



**/FREEDOM4/** Annual report and accounts 2007

**FREEDOM<sup>4</sup>**

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**//CORPORATE STATEMENT//** [FREEDOM4 Communications plc](#), (formerly Pipex Communications plc) comprises FREEDOM4 Limited and FREEDOM4 WiFi. It provides personal wireless broadband services without boundaries. With a national licence to deploy WiMAX services in the 3.6 GHz band, FREEDOM4 is working closely with businesses and local authorities to build the necessary infrastructure to provide broadband wireless Internet access across the UK.

FREEDOM4 Limited is a joint venture with Intel, and has partnerships with some of the leading names in wireless technologies and telecommunications, including Airspan Networks, Nokia Siemens Networks, Ericsson, and National Grid Wireless. Together they provide WiMAX services to nomadic workers, businesses and SoHos via a scalable and highly resilient network.

FREEDOM4 WiFi provides Hotspot Roaming access to businesses and consumers in the UK and 80 countries worldwide. Users can roam to WiFi hotspots owned by 200 different WiFi network providers through simple, one click client software.

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**REGISTERED OFFICE**  
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**REGISTERED IN ENGLAND NUMBER**  
3974683

The board believes that the sale of the hosting and network services businesses, in conjunction with the capital reduction and tender offers, crystallised for shareholders the substantial value created in this business over the previous three years.

## CHAIRMAN'S STATEMENT



**Peter Dubens**  
Executive Chairman

### STRATEGIC TRANSACTIONS DISPOSAL OF THE BROADBAND AND VOICE BUSINESS

On 13 July 2007, the company announced that it had entered into an agreement for the sale, subject to shareholder approval and competition clearance, of the companies which comprised the group's broadband and voice businesses to Tiscali UK Limited. The consideration for the disposal on a cash and debt free basis was £210 million, which sum was subject to adjustment in accordance with the terms of the sale agreement. The agreement was completed on 13 September 2007.

The board believed that although the broadband and voice businesses had experienced significant growth, this was not expected to continue due to the declining adoption rate of broadband in the UK and increasing levels of competition in the sector. These factors were considered likely to result in a higher cost of customer

acquisition and ongoing margin erosion which would limit the business's ability to increase profitability. In addition, opportunities for growth through acquisition had declined considerably as a result of the significant consolidation which has occurred in the sector.

For the period to 13 September 2007 the broadband and voice businesses contributed turnover of £210.8 million, compared to turnover of £232.9 million for the full year in 2006. The operating profit attributable to the business for the period to 13 September 2007 was £7.0 million, compared to £8.7 million for the full year in 2006. The transaction gave rise to a profit on disposal of £51.6 million.

### REDEMPTION OF 3.875% GUARANTEED CONVERTIBLE BONDS AND REPAYMENT OF BANK DEBT

On 17 September 2007, the company announced that it would redeem all of the £91,500,000 3.875% guaranteed convertible bonds due 2011. This was



implemented on 12 October 2007, with the bonds being redeemed at their principal amount plus accrued interest together with payment of a premium of £20 per £1,000 denomination of bonds. The repayment of the bonds utilised approximately £93.3 million of the cash generated by the broadband disposal. A further £35 million of the proceeds of the broadband and voice disposal was utilised in repayment of bank borrowings.

#### **POST YEAR-END DISPOSAL OF THE HOSTING AND NETWORK SERVICES BUSINESSES**

Following the disposal of the broadband and voice businesses the board believed that there was no longer a compelling strategic fit between the remaining businesses within the group.

Therefore, following receipt of a number of indicative offers the company initiated a competitive sales process and on 14 March 2008 announced that it had entered into

a conditional agreement for the sale of the hosting and network services division to a wholly-owned subsidiary of Oakley L.P. The agreed consideration was £120.0 million (on an Enterprise Value basis), to be satisfied by £20.0 million in loan notes (issued by a wholly owned subsidiary of Oakley L.P.), the assumption by the buyer of certain debt/liabilities, and the balance in cash. The disposal, which was approved by shareholders, was completed on 2 April 2008, with the final consideration satisfied by £92.5 million in cash, £17.5 million in loan notes and the assumption by the buyer of certain of the company's debts/liabilities.

For the year ended 31 December 2007 the hosting and network services businesses generated revenues of £72.3 million (2006: £61.5 million) and a loss before tax of £9.0 million (2006: loss of £3.4 million). As at 31 December 2007 the net assets of the hosting and network services

businesses were £60.5 million (2006: £65.8 million).

The board believes that the sale of the hosting and network services businesses, in conjunction with the capital reduction and tender offers, crystallised for shareholders the substantial value created in this business over the previous three years.

#### **CAPITAL REDUCTION AND TENDER OFFERS**

The board recognised that following the disposal of the broadband and voice businesses and the hosting and network services division, the company would have capital that was surplus to its requirements, and in addition that the ongoing capital requirements of the group would reduce. As a consequence of this, on 15 March 2008 the company proposed to effect a capital reduction to create distributable reserves, and subsequently to return capital of up to £156.9 million to shareholders by means of a tender offer. The board believed that the capital reduction and

Following completion of the strategic transactions, the company owns 52% of a joint venture established with Intel in 2006. The joint venture, which was re-branded from Pipex Wireless to "FREEDOM4" in October 2007, owns five radio spectrum licences and is currently building a WiMAX network using licensed spectrum in the 3.6GHz frequency band.

## **CHAIRMAN'S STATEMENT CONTINUED**

### **POST YEAR-END CONTINUED CAPITAL REDUCTION AND TENDER OFFERS CONTINUED**

tender offers were an appropriate means of returning cash to shareholders in a manner that enabled shareholders to choose whether or not to participate, and when to participate, in the return of capital.

The capital reduction required approval of shareholders at a General Meeting of the company, and the approval of the High Court. These were received such that the capital reduction became effective on 1 April 2008. The tender offers opened on 15 March 2008 and closed on 3 April 2008. In aggregate the company bought back 1,489,775,339 shares at a price of 10.39 pence per share, at a total cost of £154.8 million. Following completion of the tender offers and share options exercised of 151,085,002, the company has 1,070,541,017 ordinary shares in issue.

Following completion of the tender offers and subsequent payment of all transaction costs and certain other payables the net cash resources of the company currently comprise approximately £3.0 million

of net cash and £10.5 million held in an escrow account subject to warranty and indemnity claims in respect of the broadband and voice disposal. In addition the company has the benefit of the £17.5 million loan notes. It is the board's intention to distribute to shareholders the proceeds of the redemption of the loan notes, due to be repaid within 18 months.

### **OPERATIONAL REVIEW – WIRELESS DIVISION**

Following completion of the strategic transactions, the company owns 52% of a joint venture established with Intel in 2006. The joint venture, which was re-branded from Pipex Wireless to "FREEDOM4" in October 2007, owns five radio spectrum licences and is currently building a WiMAX network using licensed spectrum in the 3.6GHz frequency band.

### **CUSTOMER TRIALS**

During 2007 FREEDOM4 successfully completed technical and commercial trials in Milton Keynes and Warwick. These indicated significant customer interest in high speed wireless



broadband services, in both business and consumer markets. Customers valued in particular the ease of network connection and the network access speed provided by the service, and the fact that no fixed land-line subscription was required to receive the service. In Warwick the Council extended the use of the trial network to home workers, and is trialling WiMAX-based CCTV.

#### **NETWORK ROLL-OUT**

By the end of March 2008 FREEDOM4 had rolled out a total of 11 live base sites, providing WiMAX coverage to approximately 50,000 premises in Manchester, Milton Keynes and Warwick. Contracts have been let, and site roll-out is currently under way, for the next phase of network expansion, to cover up to approximately 500,000 premises. The network roll-out is being focused on areas where a high concentration of target customers has been identified, and significant direct and indirect sales leads are being generated. Major network vendors to FREEDOM4 include Airspan, Ericsson, and National Grid Wireless.

#### **COMMERCIAL ROLL-OUT**

From late 2007 FREEDOM4 launched commercial services in Milton Keynes, Warwick and Manchester, offering a range of WiMAX access products through the wholesale channel, including:

“JustData” – delivering high-speed, symmetrical upload and download speeds of up to 1Mb; companies save both time and money when home workers can access the Internet with a reliable, fast, and secure wireless connection.

“DataMax” – delivering high-speed, symmetrical upload and download speeds of up to 4Mb; for companies that have more demanding bandwidth needs such as hosting their own mail/web servers, connecting multiple users to a high-speed network, or regularly sending and receiving large data files.

FREEDOM4’s WiMAX network could become an integral part of a number of new public sector telecommunications network initiatives, following successful cooperation with Milton Keynes Council

to develop an economic, sustainable wireless service, part of delivering the Council’s “Digital Milton Keynes” objective. A number of other local and district councils have subsequently approached FREEDOM4 to develop and deliver unique services.

In addition the education sector is a potentially significant market opportunity. In Milton Keynes FREEDOM4 successfully developed a project with a local school providing WiMAX access to enable pupils to access e-learning platforms. Several further opportunities in this market have been identified, and are being pursued in collaboration with a sector specialist service provider.

#### **DISTRIBUTION AGREEMENTS**

FREEDOM4 has now signed distribution agreements with a number of new re-sellers, which will enhance FREEDOM4’s presence in the small business sector. Mumtel Limited will begin by reselling services in the Manchester area, while Konnex Networks Ltd will be the first reseller in Warwick. These agreements, signed in April 2008, follow

In January 2008 FREEDOM4 participated in an Ofcom auction of spectrum in the 28GHz frequency band and successfully acquired an additional licence, thereby extending its geographic coverage in this frequency band across the whole of Great Britain. FREEDOM4 now has 112MHz of contiguous spectrum with national coverage in the 28GHz frequency band, which will enable economic microwave backhaul to be provided for its WiMAX base stations.

## //CHAIRMAN'S STATEMENT CONTINUED//

### **OPERATIONAL REVIEW - WIRELESS DIVISION CONTINUED DISTRIBUTION AGREEMENTS CONTINUED**

the agreement previously signed with ConnectMK to provide WiMAX-based services in Milton Keynes, and the agreement in place with Vialtus Solutions (formerly Pipex Network Services).

### **WIFI ACQUISITION**

In April the company completed the acquisition of BOZII, a provider of WiFi roaming services. With access to over 40,000 wireless hotspots in 80 countries, BOZII works with leading Internet Service Providers to aggregate services to deliver high speed Internet connectivity without restrictive download limits, and to provide customers with one account, one bill and one simple log-on to wireless Internet connectivity. WiFi will be an important component in the roll-out of integrated wireless service, both in terms of supporting the WiMAX infrastructure and attracting new customers to FREEDOM4.

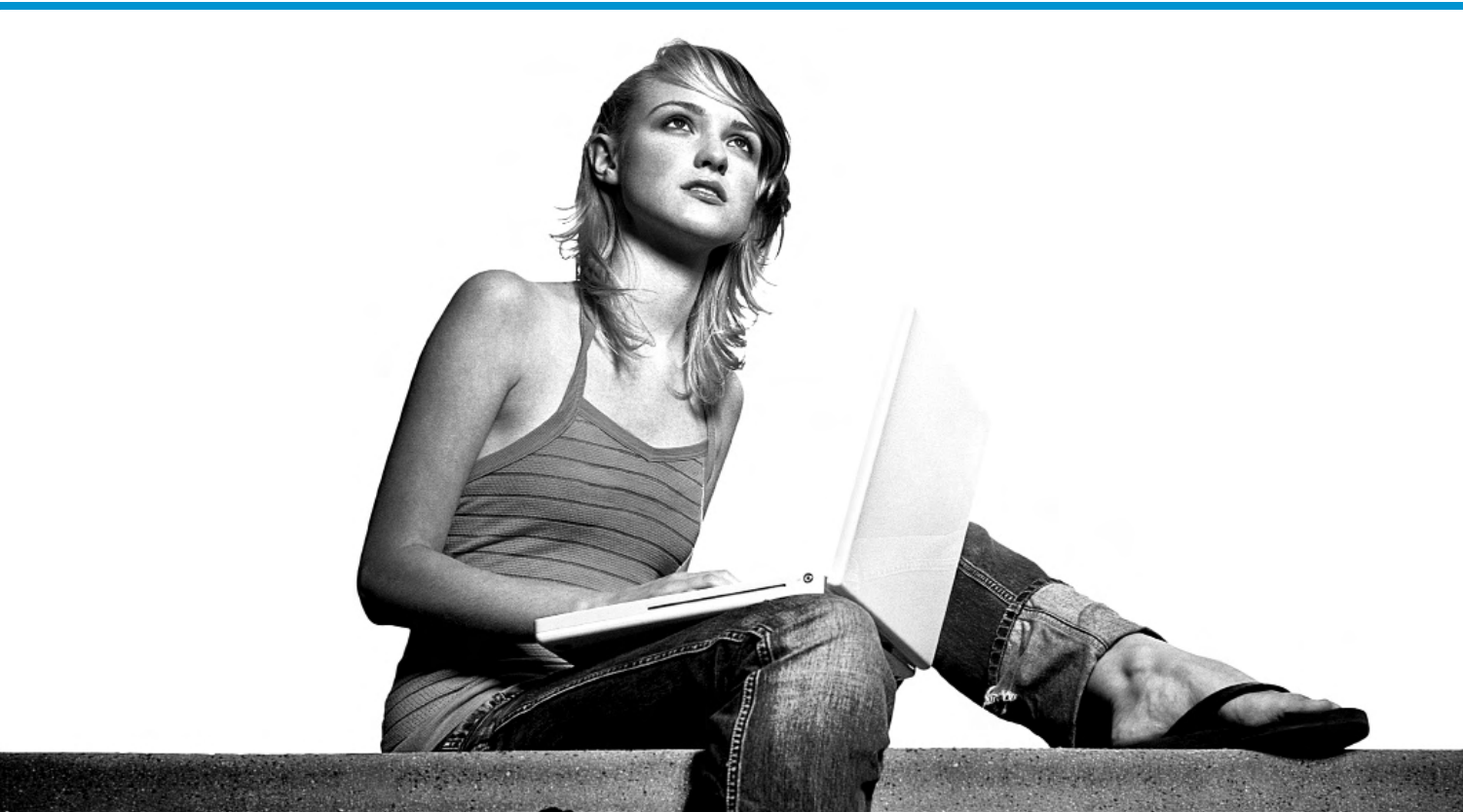
### **SPECTRUM LICENCE DEVELOPMENTS**

In January 2008 FREEDOM4 participated in an Ofcom auction of spectrum in the 28GHz frequency band and successfully acquired an additional licence which extends its geographic coverage in this frequency band across the whole of Great Britain. FREEDOM4 now has 112MHz of contiguous spectrum with national coverage in the 28GHz frequency band, which will enable economic microwave backhaul to be provided for its WiMAX base stations.

In February 2008 FREEDOM4 applied to Ofcom for an amendment to its 3.6MHz licence to permit deployment of nomadic and mobile services on this frequency. This change would enable FREEDOM4 to provide services to mobile WiMAX devices when these become available.

### **MOBILE WIMAX TRIALS**

FREEDOM4 and Airspan collaborated to demonstrate the application of mobile



WiMAX (802.16e) in the 3.6GHz frequency band, using a USB device. Following this successful initial technical test, a more extensive mobile WiMAX services trial programme will be implemented in the second and third quarters, to enable FREEDOM4 to potentially launch initial mobile services in early 2009, if the licence amendment change is granted.

#### **SUMMARY AND OUTLOOK**

The company believes that the UK wireless broadband market represents a major long-term growth opportunity. Mobile network operators are reporting strong growth in the volumes of wireless data traffic being carried on their networks, and new data-centric wireless devices are being adopted by an increasing number of business and residential customers.

In 2007 the joint venture successfully completed technical and commercial trials of high-speed, high capacity WiMAX wireless access technology, and is now rolling out WiMAX network

coverage in its initial target markets. The company believes that WiMAX technology delivers an attractive combination of range and access speed and bandwidth that will enable FREEDOM4 to capture a material part of the growing market for wireless broadband services.

Focusing initially on services for business customers, marketed through wholesale channels, during 2008 the company expects to expand network coverage in Manchester, Milton Keynes and certain other targeted areas, and to start to build a solid customer base and generate an ongoing revenue stream in these markets.

Conditional on the successful execution of its initial network and service roll-out, the joint venture then plans to extend its service offerings into the consumer market, using new direct sales channels, as well as an expanded range of indirect channel partners. Under its current business plan the joint venture plans to offer a range of fixed and mobile

wireless broadband services in 50 towns and cities by 2011.

The company has committed to invest a further US\$7.7 million in cash in the joint venture, which is expected to take place before the end of the second quarter. A further US\$6.6 million in cash will be made available should the joint venture require it. The longer-term funding of the joint venture will be dependent on the successful implementation of the first phase of the joint venture's network and services roll-out. The board believes that the working capital available to the company is sufficient for its requirements, including its current commitments to fund the joint venture, until at least the end of the second quarter of 2009.

**PETER DUBENS**  
Executive Chairman  
16 May 2008

In April 2008 the company completed the acquisition of BOZII, a provider of WiFi roaming services. With access to over 40,000 wireless hotspots in 80 countries, BOZII works with leading Internet Service Providers to aggregate services to deliver high speed Internet connectivity without restrictive download limits.

## //CHIEF EXECUTIVE'S REVIEW//



**Mike Read**  
Chief Executive

### **HOSTING BUSINESS**

Trading under the WebFusion, DonHost, SupaNames and 123-Reg brand names, this business maintained its position as one of the leading hosting companies in the UK, offering a range of cost-effective, feature-rich hosting packages for a diverse customer base. 123-Reg remained one of the UK's largest domain registrars.

During the year a range of new products was launched, including virtual private servers, e-commerce packages, and enhanced web storage products. At the same time the hosting business offices were moved from Nottingham to West London, and a further 6,000 square feet data centre in Leeds was acquired to provide additional capacity for growth.

The German hosting business, trading as Host Europe, experienced significant growth, in particular in managed hosting services and provision of virtual servers. The first phase of a new expandable data centre build was completed, allowing consolidation of other data centres as well as providing capacity for further growth.

At the end of 2007 the business had approximately 386,000 hosting customers (2006: 331,000) and the domain names customer base was over 2 million (2006: 1.25 million). This division was sold on 2 April 2008.

### **NETWORK SERVICES BUSINESS**

This business provides integrated communications solutions to large organisations and mid-market companies. With a focus on IP technologies its products include managed hosting, mobile worker and remote office security solutions, voice services and IP networking.

In 2007 the business experienced significant revenue growth, as sales resources were reorganised around specific target vertical market sectors, and sales of the multiple services to customers in these sectors were increased. A range of new products was launched, including IPCCTV and a suite of intrusion detection and mitigation services.



The business was re-branded Vialtus Solutions in March 2008. After the year end the business reached agreement to outsource the provision of circuits, and management of the connecting access network, to Cable & Wireless UK. Aiming to improve circuit pricing and operational efficiency, this five-year agreement was completed at the end of March 2008. This division was sold on 2 April 2008.

#### **WIRELESS DIVISION**

The Chief Executive's review of the wireless division is embedded in the Chairman's statement.

#### **SUMMARY**

FREEDOM4 has made encouraging progress so far: the WiMAX network roll-out is on track; the initial range of commercial wireless broadband services is attracting customer interest; new reseller agreements are being put in place to enhance FREEDOM4's reach

into target market segments and network coverage areas; strong vendor relationships have been established; and the first steps have been taken to deliver mobile WiMAX capabilities.

The management team will focus on maintaining this progress, aiming to start to build a solid customer base and ongoing revenue stream in areas of network coverage, to validate the business model, and to demonstrate the potential to deliver long-term shareholder value.

**MIKE READ**  
**Chief Executive**  
**16 May 2008**

The sale of the broadband and voice division on 13 September 2007 had a significant impact on the reported results. At the point of sale, the division had revenues and EBITDA for the period of £210.8 million and £12.0 million respectively and net assets, including attributable goodwill, of £134.1 million.

## // FINANCIAL REVIEW //



**Stewart Porter**  
Chief Financial Officer

### **TRANSACTIONS** **SALE OF THE BROADBAND AND VOICE DIVISION**

On 13 September 2007 the company completed the sale of its broadband and voice division to Tiscali UK Limited. The subsidiaries sold were Pipex Internet Limited, Pipex Homecall Limited, Toucan Residential Limited, Toucan Residential Ireland Limited and Switch2 Telecoms Limited.

Consideration for the sale was £210.0 million, before adjustments in respect of debt and working capital amounting to £12.5 million, a provision of £2.0 million and transaction costs of £9.8 million. The book value of the net assets sold was £134.1 million giving rise to a profit on disposal of £51.6 million.

The proceeds of the sale were used in part to redeem the group's convertible bonds and to repay the company's senior debt.

### **SALE OF THE HOSTING AND NETWORK SERVICES DIVISION**

In the post balance sheet period, on 2 April 2008, the company sold its

hosting and network services division to Host Europe WVS Limited, a wholly owned subsidiary of Oakley Capital Private Equity L.P.

Consideration for the sale was £120.0 million satisfied by £92.5 million in cash, £17.5 million in loan notes (issued by a wholly owned subsidiary of Oakley Capital Private Equity L.P.) and the assumption by the buyer of the division's debts.

### **PERFORMANCE OVERVIEW**

This is the first annual report and accounts produced by the company under International Financial Reporting Standards (IFRS). Note 35 to the accounts explains the exemptions applied by the group in this transition year and details the effect of transition to IFRS on the principal financial statements. The main change has been in respect of the company's intangible assets. Under IFRS 3, goodwill has been frozen at its net book value at the transition date (1 January 2006), and amortisation charged under UK GAAP for the year ended 31 December 2006



has been reversed. In addition, the fair value of customer lists acquired with business combinations in 2006 has been recognised separately from goodwill and classified as intangible assets. These intangible assets are to be amortised over their expected useful economic life of 36 months.

The sale of the broadband and voice division on 13 September 2007 had a significant impact on the reported results. At the point of sale, the division had revenues and EBITDA for the period of £210.8 million and £12.0 million respectively and net assets, including attributable goodwill, of £134.1 million.

In addition, the post year end disposal of the hosting and network services division has given rise to presentational changes in the financial statements and a number of the supporting notes. The trading results of this division, together with those of the broadband and voice division, have been classified as discontinued in the consolidated income statement. In the balance sheet, the assets and liabilities of the hosting and network services

division have been aggregated and presented under a single heading of assets/liabilities classified as held for sale.

#### **CONSOLIDATED INCOME STATEMENT**

The presentation of the consolidated income statement reflects the fundamental change which has taken place in the company since the 2006 year end. The results for the year ended 31 December 2007 include approximately 8½ months trading for the broadband and voice division. Whilst the results incorporate a full twelve months trading for the hosting and business services division, these have been disclosed as discontinued, as described above.

The remaining business, classified as continuing, comprises the wireless joint venture with Intel (FREEDOM4 Limited) and costs associated with running the plc. FREEDOM4 Limited was established to develop and market, to business and residential customers, a range of high speed wireless broadband services over licensed radio spectrum, using the WiMAX radio standard.

As a result of the disposals, the future level of central costs incurred by the company is expected to be significantly lower than the group costs incurred in 2007.

Turnover in the year was £283.1 million, 3.8% down on the previous year, reflecting the disposal of the broadband and voice division on 13 September 2007. That division contributed turnover of £210.8 million for the year to that date, compared to a turnover of £232.9 million for the full year in 2006. It should be noted that 2006 was itself not a representative full twelve months trading due to the acquisition of Homecall in March 2006 and Toucan in October 2006. Turnover in the hosting and network services division increased in the year by 18% to £72.3 million, from £61.5 million, although £1.1 million of the increase represented a reclassification of trade from broadband to network services at the time of the sale of the broadband and voice division to Tiscali.

