	Proportion of voting rights and ordinary share capital held	Nature of business
TEP-Exchange Limited	England	100%	Intermediary to the traded endowment policy market
TEP-Exchange Interim Portfolio Limited	England	100%	Trading of traded endowment policies
TEP Transfer Limited	England	100%	Dormant
Interactive Intelligence Limited	England	100%	Dormant

## 13 Stocks

	2003 Group £	2002 Group £	2003 Company £	2002 Company £
Stocks of endowment policies held for resale	<u>2,591</u>	<u>12,540</u>	<u>–</u>	<u>–</u>

There is no material difference between the replacement cost of stocks and the amounts stated above.

# Notes forming part of the financial statements

continued

<b>14 Debtors</b>	<b>2003 Group £</b>	<b>2002 Group £</b>	<b>2003 Company £</b>	<b>2002 Company £</b>
Trade debtors	52,969	6,676	44,614	1,025
Amount due from subsidiary undertaking	–	–	172,129	178,762
Other debtors	101,273	94,493	100,717	92,328
Prepayments	53,425	62,854	53,426	62,854
	<u>207,667</u>	<u>164,023</u>	<u>370,886</u>	<u>334,969</u>

Included in amounts due from subsidiary undertakings is an amount of £150,000 (2002 – £150,000) in respect of an unsecured loan to TEP-Exchange Limited and is subject to a tripartite agreement with TEP Exchange Group PLC (the lender) and the Financial Services Authority. Interest can be demanded by TEP Exchange Group PLC and if so demanded will be calculated at the annual rate of 5% above the London Inter-Bank Offered Rate for deposits of pounds sterling. The earliest repayment date was 25 September 2003.

## 15 Creditors: amounts falling due within one year

	<b>2003 Group £</b>	<b>2002 Group £</b>	<b>2003 Company £</b>	<b>2002 Company £</b>
Bank overdraft	196,330	72,565	196,477	72,565
Trade creditors*	529,180	322,030	526,211	307,036
Amount due to subsidiary undertaking	–	–	307,664	292,609
Creditors for taxation and social security	13,922	105,733	13,922	105,733
Other creditors	45,934	5,214	45,702	4,982
Accruals	142,425	123,607	150,234	114,111
	<u>927,791</u>	<u>629,149</u>	<u>1,240,210</u>	<u>897,036</u>

The bank overdraft is secured by a fixed and floating charge over the assets of the Company.

\*Included within the trade creditors of the Company and the Group at 31 December 2002 is an amount of £516,805 (2002 – £nil) owing to Surrenda-link Limited of which £476,926 has been capitalised through the issue of 47,692,579 ordinary shares of 1p each (see note 19).

## 16 Share capital

<b>Authorised</b>	<b>2003 Number</b>	<b>2002 Number</b>	<b>2003 £</b>	<b>2002 £</b>
Ordinary shares of 1p each	<u>400,000,000</u>	<u>120,000,000</u>	<u>4,000,000</u>	<u>1,200,000</u>
<b>Allotted, called up and fully paid</b>				
Ordinary shares of 1p each	<u>143,697,147</u>	<u>115,625,000</u>	<u>1,436,971</u>	<u>1,156,250</u>

Details of post balance sheet events are given on page 7.

Details of the share option schemes are shown below:

	<b>Number of shares under option</b>	<b>Exercise price</b>	<b>Exercise period</b>	
			<b>From</b>	<b>To</b>
Enterprise Management	1,027,879	3p	16.2.04	16.2.11
Incentive Scheme	600,000	8p	6.9.04	6.9.11
	582,818	10p	16.2.04	16.2.11
	1,500,000	12p	6.9.04	6.9.11
	<u>3,710,697</u>			
Unapproved Share Option Plan	200,000	8p	24.8.01	24.8.04
	<u>3,910,697</u>			