**FREEDOM4's WiMAX network could become an integral part of a number of new public sector telecommunications network initiatives, following successful cooperation with Milton Keynes Council to develop an economic, sustainable wireless service, part of delivering the Council's "Digital Milton Keynes" objective. A number of other local and district councils have subsequently approached FREEDOM4 to develop and deliver unique services.**

## **// FINANCIAL REVIEW CONTINUED //**

### **PERFORMANCE CONTINUED**

#### **CONSOLIDATED INCOME STATEMENT CONTINUED**

Gross profit for the year was £111.1 million, largely unchanged from £112.3 million in 2006. Gross margin for the year increased from 38.2% to 39.3%, an improvement of 1.1 percentage points principally reflecting the increased proportion of higher margin hosting and network services revenues in the overall turnover mix.

Operating expenses before amortisation, depreciation, and share based payment costs increased to £98.4 million from £89.2 million in 2006, an increase of 10%. The company experienced significant change during 2007, and factors that contributed to the increase in operating expenses include higher staff costs in the broadband and voice business as a result of the integration of the billing and provisioning platforms of the brands acquired in 2006, expenses

incurred building the local loop unbundling network, the costs of relocating the hosting and network services business to one consolidated group facility in West London and costs associated with the separation of the businesses in advance of the disposals.

EBITDA (before share based payment costs) fell to £12.7 million, from £23.1 million in 2006, reflecting the small reduction in gross profit and increase in operating expenses described above.

Amortisation arises predominantly from customer lists capitalised at their fair value following acquisition by the group. These intangible assets are amortised on a straight line basis over three years. Amortisation declined from £6.6 million in 2006 to £3.8 million in 2007, reflecting the sale of the broadband and voice division.

Depreciation has risen slightly in the year, increasing from £12.0 million to £12.8 million.



Share based payment costs represent the estimated benefit accruing to employees granted options, this benefit being charged as an employment cost over the anticipated vesting period of the options. The P&L cost in 2007 was £3.5 million, compared to an equivalent charge of £1.6 million in 2006. This charge does not represent a cash cost to the company.

The net finance charge for the period was £6.5 million, an increase of £0.7 million from 2006. The convertible bonds issued by the company at the end of the first quarter in 2006 accounted for £6.4 million of the 2007 charge, the cash element of which was £3.7 million (based on the bond coupon of 3.875%). However, as required for accounting purposes, the bond is split between an equity and debt component, the debt being required to carry a commercial interest rate for P&L reporting. Interest payable in respect of finance leases amounted to £0.8 million, compared

to £0.7 million in 2006, and interest on bank loans was £2.3 million, compared to £1.8 million in the previous year. The charge also includes the premium of £1.8 million payable on redemption of convertible bonds. These finance costs were partly offset by interest income arising from the net cash proceeds of the broadband and voice division disposal.

FREEDOM4 Limited, the company's joint venture with Intel, is governed by a constitution which effectively requires unanimous shareholder agreement for major business decisions. This means that the company does not have full management control of FREEDOM4 Limited, which is therefore accounted for as a joint venture.

The group's share of the trading losses of FREEDOM4 Limited was £3.4 million (2006: £2.2 million) reflecting a full year's trading in 2007 and an increase in activity in the business. This share of losses is partly offset by the gain arising on the joint venture attributable

to an increase in the carrying value of the business of £2.5 million (2006: £1.0 million). This arises primarily as a result of cash injected into the business, adjusted for changes in the company's percentage participation. The group made a profit on the disposal of the broadband and voice division of £51.6 million which contributed to the group's total profit in the year of £33.4 million compared to £0.0 million in the previous year.

#### **CONSOLIDATED BALANCE SHEET**

As described above, the presentation of the balance sheet has changed considerably from 2006, with the assets and liabilities of the hosting and network services division being shown as held for sale. Out of total net assets of £136.0 million at 31 December 2007, £60.5 million were classified as assets held for sale.

Gross profit for the year was £111.1 million, largely unchanged from £112.3 million in 2006. Gross margin for the year increased from 38.2% to 39.3%, an improvement of 1.1 percentage points principally reflecting the increased proportion of higher margin hosting and network services revenues in the overall turnover mix.

## // FINANCIAL REVIEW CONTINUED //

### PERFORMANCE CONTINUED CONSOLIDATED BALANCE SHEET CONTINUED

The balance of the net assets not held for sale amounts to £75.5 million. This comprises: the company's investment in the wireless joint venture of £7.6 million; receivables of £11.2 million; cash and cash equivalents of £60.8 million; less trade and other payables of £1.8 million and provisions of £2.2 million.

On 8 February 2008 the company announced proposals for a capital reduction scheme to create the distributable reserves necessary to enable it to return cash to shareholders. The capital reduction required both the approval of shareholders and the confirmation of the Court. Shareholder approval was given on 3 March 2008 and the Court approved the capital reduction on 19 March 2008. As part of the capital reduction, the share premium account of the company, amounting to £96.8 million, was cancelled. In addition 0.9p of each issued ordinary share of 1p was cancelled and the nominal value

reduced to 0.1p. Finally, £2.3 million of the amount outstanding to the credit of the merger reserve was capitalised creating 231 million deferred shares, which were subsequently cancelled.

### CASH FLOW

The group generated £12.4 million in net cash flow in the year compared to £34.4 million in 2006. Cash flow in 2007 included net proceeds from the sale of the broadband and voice division of £173.2 million, offset by the repayment of convertible bond principal of £91.5 million, and repayment of bank and other debt of £37.0 million.

Operating cash flow before movements in working capital was £12.9 million compared to £23.1 million in the previous year. This measure is essentially driven by EBITDA, and the decline from 2006 reflects this. The working capital outflow of £18.5 million included £10.5 million of deferred consideration due from Tiscali and held in receivables at the year end. The balance represented a reduction in creditors in the broadband and voice division.



Capital expenditure has declined to £23.7 million from £27.1 million in 2006. Work on the first phase of the Cologne data centre was completed in the first half of the year, at an additional capital cost of £1.3 million on top of the £3.4 million spent by the end of 2006. During the year, the majority of the group's UK operations were consolidated into a single building in West London and a small head office in central London, resulting in capital expenditure on leasehold improvements of £2.7 million. Excluding these property costs, capital expenditure represented 7.0% of turnover.

Net cash at the year end was £47.0 million compared to net debt of £81.1 million at the end of 2006. This comprised balance sheet cash of £60.8 million offset by finance leases of £8.7 million and German bank debt, used to fund the Cologne data centre build, of £5.1 million.

#### **TREASURY**

The group uses financial instruments to raise finance for its operations and to manage risk arising from those operations. The group does not undertake any speculative trading in financial instruments.

On 17 September 2007 the company cancelled the full undrawn amount of £15.0 million previously available to it as a facility to fund acquisitions.

On 12 October 2007 FREEDOM4 (Jersey) Limited (formerly Pipex Finance (Jersey) Limited) redeemed its £91.5 million 3.875% guaranteed convertible bonds at their principal amount of £1,000 each plus a premium of £20 together with accrued interest up to that date.

On 19 December 2007 the company repaid its senior debt financing facility of £35.0 million.

In the post balance sheet period, the company made an offer to its shareholders to buy back 58% of their shareholdings for a minimum price of 10 pence per share, capped at 11 pence per share, by way of two tender offers. The take up by shareholders of the offers was high such that 95.8% of those shares capable of being tendered were tendered, and the tender price was set at 10.39 pence. On 4 April 2008 Collins Stewart acquired 1,459,600,083 shares by means of an on-market transaction at the tender price as a result of the first tender offer. On 7 April 2008 Collins Stewart acquired 30,175,256 shares by means of an on market transaction at the tender price as a result of the second tender offer. Following the cancellation of the tendered shares and share options exercised of 151,085,002, the company had 1,070,541,017 shares left in issue.

**STEWART PORTER**  
Chief Financial Officer  
16 May 2008

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## **BOARD OF DIRECTORS**

### **PETER DUBENS** **CHAIRMAN**

Peter Dubens has experience in the acquisition, development and restructuring of business both in the public and private sectors. He has overseen the consolidation strategy of FREEDOM4 Communications plc that has included the acquisition of business both in the hosting and broadband sectors and the subsequent disposal of the broadband division to Tiscali and the hosting business to Oakley Capital Private Equity. He is one of the founding partners of Oakley Capital Limited and co founder of Palmer Capital, a hedge fund capital raising business. He was instrumental in establishing 365 Media as one of the UK's leading online sports content providers and in the disposal of the company to BSkyB in December 2006. Peter Dubens has also co-founded a number of other privately held companies.

### **MIKE READ** **CHIEF EXECUTIVE OFFICER**

With over 30 years' experience in the communications and internet sectors, Mike Read has steered companies through organic growth, acquisition and sale phases.

Mike enjoyed an extensive career at British Telecom, before moving to the US and joining AOL. He completed a 30-company ISP "roll-up" which was sold to Earthlink in 2000. He returned to the UK in 2000 to run XO Europe - the nucleus of today's FREEDOM4 Communications plc.

In September 2006, in addition to his existing role as Chief Executive Officer of FREEDOM4 Communications, Mike became Chief Executive Officer of FREEDOM4 Limited, a joint venture with Intel Capital formed in March 2006.

### **STEWART PORTER** **CHIEF FINANCIAL OFFICER**

Stewart Porter is a Chartered Accountant and holds a Bachelor of Science degree in Electrical Engineering. Prior to founding Zipcom (now FREEDOM4 Communications) as chief financial officer, Stewart was finance director for Highpoint Telecommunications Inc, a Canadian listed company, where he was closely involved in the successful establishment of a number of European start-ups. Stewart worked for Cable & Wireless for eight years in a number of senior financial positions, latterly as director of finance and business development in global markets, the business unit responsible for serving the multinational customers of Cable & Wireless.

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#### **CHRISTINA KENNEDY**

##### **NON-EXECUTIVE DIRECTOR, CHAIRMAN OF THE REMUNERATION COMMITTEE AND A MEMBER OF THE AUDIT COMMITTEE**

Christina Kennedy has a Masters degree in Business Administration and is a Fellow of the Institute of Chartered Secretaries and Administrators. Until a few years ago she worked on a consultancy basis at board level acting as Company Secretary in a variety of listed companies: AIM, top 250 and overseas companies with a secondary listing. She has more recently held roles as a non-executive director.

Industry experience is wide ranging including manufacturing, leisure and service companies. She has a good working knowledge of the Stock Exchange Regulations, Company Law and Corporate Governance. She has also worked in a consultancy capacity as Corporate Governance Advisor for a major UK pension fund and therefore has a good understanding of investors' governance requirements. Her experience has involved her working with boards on acquisitions; restructuring; board compositions and appointments; directors' service contracts and remuneration issues; long-term incentive schemes; share options and risk management issues related to internal control requirements.

#### **LAURENCE BLACKALL**

##### **NON-EXECUTIVE DIRECTOR, CHAIRMAN OF THE AUDIT COMMITTEE AND A MEMBER OF THE REMUNERATION COMMITTEE**

A former chairman of the Internet Service Providers' Association (ISPA), Laurence Blackall has a Masters degree in Marketing and over 20 years' experience in the media and telecommunications industries. After an early career that included Virgin and the SEMA group he was a director of Frost & Sullivan and a vice president at McGraw-Hill. In 1995 he founded Global Internet and took it public as Internet Technology Group in 1996.

He managed the sale of his company to Concentric Network Corporation, which was itself acquired by XO Communications Inc. Together with Peter Dubens, he acquired XO's UK business, which reversed into Zipcom plc. This was renamed GX Networks plc, before becoming Pipex Communications plc (now FREEDOM4 Communications plc) in 2003.

# //DIRECTORS' REPORT//

The directors present their annual report and the audited financial statements for the year ended 31 December 2007.

## PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the group during the period was the supply of telecommunications services. A detailed review of the business is set out in the chairman's statement on pages 2 to 7, the chief executive's report on pages 8 and 9 and the financial review on pages 10 to 15. On 3 March 2008 the company name changed from Pipex Communications plc to FREEDOM4 Communications plc.

## FINANCIAL RESULTS AND DIVIDENDS

The results for the group for the year are shown in the consolidated income statement on page 26.

The directors do not recommend the payment of a dividend.

## DIRECTORS AND DIRECTORS' INTERESTS

The directors who held office during the year were as follows:

Peter Dubens	Chairman
Michael Read	Chief Executive Officer
Stewart Porter	Chief Financial Officer
Christina Kennedy	Non-executive
Laurence Blackall	Non-executive

Christina Kennedy and Stewart Porter retire by rotation in accordance with the Articles of Association and, being eligible, offer themselves for re-election. Laurence Blackall will retire from the board following the 2008 Annual General Meeting.

The directors' remuneration and the interests of the directors in the share capital of the company are detailed in the board report on directors' remuneration on page 23 and note C2 on pages 69 to 71.

## EMPLOYEES

It is the policy of the group that there should be no unfair discrimination in recruiting and promoting staff, including applicants who are disabled. The directors are committed to maintaining and developing communication and consultation processes with employees, who in turn are encouraged to develop an awareness of the issues affecting the group. The directors place considerable emphasis on employees sharing in the success of the group. This is achieved through the performance related bonus scheme and participation in the share option schemes. The company has established an Employee Consultation Forum in line with the Information and Consultation of Employees Regulatory Directive. This Forum has elected representatives from employee constituencies and meets quarterly with the company's senior management to discuss business issues.

## SUBSTANTIAL SHAREHOLDINGS

As of 14 May 2008 the interests notified to the company in accordance with Chapter 5 of the Disclosures and Transparency Rules comprised:

	%
UBS AG	20.16
Goldman Sachs Group Inc	10.99
Prudential plc group	8.56
M & G Investment Funds 3	7.47
SR Global Fund	5.71
P Dubens	5.45
Fidelity International	4.91
Gartmore Investment Limited	4.23
AXA Group SA	4.02

## POLICY ON PAYMENT TO SUPPLIERS

Where the supply of goods and services is satisfactory and in the absence of any dispute, the group and company's policy is to pay suppliers in accordance with the terms agreed prior to the supply of goods and services. Where no such agreement exists the group and company's policy is to pay suppliers in accordance with the terms contained in the invoice. Trade creditors at 31 December 2007 as a proportion of amounts invoiced by suppliers during the period represent 52 days (2006: 48 days). The company has no material trade creditors.

## POLITICAL AND CHARITABLE CONTRIBUTIONS

The company made no political or charitable donations during the year but supported certain charities through the provision of discounted services.

## ENVIRONMENTAL POLICY

The group's environmental policy is to meet the statutory requirements placed upon it and to apply good environmental practice in its operations whilst recognising that it is contractually obliged to meet its customers' requirements.

## RISK

Senior management are aware of their responsibility for managing risks within their business units. Each business unit head reports to the board on the status of these risks through management reports. Group risk is regularly reviewed at board level to ensure that risk management is being implemented and monitored effectively.

The board's policy is to ensure that the business units are empowered to run their businesses effectively and appropriately, bearing in mind the requirements for timely decision making and commercial reality. Insurance policies are regularly reviewed to ensure these are adequate and appropriate, in line with the nature, size and complexity of the business. Standard form contracts are provided for commercial use and to assist the commercial function to negotiate within approved parameters. Through management reports, risks are highlighted and monitored to identify potential business risk areas and to quantify and address the risk wherever possible.

## BUSINESS REVIEW

The following business review has been provided by the directors in accordance with the Companies Act. The company is disclosing the main trends and factors likely to affect the future development, performance and position of the business.

Key Performance Indicators (KPIs), which are set at group level, have been devised to allow the board and shareholders to monitor the group as a whole, as well as operating businesses within the group.

The company has financial KPIs which it monitors on a regular basis at board level and where relevant at business unit management meetings as follows:

	31 December 2007	31 December 2006
Group revenue	<b>£283.1m</b>	£294.4m
Gross profit margin	<b>39.3%</b>	38.2%
EBITDA (before share option costs)	<b>£12.7m</b>	£23.1m
Free cash flow (EBITDA less capex)	<b>£(11.0m)</b>	£(4.0m)
Cash at bank and in hand	<b>£60.8m</b>	£48.3m

The chairman's statement, chief executive's report, and financial review provide details of the various risks the company faces. These include:

- \* the maintenance of a healthy cash balance and debt facilities to allow investment and future development (refer to financial review - treasury (page 15));
- \* failure to raise additional funds to support the development of the FREEDOM4 joint venture (chairman's statement summary and outlook (page 7)); and
- \* not rationalising central overheads (refer to financial review - consolidated income statement (pages 11 to 14)).

The company perceives and monitors the following major trends, opportunities and risks for the year ending 31 December 2008 and beyond:

- \* ensuring that the FREEDOM4 joint venture meets its commercial roll-out objectives;
- \* focusing on the marketing of wireless services, initially through resellers and distributors;
- \* monitoring progress of our application to add nomadic and mobile services to our WiMAX licence; and
- \* predicting the impact of the next spectrum auctions on the competitive landscape.

# **//DIRECTORS' REPORT CONTINUED//**

## **CORPORATE AND SOCIAL RESPONSIBILITY**

The company embraces corporate and social responsibility and encourages all of its subsidiaries to become involved in local projects and initiatives on an ad hoc basis dependent upon employee interest and participation.

## **GOING CONCERN**

The directors are satisfied that the company and the group have adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the "going concern" basis for preparing the accounts on pages 26 to 76.

## **ANNUAL GENERAL MEETING**

The Annual General Meeting will be held on 8 July 2008 at 11am at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB. At the Annual General Meeting, resolutions will be proposed to receive these accounts and the Directors' and Auditors' Reports, to re-elect the directors who are retiring at the Annual General Meeting in accordance with the company's Articles of Association and for the reappointment of KPMG as auditors. In view of the recent reduction of share capital and in order to maintain flexibility to act in a manner which promotes the success of the company for the benefit of its members, the directors will seek authority to allot shares and disapply pre-emption rights in respect of ordinary shares having an aggregate nominal value of up to £356,847 and to make market purchases of up to 107,054,101 ordinary shares of 0.1p each. The company also proposes to adopt new Articles of Association. These incorporate amendments to the current Articles of Association to reflect the provisions of the Companies Act 2006 which came, or will come, into effect in 2007 and 2008. It is not yet possible to fully reflect the 2006 Act changes, as the Act will not be fully enforced until October 2009. It is, therefore, anticipated that shareholders will be asked to approve further changes to our Articles of Association at the 2009 Annual General Meeting.

The principal changes in the new Articles of Association proposed to be adopted at the 2008 Annual General Meeting are set out in Appendix 1 in the accompanying Notice of Annual General Meeting.

A copy of the proposed new Articles of Association will be available for inspection at the company's registered office at 5 Roundwood Avenue, Stockley Park, Middlesex UB11 1FF and the offices of SJ Berwin LLP, 10 Queen Street Place, London EC4R 1BE during normal business hours up until the conclusion of the Annual General Meeting. A copy of the proposed new Articles of Association will also be available for inspection at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB for at least 15 minutes prior to and until the conclusion of the Annual General Meeting.

At the Annual General Meeting the company also proposes to change the name of the company to FREEDOM4 Group plc to avoid any potential confusion with a similarly-named company which operates in broadly the same market place.

## **DISCLOSURE OF INFORMATION TO AUDITORS**

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

## **AUDITORS**

In accordance with Section 385 of the Companies Act 1985, a resolution proposing that KPMG Audit Plc be reappointed as auditors of the group will be put to the Annual General Meeting.

This report was approved by the board on 16 May 2008.

## **STEWART PORTER**

**CHIEF FINANCIAL OFFICER**

**16 MAY 2008**

The board is responsible to shareholders for effective direction and control of the group and this report describes the framework for corporate governance and internal control that the directors have established to enable them to carry out this responsibility. It also explains how the company has applied the Principles of Good Governance. Although, as an AIM listed company, the company is not required to comply with the provisions of the Combined Code ("the Code") and this is not a statement of compliance as required by the Code, the board of directors recognises the importance of, and is committed to, ensuring that effective corporate governance procedures relevant to smaller listed companies are in place.

### **THE BOARD AND COMMITTEES**

At 1 January 2007 the board comprised three executive directors (P Dubens, M Read and S Porter) and two non-executive directors (C Kennedy and L Blackall). No additional appointments were made during the year to 31 December 2007. The board considers that the current composition provides a reasonable balance of independence. L Blackall, whilst a former shareholder, brings an independent view of the telecoms industry to board discussions. C Kennedy is considered to be an independent non-executive director as defined under the Code.

An evaluation of board performance has been undertaken. The executive team discussed the effectiveness and input from the non-executive directors at a management meeting and the Remuneration Committee discussed the performance of the executive team. It was agreed that the workings of the board were currently effective and there was no need to appoint external consultants to undertake a more formal review.

The board is responsible for the overall strategy and financial performance of the group and has a formal schedule of matters reserved for its approval. Each board meeting is preceded by a clear agenda and any relevant information is provided to directors in advance of the meeting. The board met on five occasions during the year to discuss operational business. All directors were in attendance.

Since September 2003 the roles of chairman and chief executive officer have been separate. The board does not consider it necessary to appoint a senior independent director.

The Remuneration Committee comprises C Kennedy and L Blackall only and is chaired by C Kennedy. The board report on directors' remuneration on page 23 contains a detailed description of remuneration and applicable policies. The committee met on four occasions during the year. Both members were present.

Given the small size of the board, and as permitted by the Code, the board has not appointed a Nominations Committee. The board as a whole considers the appointment of all directors and senior managers. The Articles of Association of the company require directors to submit themselves for re-election at the first Annual General Meeting following appointment and then every three years by rotation, but in accordance with good practice one third of the directors will be submitted for re-election each year.

The Audit Committee comprises L Blackall (chairman) and C Kennedy. C Kennedy is considered by the board to have relevant financial experience. The committee operates under written terms of reference and is scheduled to meet at least twice a year with the company's external auditors, and the executive directors present by invitation only. The committee met twice during the year. All members were present. The committee meets with the external auditors without the executive directors present as it considers appropriate. The committee is responsible for the independent monitoring of the effectiveness of the system of internal control, compliance, accounting policies and published financial statements on behalf of the board. This is achieved primarily through a review of the annual financial statements and a review of the nature and scope of the external audit. Any significant findings or identified risks are examined so that appropriate action may be taken. The committee is also responsible for keeping under review the independence and objectivity of the external auditors, including a review of non-audit services provided to the group, consideration of any relationships with the company that could affect independence, and seeking written confirmation from the auditors that, in their professional judgement, they are independent.

### **RELATIONSHIPS WITH SHAREHOLDERS**

The company encourages the participation of both institutional and private investors. Communication with private individuals is maintained through the Annual General Meeting, and annual and interim reports. In addition further details on the strategy and performance of the company can be found at its website ([www.FREEDOM4communications.com](http://www.FREEDOM4communications.com)) which includes copies of the company's press releases. The chairman provides regular updates to the board on his meetings with shareholders and analysts, and brokers' opinions are made available to the board. As required by the Combined Code, non-executive directors are available to meet major shareholders if required.

The company's share registrars provide a helpdesk, which members may contact with enquiries regarding their shareholdings. The helpdesk telephone number is 0871 664 0300\* (or +44 20 8639 3399 for overseas callers) and their e-mail address is [ssd@capitaregistrars.com](mailto:ssd@capitaregistrars.com).

\* calls cost 10p per minute plus network extras.

### **INTERNAL CONTROL**

The board has overall responsibility for the group's systems of internal control and for monitoring their effectiveness. Although no system of internal control can provide absolute assurance against material misstatement or loss, the group's systems are designed to provide the directors with reasonable assurance that issues are identified on a timely basis and dealt with appropriately.

The group has an established organisational structure with clearly defined lines of authority, responsibility and accountability, which is reviewed regularly. Group management is responsible for the identification and evaluation of key risks applicable to their areas of business.

During the year the company had contingency and disaster recovery plans, the basis of which was reviewed by the board in early 2007. These were extended to cover avian flu and other key risk areas.

The external auditors are engaged to express an opinion on the accounts. They review and test the systems of internal financial controls and data contained in the accounts, and discuss with management the reporting of operational results and the financial condition of the group, to the extent necessary to express their audit opinion.

During the year the board considered the need for an internal audit function but resolved that due to the size of the group, this could not be justified on the grounds of cost effectiveness.

### **DIRECTORS' AND OFFICERS' LIABILITY INSURANCE AND INDEMNITY**

The company has purchased insurance to cover its directors and officers against the costs of defending themselves in legal proceedings taken against them in that capacity, and in respect of any damages resulting from those proceedings. In accordance with Section 236(2) of the Companies Act 2006, the directors disclose a qualifying third party indemnity provision entered into between the company and its directors and officers which was in force at the date of approval of this report. Neither the insurance nor the indemnity provide cover where the director has acted fraudulently or dishonestly.

### **GOING CONCERN**

The directors, having made appropriate enquiries, consider that the company and the group have adequate resources to continue in operational existence for the foreseeable future and therefore it is appropriate to adopt the going concern basis in preparing the accounts on pages 26 to 76.

# **//BOARD REPORT ON DIRECTORS' REMUNERATION//**

## **REMUNERATION COMMITTEE**

The Remuneration Committee comprises C Kennedy (chairman) and L Blackall.

The committee meets not less than twice a year to determine all aspects of the remuneration of the executive directors and other senior managers. The fees of the non-executive directors are determined by the board as a whole. No director or employee has a role in determining his own remuneration.

## **REMUNERATION POLICY**

The committee determines overall policy for executive remuneration. The committee sets levels of remuneration to attract, retain and motivate executive directors and other senior managers and, in doing so, takes into account the level of remuneration throughout the telecommunications industry. Employees throughout the group, including executive directors, have performance reviews annually.

The main components of the executive directors' and senior managers' remuneration are:

- \* a competitive base salary;
- \* an annual performance bonus;
- \* pension provision;
- \* benefits in kind; and
- \* share options.

The group operates a discretionary bonus scheme. The scheme applies to directors, senior managers and certain other employees. Individual payments made under the scheme are generally dependent on the company achieving its financial targets and the attainment of individual objectives.

The group makes contributions to money purchase personal pension schemes on behalf of certain executive directors and senior managers.

Other customary benefits, such as car allowances, permanent health insurance and life assurance are made available as appropriate.

The group has three share options schemes, the Unapproved Executive Share Option Scheme, the Approved Executive Share Option Scheme and the EMI Scheme. Details of options granted under these schemes are given in note 5 to the financial statements.

## **DIRECTORS' SERVICE CONTRACTS**

The service contracts of executive directors remain in force until age 65, or age 60 in the case of the Chairman, and continue until terminated by either party giving to the other not less than twelve months' written notice.

The service contracts of non-executive directors remain in force until terminated by either party giving to the other not less than three months' written notice.

Details of directors' remuneration and emoluments can be found in note C2 of the company's financial statements.

On behalf of the board

**STEWART PORTER**  
**CHIEF FINANCIAL OFFICER**  
**16 MAY 2008**

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## **//STATEMENT OF DIRECTORS' RESPONSIBILITIES//** in respect of the annual report and the financial statements

The directors are responsible for preparing the annual report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange they are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable laws and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The group financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the group and parent company 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;
- \* for the group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- \* for the parent company financial statements, state whether applicable UK 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 and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# **//INDEPENDENT AUDITORS' REPORT//** to the members of FREEDOM4 Communications plc

We have audited the group and parent company financial statements (the "financial statements") of FREEDOM4 Communications plc for the year ended 31 December 2007 which comprise the consolidated income statement, the consolidated and company balance sheets, the consolidated cash flow statement, the consolidated statement of recognised income and expenses and the related notes. 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 auditor's 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 consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU, and for preparing the parent company financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities on page 24.

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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the annual report is consistent with the financial statements. The information given in the annual report includes that specific information presented in the chairman's statement, the chief executive's report and the financial review that is cross referred from the business review section of the annual report.

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

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## **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 group financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the group's affairs as at 31 December 2007 and of its profit for the year then ended;
- \* the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2007;
- \* the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- \* the information given in the annual report is consistent with the financial statements.

**KPMG AUDIT PLC**  
**Chartered Accountants**  
**Registered Auditor**  
**8 Salisbury Square**  
**London EC4Y 8BB**  
**United Kingdom**  
**16 May 2008**

# CONSOLIDATED INCOME STATEMENT for the year ended 31 December 2007

	Note	Continuing £'000	Discontinued £'000	Total 2007 £'000	Continuing restated (note 35) £'000	Discontinued £'000	Total 2006 restated (note 35) £'000
<b>Revenue</b>	2	–	<b>283,063</b>	<b>283,063</b>	–	294,359	294,359
Cost of sales		–	<b>(171,938)</b>	<b>(171,938)</b>	–	(182,067)	(182,067)
Operating costs before amortisation of intangibles, depreciation, impairments and share based payment costs		<b>(3,720)</b>	<b>(94,680)</b>	<b>(98,400)</b>	(1,662)	(87,533)	(89,195)
<b>Earnings before amortisation of intangibles, depreciation, impairment and share based payment costs</b>		<b>(3,720)</b>	<b>16,445</b>	<b>12,725</b>	(1,662)	24,759	23,097
Amortisation of intangibles	3,11	–	<b>(3,754)</b>	<b>(3,754)</b>	–	(6,645)	(6,645)
Depreciation	3,12	–	<b>(12,795)</b>	<b>(12,795)</b>	–	(12,033)	(12,033)
Impairment	3,12	–	<b>(1,000)</b>	<b>(1,000)</b>	–	–	–
Share based payment costs	3,4	<b>(3,377)</b>	–	<b>(3,377)</b>	(2,206)	–	(2,206)
<b>Total operating costs</b>		<b>(7,097)</b>	<b>(112,229)</b>	<b>(119,326)</b>	(3,868)	(106,211)	(110,079)
Share of loss of joint venture	14	<b>(3,528)</b>	–	<b>(3,528)</b>	(1,596)	–	(1,596)
<b>Operating (loss)/profit</b>	3	<b>(10,625)</b>	<b>(1,104)</b>	<b>(11,729)</b>	(5,464)	6,081	617
Finance income	6	<b>2,233</b>	<b>886</b>	<b>3,119</b>	472	546	1,018
Finance costs	7	<b>(8,410)</b>	<b>(1,244)</b>	<b>(9,654)</b>	(5,658)	(1,148)	(6,806)
Net finance expenses		<b>(6,177)</b>	<b>(358)</b>	<b>(6,535)</b>	(5,186)	(602)	(5,788)
Gain arising on joint venture	14	<b>2,458</b>	–	<b>2,458</b>	1,032	–	1,032
<b>(Loss)/profit before tax</b>		<b>(14,344)</b>	<b>(1,462)</b>	<b>(15,806)</b>	(9,618)	5,479	(4,139)
Income tax expense	8	–	<b>(2,330)</b>	<b>(2,330)</b>	–	4,144	4,144
<b>(Loss)/profit after tax before profit from disposal of discontinued operations</b>		<b>(14,344)</b>	<b>(3,792)</b>	<b>(18,136)</b>	(9,618)	9,623	5
Profit from disposal of discontinued operations, net of tax	18	–	<b>51,582</b>	<b>51,582</b>	–	–	–
<b>(Loss)/profit for the year attributable to equity shareholders of the parent</b>		<b>(14,344)</b>	<b>47,790</b>	<b>33,446</b>	(9,618)	9,623	5
Earnings per share:							
Basic (pence)	9	<b>(0.60)</b>	<b>1.99</b>	<b>1.39</b>	(0.41)	0.41	0.00
Diluted (pence)	9	<b>(0.60)</b>	<b>1.90</b>	<b>1.33</b>	(0.41)	0.39	0.00

# //CONSOLIDATED BALANCE SHEET// as at 31 December 2007

	Note	2007 £'000	2006 restated (note 35) £'000
<b>Assets</b>			
<b>Non current assets</b>			
Goodwill	11	–	165,183
Intangible assets	11	–	23,726
Property, plant and equipment	12	–	47,069
Investment in joint venture	14	<b>7,608</b>	5,688
		<b>7,608</b>	241,666
<b>Current assets</b>			
Inventories	15	–	47
Trade and other receivables	16	<b>11,243</b>	44,679
Cash and cash equivalents	17	<b>60,750</b>	48,328
Assets classified as held for sale	19	<b>100,954</b>	–
		<b>172,947</b>	93,054
<b>Current liabilities</b>			
Short term borrowings	21	–	(4,461)
Trade and other payables	22	<b>(1,794)</b>	(95,793)
Liabilities classified as held for sale	19	<b>(40,497)</b>	–
Tax liabilities		–	(278)
Provisions	23	<b>(2,219)</b>	(337)
		<b>(44,510)</b>	(100,869)
		<b>128,437</b>	(7,815)
<b>Net current assets/(liabilities)</b>			
<b>Non current liabilities</b>			
Long term borrowings	24	–	(125,013)
Provisions	23	–	(1,224)
Deferred tax liability	8	–	(1,765)
		–	(128,002)
		<b>136,045</b>	105,849
<b>Net assets</b>			
<b>Equity attributable to the equity holders of the parent</b>			
Share capital	26	<b>24,092</b>	23,931
Share premium reserve	26	<b>96,848</b>	96,215
Translation reserve	26	<b>25</b>	(61)
Other reserves	26	<b>8,119</b>	25,537
Retained earnings	26	<b>6,961</b>	(39,773)
		<b>136,045</b>	105,849

The consolidated financial statements on pages 26 to 76 were approved by the directors and authorised for issue on 16 May 2008, and signed on their behalf by:

**PETER DUBENS**  
Chairman

**STEWART PORTER**  
Chief Financial Officer

# **//CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSES//** for the year ended 31 December 2007

	Note	2007 £'000	2006 restated (note 35) £'000
<b>In the year</b>			
Exchange differences on translating foreign operations	26	86	(61)
Net income/(expense) recognised directly in equity		86	(61)
Profit for the year		33,446	5
<b>Total recognised income and expense for the year</b>		<b>33,532</b>	<b>(56)</b>

# **//CONSOLIDATED CASH FLOW STATEMENT//** for the year ended 31 December 2007

	Note	2007 £'000	2006 restated (note 35) £'000
<b>Profit for the year</b>		<b>33,446</b>	5
Profit from disposal of discontinued operations	18	(51,582)	–
Income tax charge/(credit)		2,330	(4,144)
Gain arising on joint venture	14	(2,458)	(1,032)
Interest received		(3,119)	(1,018)
Interest payable		9,654	6,806
<b>Operating (loss)/profit</b>		<b>(11,729)</b>	2,213
Adjustments for:			
Depreciation charge	12	12,795	12,033
Impairment of tangible fixed assets	12	1,000	–
Share of loss of joint venture	14	3,528	1,596
Amortisation of intangibles	11	3,754	6,645
Loss on sale of fixed assets		157	13
Share based payment costs		3,377	2,206
Operating cash flows before movements in working capital		12,882	23,110
Decrease in inventories		31	16
Decrease in receivables		4,197	865
(Decrease)/increase in payables		(24,292)	10,465
Increase/(decrease) in provisions		1,599	(444)
<b>Cash (used)/generated from operations</b>		<b>(5,583)</b>	34,012
Interest paid		(2,387)	(2,553)
Bond interest paid		(5,512)	(1,776)
Interest element of finance lease repayments		(827)	(668)
Income taxes (paid)/received	8	(270)	230
<b>Net cash (used)/generated from operating activities</b>		<b>(14,579)</b>	29,245
<b>Cash flows from investing activities</b>			
Acquisition of subsidiaries	11	(958)	(76,520)
Payment to acquire intangible assets	11	(152)	–
Investment in jointly controlled entity	14	(2,058)	(797)
Purchase of property, plant and equipment		(23,706)	(27,093)
Proceeds from sale of property, plant and equipment		2,648	–
Proceeds from sale of subsidiaries	18	173,170	–
Interest received		2,115	546
<b>Net cash generated/(used) in investing activities</b>		<b>151,059</b>	(103,864)
<b>Cash flows from financing activities</b>			
Proceeds from the issue of share capital		–	13,634
Proceeds from the exercise of share options		795	2,161
Proceeds from the issue of convertible bonds		–	88,279
Payment to redeem convertible bonds	28	(91,500)	–
Repayments of short term borrowings		(1,445)	–
Proceeds from long term borrowings		2,255	76,746
Repayments of long term borrowings		(35,506)	(74,310)
Drawdown of new finance leases		5,700	5,016
Payment of finance lease liabilities		(4,357)	(2,543)
<b>Net cash (used)/generated from financing activities</b>		<b>(124,058)</b>	108,983
<b>Net increase in cash and cash equivalents</b>		<b>12,422</b>	34,364
<b>Cash and cash equivalents at the beginning of the year</b>		<b>48,328</b>	13,964
<b>Cash and cash equivalents at the end of the year</b>		<b>60,750</b>	48,328

Cash flows relating to discontinued operations can be found in note 20.

# **//NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS//** for the year ended 31 December 2007

## **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union for the first time. The disclosures required by IFRS 1 concerning the transition from United Kingdom Generally Accepted Accounting Practice (UK GAAP) to IFRS are given in note 35.

The company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 67 to 76.

In addition to exempting companies from the requirement to restate comparatives for IAS32 and IAS39, IFRS1 grants certain exemptions for the full requirement of IFRS's in the transition period. The following exemptions have been taken in these financial statements:

**Business combinations:** The group has taken the exemption from restating business combinations occurring before the date of transition of 1 January 2006.

**Share based payments:** The group has applied the requirements of IFRS 2: Share based payments. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2006.

**Cumulative translation differences:** The group has taken the option to deem the cumulative level of translation differences on transition relating to foreign operations held within reserves to be nil at 1 January 2006.

In accordance with IFRS 5, the comparative income statement has been represented so that the discontinued operations disclosed relate to all discontinued operations at the balance sheet date.

### **STANDARDS AND INTERPRETATIONS NOT APPLIED**

At the date of authorisation of these financial statements, the following Standards and Interpretations (International Financial Reporting Interpretation Committee - IFRIC), which have not been applied in these financial statements, were in issue but not yet effective:

IFRS 8 Operating segments

IFRIC 11 IFRS 2: Group and treasury share transactions

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the group when the relevant standards and interpretations come into effect.

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial instruments. The principal accounting policies adopted have been applied consistently in both the current and comparative periods, and are set out below:

### **BASIS OF CONSOLIDATION**

The consolidated financial statements incorporate the financial statements of FREEDOM4 Communications plc (formerly Pipex Communications plc) (the "company") and enterprises controlled by the company (its "subsidiaries", together referred to as the "group"). The excess of cost of acquisition over the fair values of the group's share of identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair value of identifiable net assets acquired (a discount on acquisition) is recognised directly in the income statement.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at fair value at the acquisition date irrespective of the extent of any minority interest.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by other members of the group.

All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and any recognised impairment losses.

Depreciation is charged so as to write off the cost of assets, other than land, to their estimated residual values over their estimated useful life, using the straight-line method, on the following bases:

Freehold buildings	over 20 to 25 years
Leasehold improvements	over the life of the lease
Network infrastructure	over two to ten years
Plant and machinery	over three to five years
Office equipment	over three to five years

Assets held under finance leases are depreciated over their expected useful life on the same basis as owned assets or, where shorter, the term of the relevant lease.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income. The incremental costs of staff working on specific network projects are capitalised under network infrastructure costs.

### GOODWILL

Goodwill arising on consolidation represents the excess of the cost of acquisition over the group's interest in the fair value of the identifiable assets and liabilities and contingent liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Upon the acquisition of subsidiaries goodwill is separately disclosed. Goodwill on acquisition of associates and jointly controlled entities is included in investment in associates and jointly controlled entities.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. Goodwill is allocated to cash generating units for the purpose of impairment testing. Each of these cash generating units represents the group's investment in each country of operation by primary reporting segment.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

At each balance sheet date goodwill is reviewed for impairment using a discounted cash flow method applied to business forecasts. This method is more fully explained within note 11. If the test shows an impairment has occurred, this is expensed to the income statement immediately.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the amount previously calculated under UK GAAP subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

### OTHER INTANGIBLE ASSETS

Intangible assets such as patents and trademarks are measured initially at their purchase cost and amortised on a straight-line basis over their estimated useful life, on the following bases:

Patents	over ten years
Wireless licence	over 20 years
Customer lists	over three years
Licence	over 20 years

Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be reliably measured.

# **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

## **CONTINUED** for the year ended 31 December 2007

### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED**

#### **IMPAIRMENT OF PROPERTY, PLANT, EQUIPMENT, INVESTMENT IN JOINT VENTURE AND INTANGIBLE ASSETS EXCLUDING GOODWILL**

At each balance sheet date, the group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### **INVESTMENTS IN ASSOCIATES AND JOINT VENTURES**

An associate is an entity over which the group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee. A jointly controlled entity is an entity in which the company holds an interest on a long-term basis and which is jointly controlled by the company and one or more other venturers under a contractual arrangement.

The results and assets, liabilities and contingent liabilities of associates and jointly controlled entities are incorporated in these financial statements using the equity method of accounting except when classified as held for sale (see below). Investments in associates and jointly controlled entities are carried in the balance sheet at the group's share of the net assets of the associate or jointly controlled entity. Losses of the associates or jointly controlled entities in excess of the group's interest in those associates or jointly controlled entities are not recognised.

Any excess of cost of acquisition over the group's share of the fair values of identifiable net assets acquired of the associate or jointly controlled entity at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the group's share of the fair values of identifiable net assets of the associate or jointly controlled entity at the date of acquisition (a discount on acquisition) is recognised in the income statement.

Where a group company transacts with an associate or jointly controlled entity of the group, unrealised profits and losses are eliminated to the extent of the group's interest in the relevant associate or jointly controlled entity. Losses may provide evidence of an impairment of the asset transferred in which case appropriate provision is made for impairment.

#### **INVENTORIES**

Inventories are stated at the lower of cost and net realisable value. Cost comprises, direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs to completion and costs to be incurred in marketing, selling and distribution.

#### **NON CURRENT ASSETS HELD FOR SALE**

Non current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non current assets (and disposal groups) are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

## **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED**

### **FINANCIAL INSTRUMENTS**

Financial assets and financial liabilities are recognised on the group's balance sheet when the group has become a party to the contractual provisions of the instrument.

#### **Trade receivables**

Trade receivables are initially recognised at fair value and then subsequently measured at amortised cost using the effective interest rate method.

#### **Financial liability and equity**

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. A financial liability is a contractual obligation to pay cash or transfer other benefits or an obligation to exchange a financial instrument. This includes debt. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

#### **Cash and cash equivalents**

Cash for the purposes of the cash flow statement comprises cash in hand, deposits repayable on demand and credit card deposits. Restricted deposits pertaining to a rented building are shown in other debtors.

#### **Bank borrowings**

Bank borrowings are initially recognised at fair value and then subsequently measured at amortised cost using the effective interest rate method. Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption, are accounted for on an accrual basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

#### **Convertible loan notes**

Convertible loan notes are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The liability component is subsequently measured at amortised cost using the effective interest rate method. The difference between the proceeds of issue of the convertible loan notes and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the group, is included in equity.

Issue costs are apportioned between the liability and equity components of the convertible loan notes based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly against equity.

The interest expense on the liability component is calculated by applying the effective market interest rate for similar non-convertible debt to the instrument. The difference between this amount and the interest paid is added to the carrying value of the convertible loan note.

Early redemption and potential premium payable resulting from early redemption will only occur following discussions with bondholders.

#### **Trade payables**

Trade payables are initially recognised at fair value and then subsequently measured at amortised cost using the effective interest rate method.

#### **Equity instruments**

Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs.

### **PROVISIONS**

Provisions are recognised when the group has a present obligation as a result of a past event which it is probable will result in an outflow of economic benefits that can be reliably estimated. Provisions for restructuring costs are recognised when the group has a detailed formal plan for the restructuring which has been notified to affected parties.

# **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS** **CONTINUED** for the year ended 31 December 2007

## **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED**

### **LEASING**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the group's general policy on borrowing costs.

Rentals payable under operating leases are charged to income on a straight line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight line basis over the lease term.

### **REVENUE RECOGNITION**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, Value Added Tax and other sales related taxes. Sales of goods are recognised when goods are delivered and title has passed.

In particular, broadband and voice revenue is recognised evenly over the period for which the customer has received the service. Fees for hosting services, including share and dedicated hosting, are deferred over the life of the contract and recognised evenly over the period of that contract. Domain name income is recognised in full on registration of the domain names.

### **OTHER INCOME**

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

### **FOREIGN CURRENCIES**

Transactions in currencies other than Sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on retranslation are included in the income statement for the period.

On consolidation, the assets and liabilities of the group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRS as Sterling denominated assets and liabilities.

### **SHARE BASED PAYMENTS**

The share option programme allows group employees to acquire shares of the ultimate parent company; these awards are granted by the ultimate parent.

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using Black Scholes, taking into account the terms and conditions upon which the options were granted. The expected life used in the model has been adjusted, based on management's best estimate, for the effect of non-transferability, exercise restrictions, and behavioural considerations. Non market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the company revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The fair value determined at the grant date of equity-settled share based payments is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### RETIREMENT BENEFIT COSTS

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due.

Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution plans where the group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit plan.

### TAXATION

The tax expense represents the sum of the tax currently payable and deferred tax.

The current tax is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated by using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction which affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in jointly controlled entities, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

### CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The group makes estimates and assumptions concerning the future. The resulting accounting judgements will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

- \* By the year end, the company had received a number of expressions of interest from parties interested in acquiring the hosting and network service businesses. This process led to the disposal of these businesses on 2 April 2008. The financial statements show the trading results of the business as discontinued and the assets and liabilities as held for sale.
- \* Goodwill has been tested for impairment by comparing the amount of goodwill against future forecast results including cash flows expected to be generated in the future by the appropriate asset, cash-generating unit, or business segment. Assets held for sale included £39.5 million of goodwill in the hosting and network services businesses. The directors are satisfied that no impairment has occurred with regard to this goodwill and this opinion is borne out by the profit made on the disposal.
- \* FREEDOM4 Limited (formerly Pipex Wireless Limited), the joint venture, has a carrying value in the group accounts of £7.6 million. The carrying value is determined using the latest available accounts of the FREEDOM4 Limited (formerly Pipex Wireless Limited) and taking the company's share 2007 51.88% (2008 84.04%). An adjustment is made for the company's share of the joint venture share based payment costs and interest receivable by the company on the loan. The directors have considered whether this carrying value is supportable and have concluded, following an analysis of comparable spectrum valuations, that there is no requirement to impair the value.
- \* The fair value of share based payments is measured using a Black Scholes model which inherently makes use of significant estimates and assumptions concerning the future applied by the directors.
- \* Deferred tax assets and liabilities are assessed on the basis of assumptions regarding the future, the likelihood that assets will be realised and liabilities will be settled, and estimates as to the timing off those future events and as to the future tax rates that will be applicable.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 2. BUSINESS AND GEOGRAPHICAL SEGMENTS

### BUSINESS SEGMENTS

For management purposes, the group is currently organised into three operating divisions—broadband and voice services, hosting services and business services. These divisions are the basis on which the group reports its primary segment information.