# Notes forming part of the financial statements

continued

## 17 Reserves

	Profit and loss account £	Share premium account £
<b>Group</b>		
Balance at 1 January 2003	(5,197,162)	3,667,372
Loss for the year	(601,848)	–
Shares issued in the year	–	529
At 31 December 2003	<u>(5,799,010)</u>	<u>3,667,901</u>
<b>Company</b>		
Balance at 1 January 2003	(5,223,693)	3,667,372
Loss for the year	(628,447)	–
Shares issued in the year	–	529
At 31 December 2003	<u>(5,852,140)</u>	<u>3,667,901</u>

## 18 Commitments under operating leases

As at 31 December 2003, the Group had annual commitments under non-cancellable operating leases as set out below:

	Land and building	
	2003 £	2002 £
Operating leases which expire:		
Between two and five year	140,900	–
After five years	–	140,900
	<u>140,900</u>	<u>140,900</u>

## 19 Related party transactions

The Company has taken advantage of the exemption allowed by Financial Reporting Standard 8, 'Related Party Transactions', not to disclose any transactions with entities that are included in these consolidated financial statements.

During the year, the Group recharged expenditure of £154,352 (2002 – £nil) to Surrenda-link Limited, a major shareholder in the Group. In addition, Surrenda-link Limited recharged expenditure of £405,894 to the Group. A loan of £40,000 was made to the Group by Surrenda-link Limited. The balance owing to Surrenda-link Limited at the year end was £516,805 (2002 – £nil). Since the year end, the Company has issued to Surrenda-link Limited 47,692,579 ordinary shares of 1p each by way of capitalisation of the £476,926 of the year end creditor.

# Notes forming part of the financial statements

continued

## 20 Financial instruments

The Board agrees and reviews policies and financial instruments for risk management. The primary objectives of the treasury function are to provide competitively priced funding for the activities of the Group and to identify and manage financial risk. Short term liquidity risk is managed by obtaining and reviewing the adequacy of banking facilities.

All bank borrowings are in sterling and on floating interest rates. The Group does not hedge interest rate risk. The Group does not face any significant foreign currency risk. As at 31 December 2003 the Group had unutilised bank facilities of £3,670 (2002 – £127,435), secured against the stocks.

Various financial instruments, such as trade debtors and trade creditors, arise directly from the Group's operations and the Group does not treat these as financial instruments for disclosure purposes.

Floating rate financial assets of £1,494 (2002 – £19,050) comprise sterling cash deposits the majority of which earn interest at the bank base rate minus 3%. Floating rate financial liabilities of £196,330 (2002 – £72,565) represents a sterling bank overdraft repayable on demand, which attracts interest at the bank base rate plus 3%. At 31 December 2003, the Bank of Scotland Base rate was 4%.

## 21 Reconciliation of operating loss to net cash outflow from operating activities

	2003 £	2002 £
Operating loss	(606,549)	(669,022)
Depreciation	36,613	73,612
Profit on disposal of tangible fixed assets	–	(899)
Decrease in stock	9,949	233,004
(Increase)/decrease in debtors	(43,644)	45,324
Increase/(decrease) in creditors	174,877	(373,639)
Net cash outflow from operating activities	<u>(428,754)</u>	<u>(691,620)</u>

## 22 Reconciliation of net cash outflow to movement in cash and net debt

	2003 £	2002 £
Decrease in cash in the year and movement in net debt in the year	(141,321)	(517,910)
Opening cash and net debt	(53,515)	464,395
Closing cash and net debt	<u>(194,836)</u>	<u>(53,515)</u>

## 23 Analysis of net debt

	At 31 December 2002 £	Cash flow £	Non-cash movement £	At 31 December 2003 £
Cash in hand and at bank	19,050	(17,556)	–	1,494
Overdrafts	(72,565)	(123,765)	–	(196,330)
	<u>(53,515)</u>	<u>(141,321)</u>	<u>–</u>	<u>(194,836)</u>