The principal activities of each of the divisions are as follows:

#### Broadband and voice services

The group supplies Internet access via broadband and narrowband, and voice telephony services (carrier pre-select and wholesale line rental) to both residential and business customers through different brands such as Pipex, Pipex Homecall, Toucan, Nildram and Freedom 2 Surf.

#### Hosting services

The group provides a comprehensive suite of hosting services from shared and virtual private servers through to domain names and security.

#### Business services

The group provides all aspects of network support for medium and large businesses, with a range of services including voice, enterprise hosting, Internet, IP VPNs and other IP network applications and security solutions.

All segments are regarded as discontinued, with the exception of the company and the joint venture, which are regarded as continuing operations.

#### Other

Includes the company, its investment in the joint venture and the group's financing, including debt incurred to provide financing for acquisition of subsidiaries.

The segment information for these businesses in the income statement is as follows:

	For the year ended 31 December 2007				
	Broadband and voice services discontinued £'000	Hosting services discontinued £'000	Business services discontinued £'000	Other continuing £'000	Total £'000
<b>Revenue</b>					
External sales	210,776	36,111	36,176	–	283,063
	210,776	36,111	36,176	–	283,063
<b>Result</b>					
Segment result <sup>(i)</sup>	12,013	7,240	(2,808)	(3,720)	12,725
Amortisation of intangibles	(3,663)	(90)	(1)	–	(3,754)
Depreciation charge	(1,351)	(4,000)	(7,444)	–	(12,795)
Impairment of tangible fixed assets	–	–	(1,000)	–	(1,000)
Share based payment costs	–	–	–	(3,377)	(3,377)
Share of loss of joint venture	–	–	–	(3,528)	(3,528)
Operating profit/(loss)	6,999	3,150	(11,253)	(10,625)	(11,729)
Finance income	629	197	60	2,233	3,119
Finance costs	(91)	(372)	(781)	(8,410)	(9,654)
Gain arising on joint venture	–	–	–	2,458	2,458
Profit/(loss) before tax	7,537	2,975	(11,974)	(14,344)	(15,806)
Income tax (charge)	(2,189)	(141)	–	–	(2,330)
Profit on disposal of subsidiary	51,582	–	–	–	51,582
	56,930	2,834	(11,974)	(14,344)	33,446
<b>Other information</b>					
Property, plant and equipment additions	1,259	8,997	13,450	–	23,706
<b>Balance sheet</b>					
<b>Assets</b>					
Segment assets	–	47,085	53,869	79,601	180,555
	–	47,085	53,869	79,601	180,555
<b>Liabilities</b>					
Segment liabilities	–	(16,949)	(23,548)	(4,013)	(44,510)
	–	(16,949)	(23,548)	(4,013)	(44,510)

(i) Segment result refers to earnings before amortisation of intangibles, depreciation, impairment and share based payments.

## 2. BUSINESS AND GEOGRAPHICAL SEGMENTS CONTINUED

The segment information for these businesses in the Income Statement is as follows:

	For the year ended 31 December 2006				
	Broadband and voice services discontinued £'000	Hosting services discontinued £'000	Business services discontinued £'000	Other continuing restated (note 35) £'000	Total £'000
<b>Revenue</b>					
External sales	232,905	30,822	30,632	–	294,359
<b>Result</b>					
Segment result <sup>(i)</sup>	18,750	9,285	(3,276)	(1,662)	23,097
Amortisation of intangibles	(5,832)	(89)	(724)	–	(6,645)
Depreciation charge	(4,177)	(2,997)	(4,859)	–	(12,033)
Share based payment costs	–	–	–	(2,206)	(2,206)
Share of loss of joint venture	–	–	–	(1,596)	(1,596)
Operating profit/(loss)	8,741	6,199	(8,859)	(5,464)	617
Finance income	409	137	–	472	1,018
Finance costs	(282)	(246)	(620)	(5,658)	(6,806)
Gain arising on joint venture	–	–	–	1,032	1,032
Profit/(loss) before tax	8,868	6,090	(9,479)	(9,618)	(4,139)
Income tax credit/(charge)	4,152	(10)	2	–	4,144
	13,020	6,080	(9,477)	(9,618)	5
<b>Other information</b>					
Property, plant and equipment additions	9,923	8,400	9,480	–	27,803
<b>Balance sheet</b>					
<b>Assets</b>					
Segment assets	225,681	53,688	49,750	5,601	334,720
	225,681	53,688	49,750	5,601	334,720
<b>Liabilities</b>					
Segment liabilities	(70,051)	(13,118)	(24,475)	(121,227)	(228,871)
	(70,051)	(13,118)	(24,475)	(121,227)	(228,871)

(i) Segment result refers to earnings before amortisation of intangibles, depreciation, impairment and share based payments.

### GEOGRAPHICAL SEGMENTS

The group's operations are located in the United Kingdom and Germany. Germany provides mainly hosting services.

The segment information for these geographical destinations which is not materially different to its origin is as follows:

	Continuing		Discontinued		Total 2007 £'000	Continuing		Discontinued		Total 2006 £'000
	United Kingdom £'000	Germany £'000	United Kingdom £'000	Germany £'000		United Kingdom £'000	Germany £'000	United Kingdom £'000	Germany £'000	
Sales revenue	–	12,568	270,495	283,063	–	9,572	284,787	294,359		
Carrying amount of segment assets	79,601	16,186	84,768	180,555	5,601	10,212	318,907	334,720		
Additions to property, plant and equipment	–	7,931	15,775	23,706	–	7,603	20,200	27,803		

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 3. OPERATING PROFIT

The group's operating profit has been arrived after charging the following items:

	2007 £'000	2006 restated (note 35) £'000
Staff costs	47,838	45,160
Share based payment costs	3,377	2,206
Fees payable to KPMG for the audit of the groups annual accounts	320	250
Fees payable to KPMG and its associates for other services:		
– The audit of the groups subsidiaries pursuant to legislation	65	45
– Other services supplied pursuant to legislation	–	25
– Other services relating to taxation	237	322
Loss on disposals of tangible assets	157	13
Rentals repayable under operating leases – land and buildings	2,637	2,698
Rentals payable under operating leases – other assets	1,838	1,834
Amortisation of intangibles	3,754	5,921
Depreciation on owned assets	9,974	9,786
Depreciation on leased assets	2,821	2,247
Impairment losses – tangible fixed assets	1,000	–
Impairment losses – goodwill (included within amortisation)	–	724

## 4. STAFF COSTS

	2007 Number	2006 Number
The average monthly number of employees (including executive directors) for the year was as follows:		
Full time operations staff	1,251	1,473
Executive and administrative	458	473
	<b>1,709</b>	1,946
	£'000	£'000
The aggregate remuneration comprised:		
Wages and salaries	47,524	41,707
Social security costs	5,484	4,450
Share based payment costs	3,377	2,206
Other pension costs (note 10)	744	595
Staff costs capitalised	(1,334)	(1,592)
	<b>55,795</b>	47,366
Included in the above is remuneration for directors amounting to:		
Emoluments for services as a director	6,336	1,814
Pension contributions	80	60
	<b>6,416</b>	1,874

#### 4. STAFF COSTS CONTINUED DIRECTORS' REMUNERATION

	Salaries and fees £'000	Bonus £'000	Total 2007 £'000	Total 2006 £'000	Pension 2007 £'000	Pension 2006 £'000
<b>Executive</b>						
M Read	384	1,800	<b>2,184</b>	595	<b>37</b>	28
S Porter	293	1,327	<b>1,620</b>	474	<b>43</b>	32
P Dubens	417	2,025	<b>2,442</b>	675	–	–
<b>Non-executive</b>						
L Blackall	35	–	<b>35</b>	35	–	–
C Kennedy	35	–	<b>35</b>	35	–	–
	1,164	5,152	<b>6,316</b>	1,814	<b>80</b>	60

The bonus received by M Read, S Porter and P Dubens was in respect of services during the year. Within the bonuses a total amount of £4,580,000 was paid to the directors as a result of services in respect of the disposal of certain subsidiaries.

Included within the wages and salary costs and emoluments for services as a director are the bonuses paid to the three directors for services relating to the disposal of the subsidiary. Emoluments of the highest paid director (excluding pension contributions) were £2,442,000 (2006: £675,000). Amounts paid by the group in respect of pension contributions for the highest paid director were £nil (2006: £nil).

#### 5. SHARE BASED PAYMENTS AND WARRANTS

	2007 number of options (‘000)	2007 weighted average exercise price (pence)	2006 number of options (‘000)	2006 weighted average exercise price (pence)
<b>Options</b>				
Outstanding 1 January	<b>195,218</b>	<b>7.33</b>	196,144	6.95
Granted during the year	<b>25,283</b>	<b>12.66</b>	54,646	7.94
Lapsed during the year	<b>(31,136)</b>	<b>4.74</b>	(24,750)	9.08
Exercised during the year	<b>(16,156)</b>	<b>10.15</b>	(30,822)	4.56
Outstanding 31 December	<b>173,209</b>	<b>6.00</b>	195,218	7.33
Exercisable 31 December	<b>124,594</b>	<b>3.30</b>	145,572	7.24
<b>Warrants</b>				
Outstanding 1 January	<b>139,000</b>	<b>8.13</b>	135,000	8.14
Granted during the year	–	–	4,000	7.75
Lapsed during the year	–	–	–	–
Exercised during the year	–	–	–	–
Outstanding 31 December	<b>139,000</b>	<b>8.13</b>	139,000	8.13
Exercisable 31 December	<b>109,000</b>	<b>7.47</b>	109,000	7.47

The average share price during 2007 was 11.68p (2006: 11.52p).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 5. SHARE BASED PAYMENTS AND WARRANTS CONTINUED

### SHARE OPTIONS

At 31 December 2007 rights to options over 173,208,908 ordinary shares of the company were outstanding as follows:

	At 1 January 2007	Granted	Exercised	Lapsed	At 31 December 2007	Exercise price	Weighted average share price upon exercise	Exercise period
<b>Unapproved Scheme</b>								
(i)	2,693,583	–	–	–	<b>2,693,583</b>	1.00p	–	20 Nov 2001 to 19 Nov 2011
(i)	750,000	–	–	–	<b>750,000</b>	3.00p	–	20 Nov 2001 to 19 Nov 2011
(i)	2,602,440	–	–	–	<b>2,602,440</b>	3.00p	–	27 Dec 2001 to 26 Dec 2011
(ii)	5,253,000	–	–	–	<b>5,253,000</b>	4.50p	–	27 Dec 2001 to 26 Dec 2011
(iii)	17,939,247	–	–	–	<b>17,939,247</b>	2.25p	–	20 Mar 2003 to 19 Mar 2013
(i)	19,002,000	–	–	–	<b>19,002,000</b>	6.25p	–	24 Oct 2003 to 23 Oct 2013
(iv)	42,600,000	–	(2,500,000)	(10,625,000)	<b>29,475,000</b>	10.50p	13.40p	21 Jun 2004 to 20 Jun 2014
(iv)	10,000,000	–	–	–	<b>10,000,000</b>	8.50p	–	4 Aug 2004 to 3 Aug 2014
(iv)	7,500,000	–	(1,250,000)	(5,000,000)	<b>1,250,000</b>	7.50p	16.00p	20 Oct 2004 to 19 Oct 2014
(v)	9,250,000	–	–	(2,250,000)	<b>7,000,000</b>	8.25p	–	29 Jan 2005 to 28 Jan 2015
(v)	11,099,999	–	(1,500,000)	(1,000,000)	<b>8,599,999</b>	7.50p	12.58p	11 Apr 2005 to 10 Apr 2015
(vi)	1,500,000	–	(1,500,000)	–	<b>–</b>	13.50p	14.50p	27 Jan 2006 to 26 Jan 2016
(iv)	12,491,227	–	–	–	<b>12,491,227</b>	14.25p	–	7 Apr 2006 to 6 Apr 2016
(vii)	8,000,000	–	–	(8,000,000)	<b>–</b>	11.50p	–	27 Oct 2006 to 26 Oct 2016
(viii)	7,260,870	–	–	(4,260,870)	<b>3,000,000</b>	11.50p	–	27 Oct 2006 to 26 Oct 2016
(ix)	22,394,383	–	(9,381,431)	–	<b>13,012,952</b>	1.00p	7.92p	11 Oct 2006 to 10 Oct 2016
(x)	3,000,000	–	–	–	<b>3,000,000</b>	12.50p	–	14 Dec 2006 to 13 Dec 2016
(xi)	–	21,283,017	–	–	<b>21,283,017</b>	13.25p	–	16 Jan 2007 to 15 Jan 2017
(xii)	–	4,000,000	–	–	<b>4,000,000</b>	9.49p	–	1 Oct 2007 to 30 Sep 2017
	183,336,749	25,283,017	(16,131,431)	(31,135,870)	<b>161,352,465</b>			
<b>EMI Scheme</b>								
(xiii)	989,130	–	–	–	<b>989,130</b>	1.00p	–	20 Nov 2001 to 19 Nov 2011
(xiv)	325,000	–	(25,000)	–	<b>300,000</b>	3.00p	7.64p	20 Feb 2003 to 19 Feb 2013
(xiii)	3,455,313	–	–	–	<b>3,455,313</b>	2.25p	–	20 Feb 2003 to 19 Feb 2013
(xv)	7,112,000	–	–	–	<b>7,112,000</b>	6.25p	–	24 Oct 2003 to 23 Oct 2013
	11,881,443	–	(25,000)	–	<b>11,856,443</b>			
<b>Total</b>	<b>195,218,192</b>	<b>25,283,017</b>	<b>(16,156,431)</b>	<b>(31,135,870)</b>	<b>173,208,908</b>			

(i) Unapproved Scheme – no performance criteria attached.

(ii) Unapproved Scheme – were exercisable once the company's market capitalisation reached £25.0 million.

(iii) Unapproved Scheme – 10,687,290 were exercisable when the company's share price reached 5.00p and its EBITDA positive, measure on a monthly basis. The remaining 7,241,957 were exercisable once the company's share price reached 3.00p and the company was EBITDA positive, measured on a monthly basis.

(iv) Unapproved Scheme – 50% are exercisable at share price of 16.00p 50% at share price of 21.00p.

## 5. SHARE BASED PAYMENTS AND WARRANTS CONTINUED

### SHARE OPTIONS CONTINUED

- (v) Unapproved Scheme – were exercisable once the company's share price reached 12.00p.
- (vi) Unapproved Scheme – 1,000,000 were exercisable immediately, 500,000 once the company's share price reached 16.00p.
- (vii) Unapproved Scheme – were exercisable once the company's share price reaches 18.00p and is within three years of date of grant.
- (viii) Unapproved Scheme – exercisable in annual instalments of 3,000,000 starting at October 2007 until October 2009.
- (ix) Unapproved Scheme – 13,012,952 were exercisable on 11 October 2007, balance were dependent upon specific targets for Toucan Residential Limited now lapsed.
- (x) Unapproved Scheme – exercisable in annual instalments of 1,000,000 starting at December 2007 until December 2009.
- (xi) Unapproved Scheme – 60% are exercisable after 17 January 2008 and 40% exercisable after 17 January 2009.
- (xii) Vesting in instalments of 1,333,333 on 1st, 2nd and 3rd anniversary and on takeover offer.
- (xiii) EMI Scheme – no performance criteria attached.
- (xiv) EMI Scheme – vesting in equal instalments starting on 20 February 2003, until 20 February 2005.
- (xv) EMI Scheme – were exercisable once the company's share price reached 9.00p and the company was EBITDA positive, measured on a monthly basis.

No share options under the approved scheme were granted in the period or comparative period.

#### Share options granted under unapproved scheme

Number of instruments granted	12,491,227	22,394,383	8,000,000	7,260,870
Grant date	7 April 2006	11 October 2006	27 October 2006	27 October 2006
Expiration date	6 April 2016	10 October 2016	26 October 2016	26 October 2016
Contract term year(s)	10	10	10	10
Expected life of option	10	1.5	10	10
Exercise price	14.25p	1.00p	11.50p	11.50p
Share price at granting	14.25p	11.00p	11.50p	11.50p
Annual risk-free rate (%)	5.000%	5.000%	4.740%	4.740%
Annual expected dividend yield (%)	0.000%	0.000%	0.000%	0.000%
Volatility (%) (annualised)	44.27%	45.63%	50.55%	50.55%
Fair value per granted instrument	3.02p	10.07p	4.15p	4.15p
Vesting conditions	12,491,227 at share of 18.00p within 3 years of grant date	9,684,057 vest on 11 October 2007; 12,710,326 vest up to 11 October 2007 dependent upon achievement of specific business targets in relation to Toucan	4,000,000 at share price of 16.00p 4,000,000 at share price of 21.00p	Vesting in instalments of 3,000,000 annually starting at 12 months until 27 October 2009
Number of instruments granted		3,000,000	21,283,017	4,000,000
Grant date		14 December 2006	16 January 2007	1 October 2007
Expiration date		13 December 2016	15 January 2017	30 September 2017
Contract term year(s)		10	10	10
Expected life of option		6.5	6.5	6.5
Exercise price		12.50p	13.25p	9.49p
Share price at granting		12.50p	13.25p	9.49p
Annual risk-free rate (%)		4.740%	5.220%	5.090%
Annual expected dividend yield (%)		0.000%	0.000%	0.000%
Volatility (%) (annualised)		50.44%	52.44%	53.39%
Fair value per granted instrument		6.97p	7.66p	5.53p
Vesting conditions		Vesting in instalments of 1,000,000 annually starting at 12 months until 14 December 2009	Vesting in three equal instalments on 1st, 2nd and 3rd anniversary of grant	Vesting in instalments of 1,333,333 on 1st, 2nd and 3rd anniversary and on takeover offer

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 5. SHARE BASED PAYMENTS AND WARRANTS CONTINUED

### WARRANTS

At 1 January 2007 and 31 December 2007 there were outstanding warrants to subscribe to up to 75,000,000 shares of the company at an exercise price of 6.25p. These warrants can only be exercised when the company's EBITDA is positive and the company's share price has reached 12.00p.

At 1 January 2007 and 31 December 2007 there were outstanding warrants to subscribe to up to 60,000,000 shares of the company at an exercise price of 10.50p, exercisable in two stages. 50% may be exercised when the company's share price has reached 16.00p and the remaining 50% when the share price has reached 21.00p.

At 1 January 2007 and 31 December 2007 there were outstanding warrants to subscribe to up to 4,000,000 shares in the company that were granted at an exercise price of 7.75p and exercisable immediately.

No warrants were granted in the period or comparative period.

## 6. FINANCE INCOME

	2007 £'000	2006 £'000
Bank interest receivable	2,301	534
Other interest receivable	818	484
	<b>3,119</b>	1,018

Included in other interest receivable is interest receivable from the joint venture of £747,000 (2006 £472,000).

## 7. FINANCE COSTS

	2007 £'000	2006 £'000
Interest on bank loans and overdrafts	2,338	1,843
Interest on convertible bonds	4,610	4,068
Premium on redemption of convertible bonds	1,830	–
Interest on obligations under finance leases	827	668
Other interest payable	49	227
	<b>9,654</b>	6,806

## 8. TAXATION

### (i) CORPORATION TAX

	2007 £'000	2006 £'000
<b>Current tax:</b>		
UK corporation tax	499	–
Overseas tax	114	10
	<b>613</b>	10
Adjustments in respect of prior periods:		
UK corporation tax	(48)	(2)
	<b>(48)</b>	(2)
Total current tax	<b>565</b>	8
<b>Deferred tax:</b>		
Origination and reversal of timing differences	1,765	(4,152)
Adjustments in respect of prior periods	–	–
Total deferred tax	<b>1,765</b>	(4,152)
<b>Total tax charge/(credit)</b>	<b>2,330</b>	(4,144)

UK corporation tax is calculated at 30% (2006: 30%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

The profit on disposal of the voice and broadband division of £51,582,000 is not taxable because the substantial shareholding exemption legislation was applicable to this transaction.

## 8. TAXATION CONTINUED

### (i) CORPORATION TAX CONTINUED

The charge for the year can be reconciled to the profit per the income statement as follows:

	2007 £'000	2006 £'000
(Loss) before tax	<b>(15,806)</b>	(4,139)
(Loss) before taxation at 30% (2006: 30%)	<b>(4,742)</b>	(1,242)
Tax effect of expenses that are not deductible in determining taxable profit	<b>5,036</b>	1,552
Tax effect of income that is not taxable	<b>(737)</b>	(309)
Tax effect of utilisation of tax losses not previously recognised	–	(1,257)
Adjustments to tax charge in respect of previous periods	<b>(48)</b>	(2)
Effect of different tax rates of subsidiaries operating in other jurisdictions	<b>59</b>	74
Unrelieved tax losses arising in the period not recognised	<b>2,881</b>	–
Deferred tax not previously recognised	–	(2,669)
Current year deferred tax not recognised	<b>(119)</b>	(291)
<b>Total tax charge/(credit)</b>	<b>2,330</b>	(4,144)

At 31 December 2007, there were unrelieved losses in the group of approximately £54,769,000 (2006: £98,164,000). On the basis of the relevant tax rates applicable to the jurisdictions in which the tax losses arose, at 31 December 2007, the group had a potential deferred tax asset in relation to unrelieved losses, fixed asset timing differences and short term timing differences of £15,483,000 (2006: £36,422,000). The deferred tax asset has not been recognised in the accounts as, in the opinion of the directors, the group is not expected to make sufficient profits against which these unrelieved losses can be utilised in the future.

### (ii) DEFERRED TAX

	Provision for losses £'000	Depreciation in excess of capital allowances £'000	Total £'000	
<b>Assets</b>				
At 1 January 2006	590	–	590	
On acquisition	1,067	282	1,349	
Credit for the year	128	2,527	2,655	
At 1 January 2007	1,785	2,809	4,594	
(Charge) for the year	–	(2,804)	(2,804)	
On disposal	(1,511)	58	(1,453)	
<b>At 31 December 2007</b>	<b>274</b>	<b>63</b>	<b>337</b>	
	Business combinations property revaluation £'000	Development costs £'000	Customer lists £'000	Total £'000
<b>Liabilities</b>				
At 1 January 2006	590	–	–	590
On acquisition	–	–	7,266	7,266
Credit/(charge) for the year	–	81	(1,578)	(1,497)
At 1 January 2007	590	81	5,688	6,359
Credit/(charge) for the year	(590)	193	(606)	(1,003)
On disposal	–	–	(5,019)	(5,019)
<b>At 31 December 2007</b>	<b>–</b>	<b>274</b>	<b>63</b>	<b>337</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 9. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year. For the diluted earnings per year, the weighted average number of ordinary shares is adjusted and assumes conversion of share options issued where exercise price is below year end market price of 11.68p (2006: 11.52p).

The calculation of the basic and diluted earning per share is based on the following data:

### NUMBER OF SHARES

	Year ended 31 December 2007 Number million	Year ended 31 December 2006 Number million
Weighted average number of ordinary shares in issue	2,400	2,337
Dilution impact of share options	110	109
	<b>2,510</b>	2,446

### EARNINGS

	Year ended 31 December 2007			Year ended 31 December 2006		
	Continuing £'000	Discontinued £'000	Total £'000	Continuing £'000	Discontinued £'000	Total £'000
(Loss)/profit for the year attributable to the equity holders of the parent)	(14,344)	47,790	33,446	(9,618)	9,623	5
Earnings per share (pence)	(0.60)	1.99	1.39	(0.41)	0.41	0.00
Diluted earnings per share (pence)	(0.60)	1.90	1.33	(0.41)	0.39	0.00

## 10. RETIREMENT BENEFIT PLANS

The group makes payments to defined contribution retirement benefit plans that are charged as an expense as they fall due. Payments are made on the basis of a percentage of qualifying salary for certain employees to personal pension schemes.

The total cost charged to income for the year was £744,000 (2006: £595,000), and outstanding contributions of £nil (2006: £nil) were included as current liabilities in the balance sheet.

## 11. INTANGIBLE ASSETS

	Goodwill £'000	Customer lists £'000	Patents £'000	Licence £'000	Wireless licence £'000	Total £'000
<b>Cost</b>						
At 1 January 2006	99,231	–	10	–	5,000	104,241
Arising on acquisition of subsidiaries (note 30)	66,839	29,578	–	–	–	96,417
Fair value adjustments	20	–	–	–	–	20
Disposals	(183)	–	–	–	(5,000)	(5,183)
At 31 December 2006	165,907	29,578	10	–	–	195,495
Additions	958	–	–	152	–	1,110
Disposal of subsidiaries (note 18)	(126,607)	(29,308)	–	–	–	(155,915)
Transfer to held for sale (note 19)	(40,258)	(270)	(10)	(152)	–	(40,690)
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

## 11. INTANGIBLE ASSETS CONTINUED

	Goodwill £'000	Customer lists £'000	Patents £'000	Licence £'000	Wireless licence £'000	Total £'000
<b>Amortisation and impairment</b>						
At 1 January 2006	–	–	3	–	583	586
Amortisation for the year	–	5,858	1	–	62	5,921
Impairment loss	724	–	–	–	–	724
Disposals	–	–	–	–	(645)	(645)
At 31 December 2006	724	5,858	4	–	–	6,586
Amortisation for the year	–	3,753	1	–	–	3,754
Disposal of subsidiaries (note 18)	–	(9,484)	–	–	–	(9,484)
Transfer to held for sale (note 19)	(724)	(127)	(5)	–	–	(856)
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Carrying amount</b>						
At 1 January 2006	99,231	–	7	–	4,417	103,655
At 31 December 2006 and 1 January 2007	165,183	23,720	6	–	–	188,909
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

Additions of £948,000 represents a late payment of a government grant in relation to Toucan Residential Ireland Limited that was agreed to be transferred to IDT Global Limited as part of the acquisition cost for Toucan Residential Limited. The remaining £10,000 is due to legal fees related to Switch2 Telecoms Limited. The £152,000 is payment for an Ofcom licence.

The 2006 disposals relate to the sale of FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) to the joint venture, FREEDOM4 Limited (formerly Pipex Wireless Limited).

The 2006 fair value adjustment relates to additional directors' remuneration, in the pre-acquisition period, paid for Donhost Limited which was purchased in 2005.

The following cash generating units have significant carrying amounts of goodwill:

	2007 £'000	2006 £'000
Broadband and voice services	–	125,648
Hosting services	30,636	30,636
Business services	8,899	8,899
Transfer to held for sale (note 19)	(39,535)	–
	–	165,183

The directors of the company considered any potential impairment of the carrying value of goodwill within the financial statements for the UK and German hosting business, Supanetworks Limited, and the business services business separately. The method applied involved calculating the net present value of forecasted future discounted cash flows. A discount factor of 12.5% was deemed appropriate for the calculation which took into consideration directors' assessment of the prevailing risk free rate, the market risk premium and business risk premium. The directors concluded there was no impairment to the carrying value of the goodwill within the financial statement.

In 2006, there was a goodwill impairment of £724,000 that was in relation to the sale of FREEDOM4 Access Limited by the company to the joint venture, FREEDOM4 Limited. The effect of the impairment was to write down the goodwill in the company to nil.

As both the sale of the broadband and voice businesses during 2007 and the sale of the hosting and network services businesses in 2008 yielded a profit on disposal, the directors have concluded there is no impairment to goodwill on these businesses.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 12. PROPERTY, PLANT AND EQUIPMENT

	Freehold buildings £'000	Leasehold improvements £'000	Network infrastructure £'000	Plant and machinery £'000	Office equipment £'000	Total £'000
<b>Cost</b>						
As at 1 January 2006	2,087	2,204	37,195	1,241	2,377	45,104
Additions	9,948	151	13,992	1	3,711	27,803
Disposals	–	–	(748)	–	(203)	(951)
Acquired through business combinations	–	421	2	–	6,351	6,774
Exchange differences	–	–	(139)	(4)	29	(114)
At 31 December 2006 and 1 January 2007	12,035	2,776	50,302	1,238	12,265	78,616
Additions	1,254	2,675	17,252	600	1,925	23,706
Disposals	(1,998)	(237)	(1,280)	(60)	(34)	(3,609)
Disposal of subsidiaries (note 18)	–	(540)	(17,890)	(2)	(12,408)	(30,840)
Exchange differences	430	–	1,250	66	75	1,821
Transfer to held for sale (note 19)	(11,721)	(4,674)	(49,634)	(1,842)	(1,823)	(69,694)
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Accumulated depreciation</b>						
As at 1 January 2006	224	846	17,519	325	939	19,853
Charge for the year	185	293	7,843	18	3,694	12,033
Disposals	–	–	(116)	–	(135)	(251)
Exchange difference	–	–	(85)	(3)	–	(88)
At 31 December 2006 and 1 January 2007	409	1,139	25,161	340	4,498	31,547
Charge for the year	210	546	8,747	46	3,246	12,795
Disposals	(442)	(223)	(76)	(38)	(25)	(804)
Disposal of subsidiaries (note 18)	–	(139)	(11,967)	(2)	(6,311)	(18,419)
Impairment	–	–	1,000	–	–	1,000
Exchange difference	89	–	610	12	36	747
Transfer to held for sale (note 19)	(266)	(1,323)	(23,475)	(358)	(1,444)	(26,866)
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Carrying amount</b>						
At 1 January 2006	1,863	1,358	19,676	916	1,438	25,251
At 31 December 2006	11,626	1,637	25,141	898	7,767	47,069
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

Included in the total net book value are assets which were held for sale at year end and were held under finance leases with a net book value of £9,967,000 (2006: £6,750,000) comprising network infrastructure of £9,966,000 (2006: £6,497,000), plant and machinery of £nil (2006: £nil), and office equipment of £1,000 (2006: £73,000). Depreciation charged for the year on these assets was network infrastructure of £2,749,000 (2006: £2,138,000), plant and machinery of £nil (2006: £nil), and office equipment of £72,000 (2006: £89,000).

Included within network infrastructure additions above are capitalised incremental staff costs of £1,334,000 (2006: £1,592,000).

Included within network infrastructure disposals for 2006 is a net book value amount of £687,000 relating to a sale and leaseback transaction in Host Europe GmbH.

The company has impaired the carrying value of fixed assets within the hosting services segment that were leased to Tiscali UK Limited as part of a Transitional Services Agreement by £1,000,000. The adjustment brings the net book value of the assets down to a level, such that should the agreement be terminated at the earliest possible date, then the carrying value at termination would reflect the net realisable value of those assets.

### 13. SUBSIDIARIES

Details of the company's principal subsidiaries at 31 December 2007 are as follows:

Name	Place of Incorporation (or registration)	Place of operation	Proportion of ownership interest %	Voting power held %	Principal activity
Compulink Information Exchange Limited	England & Wales	United Kingdom	100	100	Telecommunications
FREEDOM4 Finance (Jersey) Limited (formerly Pipex Finance (Jersey) Limited)	Jersey	Jersey	100	100	Financing (non-trading)
GXN Limited	Scotland	United Kingdom	100	100	Holding company
GX Networks Limited (formerly Pipex Communications UK Ltd)	England & Wales	United Kingdom	100	100	Telecommunications
Host Europe GmbH	Germany	Germany	100	100	Telecommunications
Supanetwork Limited	England & Wales	United Kingdom	100	100	Telecommunications
XTML Limited	England & Wales	United Kingdom	100	100	Telecommunications

All subsidiaries operate in the United Kingdom with the exception of Host Europe GmbH which operates in Germany. All the above subsidiaries have been classified as held for sale at year end with the exception of FREEDOM4 Finance (Jersey) Limited (formerly Pipex Finance (Jersey) Limited).

### 14. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

On 31 March 2006, the group jointly formed FREEDOM4 Limited (formerly Pipex Wireless Limited) with Intel Capital (Cayman) Corporation. The group sold its interests in Pipex Communications Business Solutions Limited (the holder of the group's 3.6-4.2 GHz Spectrum Licence) and Faultbasic Limited (the holder of the group's three 28 GHz Spectrum Licences) to FREEDOM4 Limited in two share for share exchanges.

Under the terms of the shareholder agreement between the group and Intel Capital (Cayman) Corporation, key business decisions in respect of FREEDOM4 Limited require the unanimous approval of the shareholders. As a consequence, the directors of the group do not have total management control of FREEDOM4 Limited, and therefore, the group's investment is accounted for as a joint venture.

FREEDOM4 Limited is registered in England & Wales, and operates in the United Kingdom.

On 12 January 2007, in accordance with the shareholder agreement, Intel Capital (Cayman) Corporation contributed an additional £10,200,000 and FREEDOM4 Communications plc (formerly Pipex Communications plc) an additional £2,058,000, to the FREEDOM4 Limited joint venture.

The carrying value is determined using the latest available accounts of FREEDOM4 Limited and taking the company's share of profit/loss 2007 51.88% (2006: 84.04%). An adjustment is made for the company's share of the joint venture share based payment costs and interest receivable by the company on the debt element of the preference shares. Cash injections made during the year contribute to the carrying value. The gain in 2007 on the joint venture represents the gain arising in the movement in ownership from 84.04% to 51.88%. The directors have considered whether this carrying value is supportable and have concluded, following an analysis of comparable spectrum valuations, that there is no requirement to impair the value.

	£'000
As at 1 January 2006	–
Brought forward carrying value of wireless licence and associated balances	4,537
Cash injection	561
Share of attributable losses	(1,596)
Interest receivable on loan	472
Share of share based payment costs	446
Gain on joint venture (net of legal expenses of £236,000)	1,268
<b>At 31 December 2006 and 1 January 2007</b>	<b>5,688</b>
Cash injection	2,058
Share of attributable losses	(3,528)
Interest receivable on loan	747
Share of share based payment costs	185
Gain on joint venture	2,458
<b>At 31 December 2007</b>	<b>7,608</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 14. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD CONTINUED

The following amounts are included in the group's financial statements in relation to the group's 51.88% (2006: 84.04%) interest in FREEDOM4 Limited (formerly Pipex Wireless Limited):

	2007 £'000	2006 £'000
Current assets (includes (£1,219,000) of interest receivable from joint venture)	3,348	2,118
Current liabilities	(2,821)	(552)
Non current assets	7,081	4,122
Total share of joint venture	7,608	5,688
Revenue	4	–
Share of loss	(3,528)	(1,596)
Gain on joint venture	2,458	1,032

## 15. INVENTORIES

	2007 £'000	2006 £'000
Finished goods	1	47
Transfer to held for sale (note 19)	(1)	–
As per balance sheet	–	47

## 16. TRADE AND OTHER RECEIVABLES

	2007 £'000	2006 £'000
Trade receivables	–	26,276
Other receivables	11,078	9,115
Prepayments and accrued income	165	9,288
	11,243	44,679

The directors consider that the carrying amount of trade and other receivables approximates to their fair value.

## 17. CASH AND CASH EQUIVALENTS

	2007 £'000	2006 £'000
Cash at bank and in hand	60,750	47,980
Restricted deposits with credit card companies	–	329
Restricted funds held by Bank of Scotland as security for company credit cards	–	19
	60,750	48,328

The balance of group cash and cash equivalents, being £60,750,000 (2006: £47,980,000) is held in current accounts, money market accounts and no-notice deposit accounts.

## 18. DISPOSAL OF SUBSIDIARIES

On 13 September 2007 FREEDOM4 Communications plc (formerly Pipex Communications plc) sold its broadband and voice businesses to Tiscali UK Limited for £210.0 million on a debt free basis, before adjustments. The sale was of the share capital of Pipex Internet Limited, Pipex Homecall Limited, Toucan Residential Limited, Toucan Residential Ireland Limited and Switch2 Telecoms Limited, together with the subsidiaries of these entities (all listed below), and which taken together comprised the broadband and voice businesses.

- \* Accent UK Limited
- \* Freedom to Surf Limited
- \* Freedom to Surf Consumer Services Limited
- \* Freedom to Surf Registration Services Limited
- \* GX Networks Twelve Limited
- \* Highway One Limited
- \* Homecall Payment Services Limited
- \* Homecall UK Limited
- \* Nildram Limited
- \* Pipex Broadband Limited
- \* Pipex Communication Services Limited
- \* Pipex Homecall Limited
- \* Pipex Internet Limited
- \* Pipex Networks Limited
- \* Switch2 Telecoms Limited
- \* Toucan Residential Ireland Limited
- \* Toucan Residential Limited
- \* Trinite Limited
- \* Trinite Services Limited

At completion, the proceeds of the sale amounted to £195.5 million after adjusting for debt and other adjustments, before costs and after making a provision against the escrow receivable. The sale proceeds comprised £171.3 million in cash, £10.5 million in deferred consideration, payable over a fixed term up to 18 months, and £15.8 million held in an escrow account to meet any claims arising under the Sale and Purchase Agreement. At 31 December 2007, the company had received £6.5 million of the deferred consideration leaving £4.0 million as a receivable and had recovered £5.2 million from the escrow account. The balance of £10.5 million outstanding on the escrow account is expected to be recovered on 30 June 2008, subject to any claims arising by that date. A provision of £2.0 million has been made for any future claims that may arise.

For the period to 13 September 2007 the revenues attributable to the division were £210.8 million (2006: £232.9 million) with an EBITDA of £12.0 million (2006: £18.8 million) and a profit before tax of £7.5 million (2006: £8.9 million).

On 13 September 2007 the net assets of the division were £134.1 million.

# **//NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED//** for the year ended 31 December 2007

## **18. DISPOSAL OF SUBSIDIARIES CONTINUED**

The net assets of the above companies at the date of disposal were as follows:

	2007 £'000
Property, plant and equipment	12,421
Customer lists	19,824
Inventories	15
Trade receivables	23,974
Deferred tax asset	1,453
Bank and cash	–
Deferred tax liability	(5,019)
Income tax liability	(443)
Trade payables	(44,571)
Provisions	(88)
Lease creditor	(95)
Attributable goodwill	126,607
	<b>134,078</b>
Costs of disposal	9,830
Gain on disposal	51,582
Total consideration	<b>195,490</b>
<b>Satisfied by:</b>	
Cash	171,250
Deferred consideration	10,500
Escrow account	15,740
Provision against the escrow account	(2,000)
	<b>195,490</b>
<b>Net cash inflow arising on disposal:</b>	
Cash consideration	171,250
Deferred consideration received	6,500
Escrow account received	5,250
	<b>183,000</b>

The costs of disposal of £9.8 million consist of legal and professional fees of £4.1 million and payroll and bonus costs of £5.7 million.

Included in the payroll and bonus costs of £5.7 million is £5.3 million (bonus and associated national insurance costs) which relates to the directors. The balance of £0.4 million was the total payroll and bonus costs paid to other members of staff.

The balance of the deferred consideration of £4.0 million was transferred through intercompany accounts from the company to its subsidiary GX Networks Limited (formerly Pipex Communications UK Limited). Before the subsequent sale of GX Networks Limited (as part of the sale of the hosting and network services businesses), intercompany balances between the company and GX Networks Limited were settled. The balance of £10.5 million outstanding on the escrow account is expected to be recovered on 30 June 2008 and is included in other receivables.

## **19. ASSETS AND LIABILITIES CLASSIFIED AS HELD FOR SALE**

Following the sale of the broadband and voice businesses the directors believed there was no longer a compelling strategic fit between the remaining businesses in the group. At the time of the publication of the interim results on 25 September 2007, it was announced that the board intended to initiate a process leading to the demerger of the wireless joint venture and the sale of the remaining group, comprising the hosting and network services businesses, together with the proceeds from the broadband and voice sale.

Following the receipt of a number of expressions of interest during 2007 in the hosting and network services businesses the directors decided to pursue this sale and, on 8 February 2008, the company announced that it was at an advanced stage in the sale process with a single potential purchaser. The sale was completed on 2 April 2008 to Host Europe WVS Limited for £120.0 million (on an enterprise value basis). The assets and liabilities of the hosting and network services businesses were held for sale from December 2007.

For the year to 31 December 2007 the revenues attributable to the division were £72.3 million (2006: £61.5 million) with an earnings before amortisation of intangibles, depreciation, impairment and share based payments of £4.4 million (2006: £6.0 million) and a loss before tax of £9.0 million (2006: £3.4 million). On 31 December 2007 the net assets of the division were £60.5 million (2006: £65.8 million).

## 19. ASSETS AND LIABILITIES CLASSIFIED AS HELD FOR SALE CONTINUED

The major classes of the assets and liabilities in relation to the hosting and network services businesses classified as held for sale are as follows:

	2007 £'000
Property, plant and equipment	42,828
Goodwill	39,534
Intangible assets	300
Inventories	1
Trade and other receivables	18,291
Total assets classified as held for sale	100,954
Long term borrowings	(9,541)
Short term borrowings	(4,208)
Trade and other payables	(17,159)
Finance Leases	(8,642)
Provisions	(853)
Current tax liabilities	(94)
Total liabilities classified as held for sale	(40,497)
Net assets of disposal group	60,457

## 20. AGGREGATED CASH FLOW FROM DISCONTINUED OPERATIONS

The information presented in the consolidated cash flow statement on page 29 is the total cash flows arising from all the group's operations. In respect of the discontinued activities only, the following cash flows are relevant.

	Year ended 31 December 2007 £000	Year ended 31 December 2006 £000
Net cash used in operating activities	(21,510)	(2,991)
Net cash used in investing activities	(14,930)	(21,764)
Net cash (used)/generated in financing activities	(3,546)	65
Net decrease in cash and cash equivalents	(39,986)	(24,690)

## 21. SHORT TERM BORROWINGS

	2007 £'000	2006 £'000
Bank loans	–	1,445
Obligations under finance leases	–	3,016
	–	4,461

## 22. TRADE AND OTHER PAYABLES

	2007 £'000	2006 £'000
Trade payables	669	57,217
Other taxation and social security	–	5,795
Other payables	76	4,228
Accruals and deferred income	1,049	28,553
	1,794	95,793

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 52 days (2006: 48 days).

The directors consider that the carrying amount of trade and other payables approximates to their value.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 23. PROVISIONS

	Dilapidations £'000	Onerous leases £'000	National insurance £'000	Escrow account £'000	Total £'000
At 1 January 2006	138	1,518	348	–	2,004
Additional provisions in the year	12	–	–	–	12
Amounts reversed in the year	–	–	(81)	–	(81)
Utilisation of provisions	(50)	(324)	–	–	(374)
At 31 December 2006	100	1,194	267	–	1,561
Additional provisions in the year	–	–	–	2,000	2,000
Amounts reversed in the year	–	–	(48)	–	(48)
Utilisation of provisions	(88)	(353)	–	–	(441)
Transfer to liabilities classified as held for sale (note 19)	(12)	(841)	–	–	(853)
<b>At 31 December 2007</b>	<b>–</b>	<b>–</b>	<b>219</b>	<b>2,000</b>	<b>2,219</b>

The national insurance provision relates to national insurance payable on the exercise of share options and is utilised as and when the share options are exercised. The onerous leases provision is in respect of an acquired telecommunications contract and is expected to be utilised up to the end of the contract in August 2010. The dilapidation provision relates to two properties; £88,000 in relation to a lease which has been extended for three years with an option to break in October 2007; and £12,000 in relation to a lease which was acquired in December 2006. The £2,000,000 provision is against the £10,500,000 receivable from the escrow in relation to the sale of the broadband and voice division.

## 24. LONG TERM BORROWINGS

	2007 £'000	2006 £'000
Bank loans (note 25)	–	37,851
Convertible bonds (note 28)	–	82,879
Obligations under finance leases (note 29)	–	4,283
	–	125,013

## 25. BANK LOANS AND OVERDRAFTS

	2007 £'000	2006 £'000
Bank loans	–	39,296

### The borrowings are repayable as follows:

On demand or within one year	–	1,445
In the second year	–	329
In the third to fifth years inclusive	–	36,498
After five years	–	1,024
	–	39,296
Less: amounts due for settlement within twelve months (shown under current liabilities)	–	(1,445)
Amounts due for settlement after twelve months	–	37,851

### Analysis of borrowings by currency:

Bank loans denominated in Sterling	–	36,133
Bank loans denominated in Euros	–	3,163
	–	39,296

### The directors estimate the fair value of the group's borrowings to be as follows:

Bank loans	–	39,296
	–	39,296

Bank loans of £nil (2006: £39,296,000) were arranged at floating interest rates. Bank deposits are arranged at floating rates, thereby hedging the group's exposure to cash flow interest rate risk.

## 26. RESERVES

	Share capital £'000	Share premium reserve Restated (note 35) £'000	Translation reserve £'000	Other reserves			Retained earnings Restated (note 35) £'000	Total equity Restated (note 35) £'000
				Merger reserve <sup>(i)</sup> Restated (note 35) £'000	Capital reserve £'000	Bond equity reserve £'000		
At 1 January 2006	22,101	81,818	–	13,319	207	–	(42,430)	75,015
Issue of shares	1,522	12,544	–	4,319	–	–	–	18,385
Exercise share options issued	308	1,853	–	–	–	–	–	2,161
Share based payment costs	–	–	–	–	–	–	2,206	2,206
Share of joint venture share based payment (note 14)	–	–	–	–	–	–	446	446
Issue of convertible bonds (note 28)	–	–	–	–	–	7,692	–	7,692
Exchange differences on translating foreign operations	–	–	(61)	–	–	–	–	(61)
Profit for the year	–	–	–	–	–	–	5	5
At 31 December 2006 and 1 January 2007	23,931	96,215	(61)	17,638	207	7,692	(39,773)	105,849
Issue of shares	161	633	–	–	–	–	–	794
Share based payment costs	–	–	–	–	–	–	3,377	3,377
Share of joint venture share based payment (note 14)	–	–	–	–	–	–	185	185
Redemption of convertible bonds (note 28)	–	–	–	–	–	(7,692)	–	(7,692)
Loss on translation of foreign subsidiary	–	–	86	–	–	–	–	86
Disposal of subsidiaries (note 18)	–	–	–	(9,519)	(207)	–	9,726	–
Profit for the year	–	–	–	–	–	–	33,446	33,446
<b>At 31 December 2007</b>	<b>24,092</b>	<b>96,848</b>	<b>25</b>	<b>8,119</b>	<b>–</b>	<b>–</b>	<b>6,961</b>	<b>136,045</b>

(i) The previously reported 2006 merger and other reserves have been reported together as merger reserves as they are both of the same nature; being premium arising on shares issued to acquire subsidiaries.

### MERGER RESERVE

At 31 December 2007 this represents the premium on shares issued to acquire XTM Limited and Compulink Information Exchange Limited (£796,000), Donhost Limited (£1,542,000), Firstnet Services Limited (£2,309,000) and the premium on shares issued as part of the consideration for the acquisition of Transigent Limited (£3,472,000).

The acquisition of £4,319,000 in 2006 represents premium on shares issued to acquire Toucan Residential Limited and Toucan Residential Ireland Limited.

The disposal of subsidiaries in 2007, relates to the share premium issued at the time of the acquisition of Toucan Residential Limited and Pipex Internet Limited, which were sold as part of the broadband and voice business disposal in 2007.

### CAPITAL RESERVE

The disposal of the capital reserves arises due to the disposal of Pipex Internet Limited which was sold as part of the broadband and voice business disposal in 2007.

### TRANSLATION RESERVE

Comprises foreign exchange difference arising on the translation of the accounts of, and investments in, foreign operations.

## 27. SHARE CAPITAL

	2007 £'000	2006 £'000
<b>Authorised:</b>		
4,000,000,000 ordinary shares of 1p each	<b>40,000</b>	40,000
<b>Issued and fully paid:</b>		
At the start of the year, 2,393,074,923 (2006: 2,210,059,488) ordinary shares of 1p each	<b>23,931</b>	22,101
Issued during the year, 16,156,431 (2006: 183,015,435) ordinary shares of 1p each	<b>161</b>	1,830
At the end of the year, 2,409,231,354 (2006: 2,393,074,923) ordinary shares of 1p each	<b>24,092</b>	23,931

Share capital issued at nominal value in the year relates to the exercise of share options. The company has one class of ordinary shares which carry no right to fixed income.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 28. CONVERTIBLE BONDS

On 23 March 2006 FREEDOM4 (Jersey) Limited (formerly Pipex Finance (Jersey) Limited) announced the private placement of £80,000,000 3.875% Guaranteed Convertible Bonds 2011. In addition Lehman Brothers (International) Europe was granted the option to increase the size of the issue by an additional £20,000,000. The company received subscriptions for £91,500,000 and were convertible into ordinary shares of the company at a conversion price of 19p. The company has an option to call the bonds after three years should the price of the company's ordinary shares exceed 130% of the conversion price over a fixed period.

Expenses of the bonds were £3,221,000 giving rise to net proceeds of £88,279,000.

The net proceeds received from the issue of the convertible bonds were split between the equity component and a liability element representing the fair value of the embedded option to convert the liability into equity of the company.

On 12 October 2007 FREEDOM4 (Jersey) Limited exercised its option to redeem the 3.875% Guaranteed Convertible Bonds due 2011 pursuant to Condition 9(b) of the bonds. Each bond was redeemed at its principal amount of £1,000 plus a premium of £20 together with accrued interest. The total cost for the redemption of the principal was £91,500,000 and a premium for early repayment of £1,830,000.

The liability component of the bonds increases as the present value of the interest payments, calculated using a market rate of interest, increase offset by cash interest payments made. The residual amount, representing the value of the equity conversion component of the bonds was £7,692,000 at redemption date.

	£'000
Nominal value of convertible bonds issued	91,500
Costs of issue	(3,221)
Net proceeds	88,279
Equity component	(7,692)
Liability component at date of issue	80,587
Finance costs	4,065
Cash interest paid	(1,773)
Liability component at 31 December 2006	82,879
Finance costs	4,610
Cash interest paid	(3,681)
Redemption of bond principal	(83,808)
<b>Liability component at 31 December 2007</b>	<b>–</b>

Finance costs on the bonds are calculated using the effective interest method by applying the effective interest rate of 6% (2006: 6%).

The fair value of the convertible bonds at the balance sheet date was £nil (2006: £81,754,000).

## 29. OBLIGATIONS UNDER FINANCE LEASES

The majority of finance leases require the return of the goods to the lessor at the end of the initial lease term.

Leased equipment comprises mainly routers and switches used in the operation of the UK core network.

	Minimum lease payments		Present value of minimum lease payments	
	2007 £'000	2006 £'000	2007 £'000	2006 £'000
Amounts payable under finance leases:				
Within one year	4,323	3,353	3,920	3,016
In the second to fifth years inclusive	5,567	5,432	4,722	4,283
After five years	–	–	–	–
	<b>9,890</b>	8,785	<b>8,642</b>	7,299
Less: future finance charges	1,248	1,486	–	–
Present value of lease obligations	<b>8,642</b>	7,299	–	–
Less: amounts due for settlement within twelve months (shown under current liabilities)	–	–	<b>(3,920)</b>	(3,016)
Amounts due for settlement after twelve months	–	–	<b>4,722</b>	4,283
Transfer to held for sale (note 19)	<b>(8,642)</b>	–	<b>(4,722)</b>	–
	–	7,299	–	4,283

### 30. ACQUISITIONS

No acquisitions were made in the current period.

#### (i) PRIOR YEAR ACQUISITIONS SUMMARY

Below is a summary of the acquisitions made by FREEDOM4 Communications plc (formerly Pipex Communications plc) in the year ended 31 December 2006:

	2006 £'000
Fair value of liabilities acquired	(20,240)
Goodwill	66,839
Consideration	46,599

#### Satisfied by:

43,193,435 ordinary shares at market price of 11.0p per share	4,751
Cash	33,386
Costs of acquisition	2,545
	40,682

#### Effects on group cash flow:

Effects on group cash flow:	33,386
Cash consideration and costs	2,545
Bank overdrafts on acquisition	40,589
Net cash outflow	76,520

#### (ii) PIPEX HOMECALL LIMITED

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangibles	–	19,564	19,564
Fixed assets	4,912	911	5,823
Debtors	15,981	2,055	18,036
Overdraft	(43,146)	–	(43,146)
Creditors (falling due within one year)	(31,671)	(5,587)	(37,258)
<b>Net (liabilities)/assets</b>	<b>(53,924)</b>	<b>16,943</b>	<b>(36,981)</b>

Goodwill	37,971
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<b>Consideration</b>	<b>990</b>
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#### Satisfied by:

Cash	–
Costs of acquisition	990
	990

#### Effects on group cash flow:

Cash consideration and costs	990
Bank overdrafts on acquisition	43,146

<b>Net cash outflow</b>	<b>44,136</b>
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#### Explanatory notes:

##### Fixed assets

Fixed assets have been adjusted by £911,000 for capitalisation of own labour costs in accordance with FREEDOM4 Communications plc (formerly Pipex Communications plc) group policy.

##### Debtors

Debtors have been adjusted by £745,000 in respect of a refund due for discounts on prepaid circuit rentals, £464,000 in respect of adjusting for credit balances. The remaining adjustment of £846,000 is due to a change in accounting policy to prepay connection costs for newly acquired broadband customers.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 30. ACQUISITIONS CONTINUED

### (iii) TOUCAN RESIDENTIAL LIMITED AND TOUCAN RESIDENTIAL IRELAND LIMITED

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangibles	–	3,558	3,558
Fixed assets	949	–	949
Debtors	7,127	1,216	8,343
Cash	2,049	–	2,049
Creditors (falling due within one year)	(9,230)	(27)	(9,257)
<b>Net assets</b>	<b>895</b>	<b>4,747</b>	<b>5,642</b>
Goodwill			20,366
<b>Consideration</b>			<b>26,008</b>
<b>Satisfied by:</b>			
43,193,435 shares at a market price of 11.0p per share			4,751
Cash			20,000
Costs of acquisition			1,257
			<b>26,008</b>
<b>Effects on group cash flow:</b>			
Cash consideration and costs			26,008
Cash balances on acquisition			(2,049)
Net cash outflow			<b>23,959</b>

#### Explanatory notes:

##### Debtors

Debtors have been adjusted due to a change in accounting policy in order to align with group accounting policies.

##### Creditors

Creditors have been adjusted due to a small overstatement at time of acquisition.

The accounting reference date for Toucan Residential Limited has been changed from 31 July to 31 December in order to bring it in line with the reporting for the group.

### (iv) SWITCH2 TELECOMS LIMITED

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangibles	–	831	831
Debtors	687	–	687
Creditors (falling due within one year)	(1,987)	(249)	(2,236)
<b>Net (liabilities)/assets</b>	<b>(1,300)</b>	<b>582</b>	<b>(718)</b>
Goodwill			1,790
<b>Consideration</b>			<b>1,072</b>
<b>Satisfied by:</b>			
Cash			972
Costs of acquisition			100
			<b>1,072</b>
<b>Effects on group cash flow:</b>			
Cash consideration and costs			1,072
Cash balances on acquisition			–
Net cash outflow			<b>1,072</b>

### 30. ACQUISITIONS CONTINUED (v) SUPANETWORKS LIMITED

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangibles	–	270	270
Fixed assets	2	–	2
Debtors	(6)	–	(6)
Cash	508	–	508
Creditors (falling due within one year)	(149)	(81)	(230)
<b>Net assets</b>	<b>355</b>	<b>189</b>	<b>544</b>
Goodwill			1,699
<b>Consideration</b>			<b>2,243</b>
<b>Satisfied by:</b>			
Cash			2,100
Costs of acquisition			143
			<b>2,243</b>
<b>Effects on group cash flow:</b>			
Cash consideration and costs			2,243
Cash balances on acquisition			(508)
Net cash outflow			<b>1,735</b>

### (vi) BULLDOG

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangibles	–	5,355	5,355
<b>Net assets</b>	<b>–</b>	<b>5,355</b>	<b>5,355</b>
Goodwill			5,013
<b>Consideration</b>			<b>10,368</b>
<b>Satisfied by:</b>			
Cash			10,313
Costs of acquisition			55
			<b>10,368</b>
<b>Effects on group cash flow:</b>			
Cash consideration and costs			10,368
Cash balances on acquisition			–
Net cash outflow			<b>10,368</b>

#### Explanatory notes:

##### Intangibles

For all the above acquisitions, in accordance with IFRS3, the company has allocated the total purchase price of acquisitions to the total assets acquired including intangible customer relationships and contracts.

Included within the valuation is a tax amortisation benefit to reflect the value of the tax-shield afforded by the amortisation of capitalised intangible assets.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 31. FINANCIAL INSTRUMENTS

Financial disclosures under this section for the current and comparative periods include balances held for sale.

The group's activities expose it to a variety of financial risks: market risk (including interest rate risk and liquidity risk) credit risk, foreign currency risk. The group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the group's financial performance.

### (i) INTEREST RATE RISK

The group financed its operations through the year from bank deposits. The interest rate exposure of the financial assets of the group at the balance sheet date was:

	Fixed rate £'000	Floating rate £'000	Total 2007 £'000	Fixed rate £'000	Floating rate £'000	Total 2006 £'000
Sterling	360	59,828	60,188	145	47,821	47,966
Euros	287	275	562	203	159	362
	<b>647</b>	<b>60,103</b>	<b>60,750</b>	348	47,980	48,328

The deposits at fixed rate in Sterling earn interest at a rate of 4.5% and Euros earn interest at interest rates of between 2-4.5%.

The interest rate exposure of the financial liabilities of the group at the balance sheet date was:

	Fixed rate £'000	Floating rate £'000	Total 2007 £'000	Fixed rate £'000	Floating rate £'000	Total 2006 £'000
Sterling	13,748	–	13,748	93,341	36,133	129,474

Included in the 2007 fixed rate balance £13,748,000 are lease creditors of £8,642,000 and bank loans totalling £5,106,000 (£6,930,000). Of these bank loans, £288,000 (£391,000) carries interest at a rate of 6.64% and £4,818,000 (£6,539,000) carries interest at a rate of 5.19%.

Included in the 2006 fixed rate balance of £93,341,000 were lease creditors of £7,299,000, a convertible bond of £82,879,000 and bank loans totalling £3,163,000. The convertible bond had an effective interest rate of 6%. The bank loan of £3,163,000 (£4,698,000) carried interest at a rate of 5.19%. The floating rate balance of £36,133,000 was made up of two bank loans, £35,000,000 carrying interest at a rate of LIBOR +1.75% and £1,133,000 carrying interest at a rate of bank base rate +1.35%.

The group finances its operations through a mixture of cash and the availability of a borrowing facility. Management manage the interest rate risk by using a combination of fixed and floating rates. No interest rate derivative contracts have been entered into. We will continue to monitor this position to ensure that the interest rate profile is appropriate for the group.

All the cash and cash equivalents have been classified as continuing. All the trade and other receivables and the borrowings are classified as held for sale.

### (ii) LIQUIDITY RISK

The group's objective is to ensure adequate funding for its operations ahead of commitments being made for expansion. This has been achieved through the issue in 2006 of convertible bonds and the draw down of loan facilities. Following the disposal of the broadband and voice businesses in 2007, the group used the proceeds of the disposal to redeem the convertible bond and to repay bank debt. This left sufficient cash and cash equivalents at the year end to support the group's operations going forward and to contemplate a distribution to shareholders. These net proceeds together with the net cash proceeds of sale from the hosting and network services businesses were returned to shareholders by way of two tender offers in April 2008 leaving sufficient cash and cash equivalents in the group to meet its requirements.

All of the group's debt is secured by means of fixed and floating charges over the group's assets. The convertible bonds comprising £nil (2006: £82,879,000) of other financial liabilities constitutes unsubordinated, unsecured obligations of the group.

	Debt £'000	Other financial liabilities £'000	Total 2007 £'000	Debt £'000	Other financial liabilities £'000	Total 2006 £'000
<b>Financial liabilities maturing:</b>						
In one year or less or on demand	288	3,920	4,208	1,445	3,016	4,461
In more than one year, but not more than two years	1,691	2,695	4,386	329	2,662	2,991
In more than two years, but not more than five years	3,127	2,027	5,154	36,498	84,500	120,998
After five years	–	–	–	1,024	–	1,024
	<b>5,106</b>	<b>8,642</b>	<b>13,748</b>	39,296	90,178	129,474

## 31. FINANCIAL INSTRUMENTS CONTINUED

### (iii) CREDIT RISK

The group's principal financial assets are trade and other receivables and cash and cash equivalents, which represent the group's maximum exposure to credit risk in relation to financial assets.

The group's credit risk is primarily attributable to its trade receivables. The average credit period taken on sale of goods is 49 days (2006: 40 days). An allowance has been made for estimated irrecoverable amounts included in trade receivables of £4,304,000 (2006: £15,300,000). This allowance has been determined by management with reference to past default experience and the current economic environment.

The company has £10.5 million held within an escrow account (note 18) and a £2.0 million provision has been made in respect of this.

The credit risk on liquid funds included in cash and cash equivalents is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies. The group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

### (iv) FOREIGN CURRENCY RISK

The group has occasional transactional currency exposures. Such exposures mainly arise from purchases in US Dollars and Euros. The group has a German subsidiary which has monetary assets of £16,186,000 and monetary liabilities of £13,270,000.

Where it is considered appropriate, the group enters into derivative transactions (principally forward foreign currency transactions). The purpose of such transactions is to manage the currency risks arising from the group's operations and its sources of finance. It is the group's policy that not speculative trading in financial instruments is undertaken.

### (v) FAIR VALUES

The following table sets out the book values and estimated fair values of the group's financial instruments:

	Book value 2007 £'000	Fair value 2007 £'000	Book value 2006 £'000	Fair value 2006 £'000
Primary financial instruments:				
Cash at bank and in hand	60,750	60,750	48,328	48,328
Bank loans	(5,106)	(5,106)	(39,296)	(39,296)
Convertible bonds	—	—	(82,879)	(81,754)
Finance lease due within one year	(3,920)	(3,920)	(3,016)	(3,016)
Finance leases due after more than one year	(4,722)	(4,722)	(4,283)	(4,283)
	47,002	47,002	(81,146)	(80,021)

### (v) SENSITIVITY ANALYSIS

In managing interest rates and currency risks the group aims to reduce the impact of short-term fluctuations on the group's earnings. Over the long-term however, permanent changes in foreign exchange and interest rates would have an impact on the consolidated results.

The impact of currency fluctuations on profit before tax and equity is immaterial.

At 31 December 2007, it is estimated that a general increase of one percentage point in interest rates would decrease the group's profit before tax by approximately £65,000.

It is estimated that a general increase of one percentage point in the value of the Euro would have decreased the group's profit before tax by approximately £1,300 for the year ended 31 December 2007.

### (vi) CAPITAL MANAGEMENT

The group's objective when managing capital (equity and borrowings) is to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

Surplus cash, following the disposal of both the broadband and voice and the hosting and network services businesses, was returned to shareholders by way of tender offer in April 2008 (note 34).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 32. OPERATING LEASE ARRANGEMENTS

The group has commitments under non-cancellable operating leases, and the rentals are payable as follows:

	Short leasehold property £'000	Other assets £'000	Total 2007 £'000	Short leasehold property (restated) £'000	Other assets (restated) £'000	Total 2006 (restated) £'000
In less than one year	2,890	1,648	4,538	2,151	1,794	3,945
Between two and five years	6,154	60	6,214	4,329	121	4,450
After five years	10,940	–	10,940	4,249	–	4,249
	<b>19,984</b>	<b>1,708</b>	<b>21,692</b>	10,729	1,915	12,644

Short leasehold property comprises office accommodation and data centre facilities. Other comprises mainly bandwidth or circuits rental agreements.

All the above leases have been classified as held for sale as at 31 December 2007 (note 19).

## 33. RELATED PARTY TRANSACTIONS

Peter Dubens, an executive director of the company, was a director of the following companies:

Oakley Capital Limited which provided services to the group of £795,000 (2006: £146,000) of which £21,000 (2006: £39,000) was outstanding at the end of the year end. Oakley Capital Limited was also a customer of the company and the accounted for sales of £43,000 (2006: £6,000), of which £5,000 (2006: £1,400) was outstanding at the end of the year.

365 Media Group plc (formerly ukbetting plc) and its fellow group companies, provided services to the group of £71,000 (2006: £590,000) of which £nil (2006: £920,000) was outstanding at the end of the year end. 365 Media Group plc (formerly ukbetting plc) was also a customer of the company and the accounted for sales of £88,000 (2006: £350,000), of which £14,000 (2006: £510,000) was outstanding at the end of the year. Peter Dubens ceased to be a director of 365 Media Group plc (formerly ukbetting plc) on 23 January 2007.

Peter Dubens and Mike Read are directors of FREEDOM4 Limited (formerly Pipex Wireless Limited). FREEDOM4 Limited is accounted for as joint venture. FREEDOM4 Limited was a customer of the company and the accounted for sales of £61,000 (2006: £nil), of which £1,000 (2006: £nil) was outstanding at the end of the year.

On 31 March 2006 the group sold the entire share capital of its subsidiary, FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) and Faultbasic Limited to its joint venture FREEDOM4 Limited.

## 34. POST BALANCE SHEET EVENTS

On 24 January 2008, in accordance with shareholder agreement, Intel Capital Corporation contributed an additional £3,309,000, and FREEDOM4 Communications plc (formerly PIPEX Communications plc) an additional £3,913,000, to the FREEDOM4 Limited (formerly Pipex Wireless Limited) joint venture.

On 14 March 2008, the company announced that it had entered into an agreement for the sale of the hosting and network services businesses to Host Europe WVS Limited (a wholly owned subsidiary of Oakley Capital Private Equity L.P.) for £120 million. On 2 April 2008, the company sold the businesses to Host Europe WVS Limited a wholly owned subsidiary of Oakley Capital Private Equity L.P. Consideration for the sale was £120.0 million satisfied by £92.5 million in cash, £17.5 million in loan notes (issued by a wholly owned subsidiary of Oakley Capital Private Equity L.P.) and the assumption by the buyer of the division's debts. Peter Dubens, an executive director of the company is a director of Oakley Capital Private Equity L.P.

On 15 March 2008, the company made a conditional offer to its shareholders to buy back 58% of their shareholdings for a minimum price of 10p per share, capped at 11p per share, by way of two tender offers. On 19 March 2008 the court approved a capital reduction scheme to eliminate the deficit on the company's profit and loss account and create distributable reserves to facilitate the return of cash to shareholders. The take up by shareholders of the offers was high such that 95.8% of those shares capable of being tendered were tendered and the tender price was set at 10.39p. On 4 April 2008 Collins Stewart acquired 1,459,600,083 shares by means of an on-market transaction at the tender price as a result of the first tender offer. On 7 April 2008 Collins Stewart acquired 30,175,256 shares by means of an on-market transaction at the tender price as a result of the second tender offer. Following the cancellation of the tendered shares and exercise of share options of 151,085,002, the company had 1,070,541,017 ordinary shares of 0.1p each left in issue.

During April 2008, the company acquired the trade and assets of BOZII Limited, a WiFi roaming service provider, through the company's subsidiary FREEDOM4 WiFi Limited.

The group has not incurred any capital commitments nor are there any capital contingencies post balance date.

### 35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

This is the first year that the company has presented its group financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union for the first time. The disclosures required by IFRS 1 concerning the transition from United Kingdom Generally Accepted Accounting Practice ("UK GAAP") to IFRS are given in this note.

The last set of group financial statements presented by the company under UK GAAP were for the year ended 31 December 2006. The date of the transition to IFRS was therefore 1 January 2006.

#### EXEMPTIONS APPLIED BY THE GROUP IN THE YEAR OF TRANSITION

The group has taken the exemption in respect of business combinations from the requirement to restate combinations occurring before the date of transition.

The group has also elected to apply the foreign exchange exemption and set cumulative exchange translation differences to zero at the date of transition.

#### MAIN CHANGES IN THE BASIS OF PREPARATION BETWEEN IFRS AND UK GAAP

In accordance with the requirements of IFRS 3, goodwill has been frozen at its brought forward net book value at the date of transition, and amortisation charged under UK GAAP for the period ended 31 December 2006 has been reversed.

In addition, under the requirements of IFRS 3, the fair values of customer lists acquired with the business combinations arising during the period ended 31 December 2006 has been recognised separately from goodwill and classified as intangible assets to be amortised over their expected useful economic life of 36 months.

Adoption of IFRS also results in a number of minor changes such as holiday pay accruals, rebasing of residual values on certain property assets, changes to the definition of cash and cash equivalents, and changes to the reclassifications of provisions between current and non current.

The adoption of IFRS has not however had an impact on the amount of cash previously disclosed under UK GAAP in any of the periods of account in the financial statements.

Accounting policies as set out have been used on a consistent basis on transition to IFRS.

#### CONSOLIDATED BALANCE SHEET RECONCILIATION AT 1 JANUARY 2006 (TRANSITION DATE)

	Adjustments	UK GAAP in IFRS format £'000	Effect of UK GAAP prior year adjustments £'000	Effect of transition to IFRS £'000	Reported under IFRS £'000
<b>Assets</b>					
<b>Non current assets</b>					
Goodwill		99,231	–	–	99,231
Intangible assets		4,424	–	–	4,424
Property, plant and equipment		25,251	–	–	25,251
		128,906	–	–	128,906
<b>Current assets</b>					
Inventories		63	–	–	63
Trade and other receivables		18,953	–	–	18,953
Cash and cash equivalents		13,964	–	–	13,964
		32,980	–	–	32,980
<b>Current liabilities</b>					
Short term borrowings		(16,815)	–	–	(16,815)
Trade and other payables	a	(42,605)	–	(130)	(42,735)
Corporation tax		(446)	–	–	(446)
Current provisions	b	–	–	(619)	(619)
		(59,866)	–	(749)	(60,615)
<b>Net current liabilities</b>		(26,886)	–	(749)	(27,635)
<b>Total assets less current liabilities</b>		102,020	–	(749)	101,271
<b>Non current liabilities</b>					
Long term borrowings		(24,871)	–	–	(24,871)
Long term provisions	b	(2,004)	–	619	(1,385)
		(26,875)	–	619	(26,256)
<b>Net assets</b>		75,145	–	(130)	75,015

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS CONTINUED CONSOLIDATED BALANCE SHEET RECONCILIATION AT 1 JANUARY 2006 (TRANSITION DATE) CONTINUED

	Adjustments	UK GAAP in IFRS format £'000	Effect of UK GAAP prior year adjustments £'000	Effect of transition to IFRS £'000	Reported under IFRS £'000
<b>Equity attributable to the equity holders of the parent</b>					
Share capital		22,101	–	–	22,101
Share premium reserve	c	84,127	(2,309)	–	81,818
Other reserves	c	11,217	2,309	–	13,526
Retained earnings	a	(42,300)	–	(130)	(42,430)
<b>Equity shareholders' funds</b>		<b>75,145</b>	<b>–</b>	<b>(130)</b>	<b>75,015</b>

### Effect of transition to IFRS

- a Holiday pay adjustments as at 31 December 2005 (£130,000).  
b Reclassifications of provisions between current and non current as at 31 December 2005 (£619,000).

### Effect of UK GAAP prior year adjustments

- c On 28 August 2003, FREEDOM4 Communications plc (formerly Pipex Communications plc) purchased Firstnet Services Limited for consideration that consisted of cash and shares within FREEDOM4 Communications plc. The £2,309,000 premium arising on the shares issued to vendor parties was credited to the share premium account in error instead of the merger reserve. The share premium and merger reserve accounts have been restated to reflect the correct accounting treatment.

This UK GAAP prior year adjustment had £nil effect on income tax.

## CONSOLIDATED BALANCE SHEET RECONCILIATION AT 31 DECEMBER 2006

	Adjustments	UK GAAP in IFRS format adjustments £'000	Effect of UK GAAP prior year to IFRS £'000	Effect of transition under IFRS £'000	Reported £'000
<b>Assets</b>					
<b>Non current assets</b>					
Goodwill	d	170,692	–	(5,509)	165,183
Intangible assets	e,g	6	–	23,720	23,726
Property, plant and equipment	c	46,989	–	80	47,069
Investment in joint venture	f,i	(5,620)	11,037	271	5,688
		212,067	11,037	18,562	241,666
<b>Current assets</b>					
Inventories		47	–	–	47
Trade and other receivables		44,679	–	–	44,679
Cash and cash equivalents		48,328	–	–	48,328
		93,054	–	–	93,054
<b>Current liabilities</b>					
Short term borrowings		(4,461)	–	–	(4,461)
Trade and other payables	a	(95,569)	–	(224)	(95,793)
Tax liabilities		(278)	–	–	(278)
Current provisions	b	–	–	(337)	(337)
		(100,308)	–	(561)	(100,869)
		(7,254)	–	(561)	(7,815)
<b>Net current liabilities</b>		<b>204,813</b>	<b>11,037</b>	<b>18,001</b>	<b>233,851</b>
<b>Total assets less current liabilities</b>					
<b>Non current liabilities</b>					
Long term borrowings		(125,013)	–	–	(125,013)
Long term provisions	b	(1,561)	–	337	(1,224)
Deferred tax liability	g	–	–	(1,765)	(1,765)
		(126,574)	–	(1,428)	(128,002)
<b>Net assets</b>		<b>78,239</b>	<b>11,037</b>	<b>16,573</b>	<b>105,849</b>
<b>Equity attributable to the equity holders of the parent</b>					
Share capital		23,931	–	–	23,931
Share premium reserve	h	98,524	(2,309)	–	96,215
Translation reserve		(61)	–	–	(61)
Other reserves	h	23,228	2,309	–	25,537
Retained earnings	a,c,d,e,f,g,i	(67,383)	11,037	16,573	(39,773)
<b>Equity shareholders' funds</b>		<b>78,239</b>	<b>11,037</b>	<b>16,573</b>	<b>105,849</b>

### 35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS CONTINUED CONSOLIDATED BALANCE SHEET RECONCILIATION AT 31 DECEMBER 2006 CONTINUED

#### Effect of transition to IFRS

- a Holiday pay adjustments as at 31 December 2006 (£224,000).
- b Reclassifications of provisions between current and non current as at 31 December 2006 (£337,000).
- c Reduction in the depreciation charge for the year arising as a result of rebasing the residual value of a property asset (£80,000).
- d Reversing of amortisation charged in the year on goodwill (£18,152,000), and reclassifying customer list values previously included in the value of goodwill arising on consolidation (£29,578,000).
- e After recognition of customer list values at 31 December 2006 as per note 'd' above, the amortisation charge thereon for the year was £5,858,000.
- f The group's share of development costs recognised as a capital asset as at 31 December 2006 in the joint venture (£271,000).
- g As a result of the purchase accounting for entities acquired in a business combination during 2006, a number of deferred tax adjustments needed to be made on conversion to IFRS:

Deferred tax liabilities recognised in respect of the intangible assets acquired as part of the business combinations totalling £7,266,000 together with a deferred asset in respect of losses carried forward and temporary differences in respect of property, plant and equipment totalling £1,349,000 which results in a net adjustment to goodwill of £5,917,000. In addition, deferred tax liabilities arose from property revaluations on the above business combinations and capitalisation of development costs by the joint venture totalling £671,000 which is offset by an equal deferred tax asset arising from trading losses carried forward.

As a result of these acquisitions, a £2,524,000 deferred tax asset could be recognised in respect of the existing group's temporary differences resulting in a credit to the income statement of £2,524,000.

The movements in the deferred tax liabilities and assets set-up on acquisition above which were unwound during 2006 resulted in a net credit to the income statement at year end of £1,628,000.

#### Effect of UK GAAP prior year adjustments

- h On 28 August 2003, FREEDOM4 Communications plc (formerly Pipex Communications plc) purchased FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) for consideration that consisted of cash and shares within FREEDOM4 Communications plc. The £2,309,000 premium arising on the shares issued to vendor parties was credited to the share premium account in error instead of the merger reserve. The share premium and merger reserve accounts have been restated to reflect the correct accounting treatment.

This UK GAAP prior year adjustment had £nil effect on income tax.

- i On 22 March 2006 FREEDOM4 Communications plc (formerly Pipex Communications plc) entered into a joint venture with Intel Capital Corporation, known as FREEDOM4 Limited (formerly Pipex Wireless Limited). During 2006, FREEDOM4 Limited issued £14,185,000 convertible redeemable preference shares to FREEDOM4 Communications plc in exchange for the sale of FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) and Faultbasic Limited and \$1,000,000 cash. At the same time FREEDOM4 Limited also issued convertible redeemable preference share to Intel Capital Corporation in exchange of \$5,000,000 cash. During 2006 the group held a 84.04% equity interest in FREEDOM4 Limited.

During the year to and as at 31 December 2006 the company had not previously accounted for the convertible redeemable preference shares totalling £10,565,000 within its investment in the joint venture on the balance sheet, and as a result recorded an equivalent loss within the statement of recognised gains and losses on the original recognition of the joint venture. However, since approving last year's financial statements, the directors have formed the opinion that under UK GAAP the company should have also recognised this amount as a loan to the joint venture. In addition the company did not record an interest receivable amount in relation to the loan amounting to £472,000. The company has restated the prior year by increasing its value in investment in joint venture by £11,037,000 with a corresponding credit of £10,565,000 to the statement of recognised gains and losses and a credit to the income statement for £472,000. The unrealised gain on the set up of the joint venture has been adjusted to £1,032,000 from a loss of £9,533,000.

This UK GAAP prior year adjustment had £nil effect on income tax.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS CONTINUED RECONCILIATION OF THE CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	Adjustments	UK GAAP in IFRS format £'000	Effect of UK GAAP prior year adjustments £'000	Effect of transition to IFRS £'000	Reported under IFRS £'000
<b>Revenue</b>		294,359	–	–	294,359
Cost of sales	a	(182,004)	–	(63)	(182,067)
Operating costs before amortisation of intangibles, depreciation, impairments and share based payment costs	b	(89,164)	–	(31)	(89,195)
<b>Earnings before amortisation of intangibles, depreciation, impairment and share based costs</b>		23,191	–	(94)	23,097
Amortisation of intangibles	c	(18,939)	–	12,294	(6,645)
Depreciation	d	(12,113)	–	80	(12,033)
Share based payment costs		(2,206)	–	–	(2,206)
<b>Total operating costs</b>		(122,422)	–	12,343	(110,079)
Share of (loss)/profit of joint venture	e,h	(1,421)	(446)	271	(1,596)
<b>Operating (loss)/profit</b>		(11,488)	(446)	12,551	617
Finance income	i	546	472	–	1,018
Finance costs		(6,806)	–	–	(6,806)
Net finance expenses		(6,260)	472	–	(5,788)
Gain arising on contribution of intangible assets to joint venture	g	–	–	1,032	1,032
<b>(Loss)/profit before tax</b>		(17,748)	26	13,583	(4,139)
Income tax (charge)/credit	f	(8)	–	4,152	4,144
<b>(Loss)/profit for the year</b>		(17,756)	26	17,735	5

### Effect of transition to IFRS

- a Holiday pay accruals recognised as at 31 December 2005 (£106,000) and as at 31 December 2006 (£169,000).
- b Holiday pay accruals recognised as at 31 December 2005 (£24,000) and as at 31 December 2006 (£55,000).
- c Reversing amortisation charged in the year on goodwill (£18,152,000), and recognising the amortisation charge on customer list values for the year (£5,858,000).
- d Reduction in the depreciation charge for the year arising as a result of rebasing the residual value of a property asset (£80,000).
- e The group's share of development costs recognised as a capital asset as at 31 December 2006 in the jointly controlled entity (£271,000).
- f Credit of £2,524,000 in respect of the recognition of deferred tax assets which was triggered as a result of the acquisitions which occurred in 2006 together with a £1,628,000 credit following the release of deferred tax liabilities due to the amortisation of intangible assets as at 31 December 2006, producing a net income tax credit (£4,152,000). See point 'g' of the notes to the consolidated balance sheet reconciliation at 31 December 2006 for details.
- g In accordance with the guidance provided by SIC 13, Jointly Controlled Entities – Non-Monetary Contributions by Ventures the unrealised gain on forming FREEDOM4 Limited (formerly Pipex Wireless Limited), a joint venture with Intel Capital (Cayman) Corporation, of £1,032,000 which was recognised in the statement of recognised gains and losses under UK GAAP is recognised in the income statement. The guidance in SIC 13 sets out criteria as to when a gain may be recognised in this situation although it does not distinguish between unrealised and realised gains as it indicates that all gains should be recognised in the income statement.

### Effect of UK GAAP prior year adjustments

- h Restatement of prior year in relation to the group's share of the joint venture's share option charge of £446,000. The company did not account for its share of the charge recognised by the joint venture in relation to share options that were granted by the joint venture for shares in the joint venture. The company has restated its share of joint venture loss for £446,000 with a corresponding credit to the retained earnings account.

This UK GAAP prior year adjustment had £nil effect on income tax.

- i Restatement of prior year in relation to interest receivable on the convertible redeemable preference shares outstanding from the joint venture amounting to £472,000. See point 'i' of the notes to the consolidated balance sheet reconciliation at 31 December 2006 for further details.

This UK GAAP prior year adjustment had £nil effect on income tax.

**35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS CONTINUED**  
**RECONCILIATION OF THE CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006**

	Adjustments	UK GAAP in IFRS format £'000	Effect of UK GAAP prior year adjustments £'000	Effect of transition to IFRS £'000	Reported under IFRS £'000
<b>(Loss)/profit for the year</b>		(17,756)	26	17,735	5
Income tax charge/(credit)	f	8	–	(4,152)	(4,144)
Gain arising on joint venture	h	–	–	(1,032)	(1,032)
Interest received	i	(546)	(472)	–	(1,018)
Interest payable		6,806	–	–	6,806
<b>Operating (loss)/profit</b>		(11,488)	(446)	12,551	617
<b>Adjustments for:</b>					
Amortisation of intangibles	c	18,939	–	(12,294)	6,645
Depreciation charge	d	12,113	–	(80)	12,033
Share of joint venture	e,g	1,421	446	(271)	1,596
Loss on sale of fixed assets		13	–	–	13
Share based payment costs		2,206	–	–	2,206
Operating cash flows before movements in working capital		23,204	–	(94)	23,110
Decrease in inventories		16	–	–	16
Decrease in receivables		865	–	–	865
Increase in payables	a,b	10,371	–	94	10,465
Decrease in provisions		(444)	–	–	(444)
Cash generated from operations		34,012	–	–	34,012
Interest paid		(4,997)	–	–	(4,997)
Income taxes received		230	–	–	230
<b>Net cash generated from operating activities</b>		29,245	–	–	29,245
<b>Cash flows from investing activities</b>					
Acquisition of subsidiaries net of cash acquired		(66,152)	–	–	(66,152)
Acquisition of businesses net of cash acquired		(10,368)	–	–	(10,368)
Investment in joint venture		(797)	–	–	(797)
Purchase of property, plant and equipment		(22,077)	–	–	(22,077)
Interest received		546	–	–	546
<b>Net cash used in investing activities</b>		(98,848)	–	–	(98,848)
<b>Cash flows from financing activities</b>					
Proceeds from the issue of share capital		13,634	–	–	13,634
Proceeds from the exercise of share options		2,161	–	–	2,161
Proceeds from the issue of convertible bonds		88,279	–	–	88,279
Proceeds from long term borrowings		76,746	–	–	76,746
Repayments of long term borrowings		(74,310)	–	–	(74,310)
Payment of finance lease liabilities		(2,543)	–	–	(2,543)
<b>Net cash generated from financing activities</b>		103,967	–	–	103,967
<b>Net increase in cash and cash equivalents</b>		34,364	–	–	34,364
<b>Cash and cash equivalents at the beginning of the year</b>		13,964	–	–	13,964
<b>Cash and cash equivalents at the end of the year</b>		48,328	–	–	48,328

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED for the year ended 31 December 2007

## 35. EXPLANATION OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS CONTINUED

### RECONCILIATION OF THE CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006 CONTINUED

#### Effect of transition to IFRS

- a Holiday pay accruals recognised as at 31 December 2005 (£106,000) and as at 31 December 2006 (£169,000).
- b Holiday pay accruals recognised as at 31 December 2005 (£24,000) and as at 31 December 2006 (£55,000).
- c Reversing amortisation charged in the year on goodwill (£18,152,000), and recognising the amortisation charge on customer list values for the year (£5,858,000).
- d Reduction in the depreciation charge for the year arising as a result of rebasing the residual value of a property asset (£80,000).
- e The group's share of development costs recognised as a capital asset as at 31 December 2006 in the jointly controlled entity (£271,000).
- f Credit of £2,524,000 in respect of the recognition of deferred tax assets which was triggered as a result of the acquisitions which occurred in 2006 together with a £1,628,000 credit following the release of deferred tax liabilities due to the amortisation of intangible assets as at 31 December 2006, producing a net income tax credit (£4,152,000). See point 'g' of the notes to the consolidated balance sheet reconciliation at 31 December 2006 for details.
- g In accordance with the guidance provided by SIC 13, Jointly Controlled Entities – Non-Monetary Contributions by Ventures the unrealised gain on forming FREEDOM4 Limited (formerly Pipex Wireless Limited), a joint venture with Intel Capital (Cayman) Corporation, of £1,032,000 which was recognised in the statement of recognised gains and losses under UK GAAP is recognised in the income statement. The guidance in SIC 13 sets out criteria as to when a gain may be recognised in this situation although it does not distinguish between unrealised and realised gains as it indicates that all gains should be recognised in the income statement.

#### Effect of UK GAAP prior year adjustments

- h Restatement of prior year in relation to the group's share of the joint venture's share option charge of £446,000. See point 'h' of the notes to the consolidated balance sheet reconciliation at 31 December 2006 for further details.
- i Restatement of prior year in relation to interest receivable on the convertible redeemable preference shares outstanding from the joint venture amounting to £472,000. See point 'i' of the notes to the consolidated balance sheet reconciliation at 31 December 2006 for further details.

None of the above adjustments had an effect of income tax.

### RECONCILIATION OF THE CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSS FOR THE YEAR ENDED 31 DECEMBER 2006

	Adjustments	UK GAAP in IFRS format £'000	Effect of UK GAAP prior year adjustments £'000	Effect of transition to IFRS £'000	Reported under IFRS £'000
Loss for the financial year	a	(17,756)	26	17,735	5
Unrealised loss on joint venture	b,c	(9,533)	10,565	(1,032)	–
Translation difference in respect of net investment in overseas subsidiary undertaking		(61)	–	–	(61)
Total recognised losses in the year		(27,350)	10,591	16,703	(56)

- a See points 'a' – 'i' the notes to the consolidated income statement reconciliation at 31 December 2006 for further details.

#### Effect of UK GAAP prior year adjustments

- b See point 'i' of the note to the consolidated balance sheet reconciliation at 31 December 2006 for details.

#### Effect of transition to IFRS

- c See point 'g' of the notes of the consolidated income statement reconciliation at 31 December 2006 for details.

# //COMPANY BALANCE SHEET// as at 31 December 2007

	Notes	2007 £'000	2006 £'000 (restated note C12)
<b>Fixed assets</b>			
Investments	C3	<b>68,353</b>	181,472
<b>Current assets</b>			
Debtors	C4	<b>28,142</b>	72,954
Cash at bank and in hand	C5	<b>44,469</b>	8,342
		<b>72,611</b>	81,296
<b>Creditors</b>			
Amounts falling due within one year	C6	<b>(1,794)</b>	(6,443)
<b>Net current assets</b>		<b>70,817</b>	74,853
<b>Total assets less current liabilities</b>		<b>139,170</b>	256,325
<b>Creditors</b>			
Amounts falling due after more than one year	C7	–	(117,879)
<b>Provisions for liabilities and charges</b>	C9	<b>(2,219)</b>	(267)
<b>Net assets</b>		<b>136,951</b>	138,179
<b>Capital and reserves</b>			
Called up share capital	C10	<b>24,092</b>	23,931
Share premium account	C10	<b>96,848</b>	96,215
Merger reserves	C10	<b>8,119</b>	25,330
Profit and loss account	C10	<b>7,892</b>	(7,297)
<b>Equity shareholders' funds</b>	C11	<b>136,951</b>	138,179

The financial statements on pages 26 to 76 were approved by the directors and authorised for issue on 16 May 2008, and signed on their behalf by:

**PETER DUBENS**  
Chairman

**STEWART PORTER**  
Chief Financial Officer

# **//NOTES TO THE COMPANY FINANCIAL STATEMENTS//** for the year ended 31 December 2007

## **C1. ACCOUNTING POLICIES**

### **BASIS OF PREPARATION**

The financial statements have been prepared to comply with current statutory requirements, under the historical cost convention, and in accordance with United Kingdom Generally Accepted Accounting Practice. Unless otherwise stated all policies have been applied consistently throughout the current and comparative periods.

As permitted by Section 230 of the Companies Act 1985, a separate income statement has not been presented in respect of the company. The profit after taxation attributable to FREEDOM4 Communications plc (formerly Pipex Communications plc) and dealt with in the financial statements of the company is £2,293,000 (2006: £4,418,000).

### **INVESTMENTS**

Investments in subsidiary undertakings are stated at cost in the balance sheet of the company unless, in the opinion of the directors, there has been an impairment, in which case an appropriate provision will be made.

### **JOINT VENTURES**

A jointly controlled entity is an entity in which the company holds an interest on a long-term basis and which is jointly controlled by the company and one or more other venturers under a contractual arrangement.

The results and assets, liabilities and contingent liabilities of associates and jointly controlled entities are incorporated in these financial statements using the equity method of accounting except when classified as held for sale (see below). Investments in associates and jointly controlled entities are carried in the balance sheet at the group's share of the net assets of the associate or jointly controlled entity. Losses of the associates or jointly controlled entities in excess of the group's interest in those associates or jointly controlled entities are not recognised.

Any excess of cost of acquisition over the group's share of the fair values of identifiable net assets acquired of the associate or jointly controlled entity at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the group's share of the fair values of identifiable net assets of the associate or jointly controlled entity at the date of acquisition (a discount on acquisition) is recognised in the income statement.

Where a group company transacts with an associate or jointly controlled entity of the group, unrealised profits and losses are eliminated to the extent of the group's interest in the relevant associate or jointly controlled entity. Losses may provide evidence of an impairment of the asset transferred in which case appropriate provision is made for impairment.

### **INTEREST BEARING BORROWINGS**

Borrowings are recognised initially at fair value less associated transaction costs and subsequently at amortised cost.

### **CASH FLOW STATEMENT**

The company has taken advantage of the exemptions permitted by FRS1 "Cash Flow Statements" not to produce a cash flow statement, on the basis that the cash flows of the company are included within the consolidated cash flow statement of FREEDOM4 Communications plc (formerly Pipex Communications plc).

### **FOREIGN CURRENCIES**

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange at the balance sheet date and the gains or losses on translation are included in the income statement.

### **TAXATION**

The charge for taxation is based on the results for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed, by the balance sheet date, except as required by FRS 19.

### **SHARE BASED PAYMENTS**

The share option programme allows employees to acquire shares of the company. The fair value of options granted after 7 November 2002 and those not yet vested as at 31 December 2007 is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where variations are due only to share prices not achieving the threshold for vesting.

### **CASH**

Cash at bank and in hand, comprises cash in hand, and deposits repayable on demand, less overdrafts payable on demand and restricted deposits.

## C2. DIRECTORS' REMUNERATION

The company employed no members of staff in 2007 (2006: nil). Additional information on share options is included in note 5 of the group accounts. Details of directors' emoluments are shown below:

### DIRECTORS' REMUNERATION

	Salaries and fees £'000	Bonus £'000	Total 2007 £'000	Total 2006 £'000	Pension 2007 £'000	Pension 2006 £'000
<b>Executive</b>						
M Read	384	1,800	2,184	595	37	28
S Porter	293	1,327	1,620	474	43	32
P Dubens	417	2,025	2,442	675	–	–
<b>Non-executive</b>						
L Blackall	35	–	35	35	–	–
C Kennedy	35	–	35	35	–	–
	<b>1,164</b>	<b>5,152</b>	<b>6,316</b>	1,814	80	60

The bonus received by M Read, S Porter and P Dubens was in respect of services during the year. Within the bonuses a total amount of £4,580,000 was paid to the directors as a result of services in respect of the disposal of certain subsidiaries and was included as part of the cost of disposal.

For details on pension refer to board report on directors' remuneration on page 23.

Shareholdings and option interests of the directors in office at 31 December 2007 are as follows:

### DIRECTORS' SHAREHOLDINGS

	1p ordinary shares		0.1p ordinary shares
	31 December 2007	31 December 2006	Shareholdings after capital reduction
M Read	–	–	–
S Porter	174,500	174,500	73,290
P Dubens	138,888,889	138,888,889	58,333,334
L Blackall	–	–	–
C Kennedy	223,355	223,355	93,810

The directors will continue to pursue opportunities within the wireless broadband market in conjunction with their responsibilities for the FREEDOM4 Limited (formerly Pipex Wireless Limited) joint venture.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS CONTINUED

## for the year ended 31 December 2007

### C2. DIRECTORS' REMUNERATION CONTINUED

#### DIRECTORS' SHARE OPTIONS

	Note	At 1 January 2006	Granted	Exercised/lapsed	At 31 December 2007	Exercise price	Exercise Period
S Porter	(i)	989,130	–	–	<b>989,130</b>	1.00p	20 Nov 2001 to 19 Nov 2011
	(ii)	750,000	–	–	<b>750,000</b>	3.00p	20 Nov 2001 to 19 Nov 2011
	(ii)	2,693,583	–	–	<b>2,693,583</b>	1.00p	20 Nov 2001 to 19 Nov 2011
	(ii)	2,602,440	–	–	<b>2,602,440</b>	3.00p	27 Dec 2001 to 26 Dec 2011
	(iii)	5,253,000	–	–	<b>5,253,000</b>	4.50p	27 Dec 2001 to 26 Dec 2011
	(i)	3,455,313	–	–	<b>3,455,313</b>	2.25p	20 Feb 2003 to 19 Feb 2013
	(iv)	17,939,247	–	–	<b>17,939,247</b>	2.25p	20 Mar 2003 to 19 Mar 2013
	(vi)	2,333,333	–	–	<b>2,333,333</b>	7.50p	11 Apr 2005 to 10 Apr 2015
	(vii)	3,368,421	–	–	<b>3,368,421</b>	14.25p	7 Apr 2006 to 6 Apr 2016
(viii)	–	4,452,830	–	<b>4,452,830</b>	13.25p	17 Jan 2007 to 16 Jan 2017	
M Read	(ii)	9,650,000	–	–	<b>9,650,000</b>	6.25p	24 Oct 2003 to 23 Oct 2013
	(v)	1,600,000	–	–	<b>1,600,000</b>	6.25p	24 Oct 2003 to 23 Oct 2013
	(vi)	2,933,333	–	–	<b>2,933,333</b>	7.50p	11 Apr 2005 to 10 Apr 2015
	(vii)	4,210,526	–	–	<b>4,210,526</b>	14.25p	7 Apr 2006 to 6 Apr 2016
	(viii)	–	6,037,735	–	<b>6,037,735</b>	13.25p	17 Jan 2007 to 16 Jan 2017
P Dubens	(ii)	8,400,000	–	–	<b>8,400,000</b>	6.25p	24 Oct 2003 to 23 Oct 2013
	(v)	1,600,000	–	–	<b>1,600,000</b>	6.25p	24 Oct 2003 to 23 Oct 2013
	(vi)	3,333,333	–	–	<b>3,333,333</b>	7.50p	11 Apr 2005 to 10 Apr 2015
	(vii)	4,912,280	–	–	<b>4,912,280</b>	14.25p	7 Apr 2006 to 6 Apr 2016
	(viii)	–	6,792,452	–	<b>6,792,452</b>	13.25p	17 Jan 2008 to 16 Jan 2017
L Blackall		–	–	–	–		
C Kennedy		–	–	–	–		

(i) EMI Scheme - no performance criteria attached.

(ii) Unapproved Scheme - no performance criteria attached.

(iii) Unapproved Scheme - were exercisable once the company's market capitalisation reached £25.0 million.

(iv) Unapproved Scheme - 10,697,290 were exercisable when the company's share price reached 5.00p and it is EBITDA positive, measured on a monthly basis. The remaining 7,241,957 were exercisable once the company's share price reached 3.00p and the company was EBITDA positive, measured on a monthly basis.

(v) EMI Scheme - were exercisable once the company's share price reached 9.00p and the company was EBITDA positive, measured on a monthly basis.

(vi) Unapproved Scheme - were exercisable once the company's share price reached 12.00p.

(vii) Unapproved Scheme - exercisable once the company's share price reaches 18.00p and is within three years of date of grant.

(viii) Unapproved Scheme - 60% are exercisable after 17 January 2008 and 40% exercisable after 17 January 2009.

## C2. DIRECTORS' REMUNERATION CONTINUED

### DIRECTORS' SHARE OPTIONS CONTINUED

No directors in office at 31 December 2007 exercised any share options during the year. At 31 December 2007 directors of the company held the following warrants over ordinary shares in the company:

	Warrants	Exercise price
M Read	15,000,000	6.25p
P Dubens	50,000,000	6.25p
M Read	10,000,000	10.50p
M Read	10,000,000	10.50p
P Dubens	17,500,000	10.50p
P Dubens	17,500,000	10.50p
S Porter	2,500,000	10.50p
S Porter	2,500,000	10.50p

As at 31 December 2007 the above warrants at 6.25p were exercisable at any time, the performance criteria attaching to the warrants having been met.

Warrants at 10.50p are exercisable in two stages. 50% can now be exercised at any time, the performance criteria attaching to the warrants having been met, with the remaining 50% exercisable on the share price reaching 21.00p.

The mid-market price for the company's shares at 31 December 2007 was 8.47p. The high and low mid-market prices of the ordinary shares during the year to 31 December 2007 were 17.00p and 6.98p respectively.

## C3. INVESTMENTS

	Subsidiary undertakings £'000	Joint ventures £'000	Total £'000
<b>Cost</b>			
At 1 January 2007 (restated note C12)	167,555	14,657	182,212
Additions	958	2,805	3,763
Disposals	(116,882)	-	(116,882)
<b>At 31 December 2007</b>	<b>51,631</b>	<b>17,462</b>	<b>69,093</b>
<b>Amounts provided</b>			
<b>At 1 January 2007 and 31 December 2007</b>	<b>740</b>	<b>-</b>	<b>740</b>
<b>Net book value</b>			
<b>At 31 December 2007</b>	<b>50,891</b>	<b>17,462</b>	<b>68,353</b>
At 31 December 2006	166,815	14,657	181,472

Additions of £948,000 represents a late payment of a government grant in relation to Toucan Residential Ireland Limited that was agreed to be transferred to IDT Global Limited as part of the acquisition cost for Toucan Residential Limited. The remaining £10,000 is due to legal fees related to Switch2 Telecoms Limited.

The addition to the investment in the joint venture is due to an additional contribution by the company of £2,058,000 and interest receivable of £747,000 on the loan.

The investments disposed of were the investments in the broadband and voice companies which were sold during the year (note 18).

The company's principal subsidiary undertakings included in the financial statements are as follows:

Company	Country of registration or incorporation	Shares held class	Proportion of shares held	Nature of business
Compulink Information Exchange Limited	England and Wales	Ordinary	100%	Telecommunications
FREEDOM4 Finance (Jersey) Limited (formerly Pipex Finance (Jersey) Limited) <sup>(i)</sup>	Jersey	Ordinary	100%	Financing (non-trading)
GXN Limited	Scotland	Ordinary	100%	Holding company
GX Networks Limited (formerly Pipex Communications UK Limited) <sup>(i)</sup>	England and Wales	Ordinary	100%	Telecommunications
Host Europe GmbH	Germany	Ordinary	100%	Telecommunications
SupaNetwork Limited <sup>(i)</sup>	England and Wales	Ordinary	100%	Telecommunications
XTML Limited	England and Wales	Ordinary	100%	Telecommunications

(i) Directly owned by the company.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS CONTINUED

## for the year ended 31 December 2007

### C3. INVESTMENTS CONTINUED

All subsidiaries operate in the United Kingdom with the exception of Host Europe GmbH which operates in Germany and FREEDOM4 Finance (Jersey) Limited (formerly Pipex Finance (Jersey) Limited) which operates in Jersey. All the above subsidiaries have been classified as held for sale at year end with the exception of FREEDOM4 Finance (Jersey) Limited.

### C4. DEBTORS

	2007 £'000	2006 £'000
Amounts due from subsidiary undertakings	16,899	72,267
Other debtors	11,078	157
Prepayments and accrued income	165	530
	<b>28,142</b>	<b>72,954</b>

Included within other debtors are rent deposits of £262,500 (2006: £132,000) which are recoverable after more than one year.

### C5. CASH AT BANK AND IN HAND

Cash at bank and in hand per the company balance sheet comprises £44,469,000 (2006: £8,343,000) held in current accounts, money market accounts and no-notice deposit accounts.

### C6. CREDITORS DUE WITHIN ONE YEAR

	2007 £'000	2006 £'000 (restated note C12)
<b>Amounts falling due within one year:</b>		
Trade creditors	669	1,440
Amounts owed to group undertakings	–	3,919
Other tax and social security costs	–	261
Other creditors	76	455
Accruals and deferred income	1,049	368
	<b>1,794</b>	<b>6,443</b>

### C7. CREDITORS DUE AFTER MORE THAN ONE YEAR

	2007 £'000	2006 £'000
<b>Amounts falling due after more than one year:</b>		
Bank loan	–	35,000
Convertible bonds	–	82,879
	–	<b>117,879</b>

The bank loan was secured by means of fixed and floating charges over the assets of the company, fell due for repayment between two and five years from the balance sheet date, and carries interest at a variable rate of LIBOR plus 1.75%. The bank loan was repaid on 17 December 2007.

### C8. CONVERTIBLE BONDS

On 23 March 2006 FREEDOM4 (Jersey) Limited (formerly Pipex Finance (Jersey) Limited) announced the private placement of £80,000,000 3.875% Guaranteed Convertible Bonds 2011 and were convertible into ordinary shares of the company at a conversion price of 19p. In addition Lehman Brothers (International) Europe was granted the option to increase the size of the issue by an additional £20,000,000. The company received subscriptions for £91,500,000.

The company had an option to call the bonds after three years, should the price of the company's ordinary shares exceed 130% of the conversion price over a fixed period.

Expenses of the bonds were £3,221,000 giving rise to net proceeds of £88,279,000.

The net proceeds received from the issue of the convertible bonds were split between the equity component and a liability element representing the fair value of the embedded option to convert the liability into equity of the company.

On 12 October 2007 FREEDOM4 (Jersey) Limited exercised its option to redeem the 3.875% Guaranteed Convertible Bonds due 2011 pursuant to Condition 9(b) of the bonds. Each bond was redeemed at its principal amount of £1,000 plus a premium of £20 together with accrued interest. The total cost for the redemption of the principal and premium was £93,330,000.

The liability component of the bond increases as the present value of the interest payments, calculated using a market rate of interest, increase offset by cash interest payments made. The residual amount, representing the value of the equity conversion component of the bond, was valued at £7,692,000 just prior to the redemption date.

## C8. CONVERTIBLE BONDS CONTINUED

The value of the convertible bonds recognised in the balance sheet is calculated as follows:

	£'000
Nominal value of convertible bonds issued	91,500
Costs of issue	(3,221)
Net proceeds	88,279
Equity component	(7,692)
Liability component at date of issue	80,587
Finance costs	4,065
Cash interest paid	(1,773)
Liability component at 31 December 2006	82,879
Finance costs	4,610
Cash interest paid	(3,681)
Redemption of bond principal	(83,808)
<b>Liability component at 31 December 2007</b>	<b>–</b>

Finance cost on the bond is calculated using the effective interest method by applying the effective interest rate of 6%.

## C9. PROVISIONS FOR LIABILITIES AND CHARGES

	2007 £'000	2006 £'000
At 1 January	267	348
Additional provisions in the year	2,000	–
Amounts reversed in the year	(48)	(81)
At 31 December	2,219	267

The £2,000,000 provision is against the £10,500,000 receivable from the escrow account in relation to the sale of the broadband and voice business.

The provision relates to national insurance payable on the exercise of share options and is utilised as and when the share options are exercised.

## C10. SHARE CAPITAL AND RESERVES

### (i) SHARE CAPITAL

	2007 £'000	2006 £'000
<b>Authorised:</b>		
4,000,000,000 ordinary shares of 1p each	40,000	40,000
<b>Issued and fully paid:</b>		
At the start of the year, 2,393,074,923 (2006: 2,210,059,488) ordinary shares of 1p each	23,931	22,101
Issued during the year, 16,156,431 (2006: 183,015,435) ordinary shares of 1p each	161	1,830
At the end of the year, 2,409,231,354 (2006: 2,393,074,923) ordinary shares of 1p each	24,092	23,931

Share capital issued at nominal value in the year relates to the exercise of share options. The company has one class of ordinary shares which carry no right to fixed income.

### (ii) RESERVES

	Share capital £'000	Share premium account £'000	Merger reserve <sup>(i)</sup> restated (note C12) £'000	Bond equity reserve £'000	Profit and loss account £'000	Total £'000
Opening balance at 1 January 2007 (restated note C12)	23,931	96,215	17,638	7,692	(7,297)	138,179
Issue of shares	161	633	–	–	–	794
Disposal of subsidiaries (note 18)	–	–	(9,519)	–	9,519	–
Bond repayment (note C8)	–	–	–	(7,692)	–	(7,692)
Share based payment costs	–	–	–	–	3,377	3,377
Profit for the year	–	–	–	–	2,293	2,293
<b>Balance at 31 December 2007</b>	<b>24,092</b>	<b>96,848</b>	<b>8,119</b>	<b>–</b>	<b>7,892</b>	<b>136,951</b>

(i) The previously reported 2006 merger and other reserves have been reported together as merger reserves as they are both of the same nature being premium arising on shares issued to acquire subsidiaries.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS CONTINUED

## for the year ended 31 December 2007

### C10. SHARE CAPITAL AND RESERVES CONTINUED

#### (ii) RESERVES CONTINUED

The merger reserve represents the share premium on shares issued to acquire XTM Limited and Compulink Information Exchange Limited (£796,000), Donhost Limited (£1,542,000), Firstnet Services Limited (£2,309,000) and the premium on shares issued as part of the consideration for the acquisition of Transigent Limited (£3,472,000).

The disposal of subsidiaries relates to the share premium issued at the time of the acquisition of Toucan Residential Limited and Pipex Internet Limited.

### C11. EQUITY SHAREHOLDERS' FUNDS

#### RECONCILIATION OF THE MOVEMENT IN EQUITY SHAREHOLDERS' FUNDS

	2007 £'000	2006 (restated note C12) £'000
<b>Loss for the financial year</b>	<b>2,293</b>	11,499
New share capital subscribed (net of issue costs)	794	13,634
Share capital issued on acquisitions during the year	–	4,751
(Settlement)/issue of equity component of convertible bonds (note 28)	<b>(7,692)</b>	7,692
Share based payment costs	<b>3,377</b>	2,206
Exercise of share options	–	2,161
<b>Net increase in equity shareholders' funds</b>	<b>(1,228)</b>	41,943
Opening equity shareholders' funds	<b>138,179</b>	96,236
<b>Closing equity shareholders' funds</b>	<b>136,951</b>	138,179

### C12. PRIOR YEAR ADJUSTMENT

During the consolidation workings prepared by the company as part of the sale of the broadband and voice businesses, it was noted that certain inter-group transactions had been incorrectly recorded. Due to the significance of the amounts and/or the nature of the error, it was deemed appropriate to correct these errors as prior year adjustments.

#### (i) SALE OF PIPEX NETWORKS LIMITED TO PIPEX BROADBAND LIMITED

On 31 December 2003, FREEDOM4 Communications plc (formerly Pipex Communications plc) sold Pipex Networks Limited to Pipex Broadband Limited (formerly Pipex Internet Limited, then Zipcom Telecommunications Limited). The consideration received by the plc was £56,322,900 but was recorded at the time at £47,500,000. The company has restated its prior year reserves with a credit of £8,822,900.

#### (ii) SALE OF PIPEX BROADBAND LIMITED TO PIPEX INTERNET LIMITED

On 1 January 2006, FREEDOM4 Communications plc (formerly Pipex Communications plc) sold Pipex Broadband Limited (then Pipex Internet Limited) to Pipex Internet Limited (then Nildram Limited) for £60,000,000 but the consideration was incorrectly recorded at £56,322,900. In addition, the cost of investment was recorded as £57,365,265 whereas the correct value was £56,322,900. The company has restated its prior year reserves with a credit to reserves of £4,719,465 to reflect the correct profit on sale.

#### (iii) SALE OF FREEDOM TO SURF LIMITED TO PIPEX INTERNET LIMITED

On 1 January 2006, FREEDOM4 Communications plc (formerly Pipex Communications plc) sold Freedom to Surf Limited to Pipex Internet Limited (then Nildram Limited). The cost of investment disposed of was understated by £50,000. The company has restated its prior year reserves with a debit of £50,000 to reflect the correct investment disposed of.

During the consolidation workings prepared by the company as part of the sale of the broadband and voice businesses, it was noted that certain inter-group transactions had been incorrectly recorded. Due to the significance of the amounts and/or the nature of the error, it was deemed appropriate to correct these errors as prior year adjustments.

#### (iv) SALE OF HOST EUROPE LIMITED TO PIPEX COMMUNICATIONS UK LIMITED

In 2004 prior to the sale of Host Europe Limited (formerly Host Europe Plc) by FREEDOM4 Communications plc (formerly Pipex Communications plc) to GX Networks Limited (formerly Pipex Communications UK Limited), a payment for share options of £862,000 made to Host Europe Limited's employees was incorrectly recorded as a reduction in FREEDOM4 Communications plc's (cost of investment for the purchase of Host Europe Limited). This refund was due to Host Europe Limited (now part of the trading activities of GX Networks Limited). In addition, the original loss on disposal of £460,000 was omitted from the company's accounts. Consequently, the company has restated its prior year reserves with a debit of £1,322,000 to reflect the revised loss on the subsequent sale of Host Europe Limited to GX Networks Limited.

## C12. PRIOR YEAR ADJUSTMENT CONTINUED

### (V) PURCHASE OF FIRSTNET SERVICES LIMITED

On 28 August 2003, FREEDOM4 Communications plc (formerly Pipex Communications plc) purchased Firstnet Services Limited for consideration that consisted of cash and shares within FREEDOM4 Communications plc. The £2,309,000 premium arising on the shares issued to vendor parties was credited to the share premium account in error instead of the merger reserve. The share premium and merger reserve accounts have been restated to reflect the correct accounting treatment.

### (VI) JOINT VENTURE

On 22 March 2006 the group jointly formed FREEDOM4 Limited (formerly Pipex Wireless Limited) with Intel Capital (Cayman) Corporation. As a result of setting up the joint venture, the company incurred legal costs of £236,900 which were incorrectly capitalised as part of the cost of investment in joint venture. This cost should have been expensed to the profit and loss account in the year, which has now been reflected in the 2006 comparatives of the financial statements. These legal costs were correctly included within the consolidated statement of total recognised gains and losses as part of the unrealised loss on disposal of £9,533,000 as stated in the prior year consolidated financial statements.

In addition, as a result of forming the joint venture, the company sold its investments in FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) and Faultbasic Limited to FREEDOM4 Limited on 31 March 2006 for £13,624,000 consideration that was satisfied by the issue of convertible redeemable preference shares in the joint venture. At the time of disposal, the carrying value of the investment in subsidiary was £7,014,000. The company did not correctly record the unrealised gain of £6,610,000 and a corresponding increase in its carrying value of investment in joint ventures. The company has restated its carrying value in investment in joint ventures by £6,610,000 with a corresponding unrealised gain in its prior year reserves.

Later in 2006, the company injected cash of £561,000 in FREEDOM4 Limited in exchange for convertible redeemable preference shares at carrying value.

The joint venture recorded an interest charge on the preference shares at an effective interest rate of 6%. In 2006, FREEDOM4 Communications plc (formerly Pipex Communications plc) did not record an interest receivable amount in relation to the convertible redeemable preference shares that it received during the year. The company has restated its profit and loss account with an interest receivable amount for £472,000 with a corresponding increase in the carrying value of its investment FREEDOM4 Limited.

	As reported £'000	Sale of Pipex Networks Limited £'000	Sale of Pipex Broadband Limited £'000	Sale of Freedom to Surf Limited £'000	Sale of Host Europe Limited £'000	Purchase of Firstnet Limited £'000	Joint venture costs £'000	As restated £'000
Cost of investment	161,135	8,822	4,719	(50)	–	–	6,846	181,472
Current assets	81,296	–	–	–	–	–	–	81,296
Creditors falling due within one year	(5,121)	–	–	–	(1,322)	–	–	(6,443)
Creditors falling due after one year	(117,879)	–	–	–	–	–	–	(117,879)
Provision for liabilities	(267)	–	–	–	–	–	–	(267)
<b>Net assets</b>	<b>119,164</b>	<b>8,822</b>	<b>4,719</b>	<b>(50)</b>	<b>(1,322)</b>	<b>–</b>	<b>6,846</b>	<b>138,179</b>
Called up share capital	23,931	–	–	–	–	–	–	23,931
Share premium accounts	98,524	–	–	–	–	(2,309)	–	96,215
Merger reserves (i)	15,329	–	–	–	–	2,309	–	17,638
Bond equity reserve	7,692	–	–	–	–	–	–	7,692
Profit and loss	(26,312)	8,822	4,719	(50)	(1,322)	–	6,846	(7,297)
	<b>119,164</b>	<b>8,822</b>	<b>4,719</b>	<b>(50)</b>	<b>(1,322)</b>	<b>–</b>	<b>6,846</b>	<b>138,179</b>

(i) The merger and other reserves have been reported together as merger reserves as they are both of the same nature being premium arising on shares issued to acquire subsidiaries.

The effect of the above prior year adjustments on the basic and diluted earnings per share is an increase of 0.81p and 0.78p respectively in 2006.

# **NOTES TO THE COMPANY FINANCIAL STATEMENTS CONTINUED**

## for the year ended 31 December 2007

### **C13. RELATED PARTY TRANSACTIONS**

Peter Dubens, an executive director of the company, was a director of the following companies:

Oakley Capital Limited which provided services to the group of £795,000 (2006: £146,000) of which £21,000 (2006: £39,000) was outstanding at the end of the year end. Oakley Capital Limited was also a customer of the company and accounted for sales of £43,000 (2006: £6,000), of which £5,000 (2006: £1,400) was outstanding at the end of the year.

365 Media Group plc (formerly ukbetting plc) and its fellow group companies, provided services to the group of £71,000 (2006: £590,000) of which £nil (2006: £920,000) was outstanding at the end of the year end. 365 Media Group plc (formerly ukbetting plc) was also a customer of the company and accounted for sales of £88,000 (2006: £350,000), of which £14,000 (2006: £510,000) was outstanding at the end of the year. Peter Dubens ceased to be a director of 365 Media Group plc (formerly ukbetting plc) on 23 January 2007.

Peter Dubens and Mike Read are directors of FREEDOM4 Limited. FREEDOM4 Limited (formerly Pipex Wireless Limited) is accounted for as a joint venture. FREEDOM4 Limited was a customer of the company and accounted for sales of £61,000 (2006: £nil), of which £1,000 (2006: £nil) was outstanding at the end of the year.

On 31 March 2006 the group sold the entire share capital of its subsidiary, FREEDOM4 Access Limited (formerly Pipex Communications Business Solutions Limited) and Faultbasic Limited to its joint venture FREEDOM4 Limited.

### **C14. POST BALANCE SHEET EVENTS**

On 24 January 2008, in accordance with shareholder agreement, Intel Capital Corporation contributed an additional £3,309,000, and FREEDOM4 Communications plc (formerly PIPEX Communications plc) an additional £3,913,000, to the FREEDOM4 Limited (formerly Pipex Wireless Limited) joint venture.

On 14 March 2008, the company announced that it had entered into an agreement for the sale of the hosting and network services businesses to Host Europe WVS Limited (a wholly owned subsidiary of Oakley Capital Private Equity L.P.) for £120 million. On 2 April 2008, the company sold the businesses to Host Europe WVS Limited a wholly owned subsidiary of Oakley Capital Private Equity L.P. Consideration for the sale was £120.0 million satisfied by £92.5 million in cash, £17.5 million in loan notes (issued by a wholly owned subsidiary of Oakley Capital Private Equity L.P.) and the assumption by the buyer of the division's debts. Peter Dubens, an executive director of the company is a director of Oakley Capital Private Equity L.P.

On 15 March 2008, the company made a conditional offer to its shareholders to buy back 58% of their shareholdings for a minimum price of 10p per share, capped at 11p per share, by way of two tender offers. On 19 March 2008 the court approved a capital reduction scheme to eliminate the deficit on the company's profit and loss account and create distributable reserves to facilitate the return of cash to shareholders. The take up by shareholders of the offers was high such that 95.8% of those shares capable of being tendered were tendered and the tender price was set at 10.39p. On 4 April 2008 Collins Stewart acquired 1,459,600,083 shares by means of an on-market transaction at the tender price as a result of the first tender offer. On 7 April 2008 Collins Stewart acquired 30,175,256 shares by means of an on-market transaction at the tender price as a result of the second tender offer. Following the cancellation of the tendered shares and exercise of share options of 151,085,002, the company had 1,070,541,017 of ordinary shares of 0.1p each left in issue.

During April 2008, the company acquired the trade and assets of BOZII Limited, a WiFi roaming service provider, through the company's subsidiary FREEDOM4 WiFi Limited.

The company has not incurred any capital commitments nor are there any capital contingencies post balance date.

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