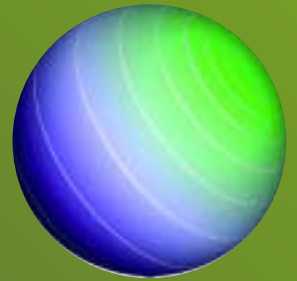




Annual report & accounts **2003**



Business communication made simple



Business communication made simple

“PIPEX has consistently delivered reliable Internet services, ensuring our network of 47 independent Wildlife Trusts stays connected both internally and externally.”

The Wildlife Trust

“The scalability of the solutions provided by PIPEX can not only cope with the constant changes in the service requirements and working practices of incoming and outgoing clients, but it is also responsive to an organisation’s evolving needs and the 24 hour demands of international businesses. This has enabled us to offer a truly flexible service to our clients.”

Stonemartin Corporate Centres

“The support service itself has been excellent. The maintenance of the account and the account manager has also been of high standards. In network management you have enough problems, so it is nice to be able to just think, well that’s sorted.”

Birmingham City Council

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Chairman's Statement



Coventry University

"We have an excellent partnership with PIPEX and we are delighted with every aspect of the connection and service the company provides."

Overview

2003 was an extremely important year in the development of the group. Our transformation plan has had three clear objectives:

- To grow the Company by acquisition
- To use our increased scale to leverage our infrastructure and operational assets
- To refocus our product portfolio on the fastest growing sectors of the market.

In July 2003 we acquired XTM Ltd and Compulink Information eXchange Ltd (for £1.0 million) and, in August 2003, we acquired Firstnet Services Ltd (for £7.0 million), culminating in the acquisition of PIPEX Internet Limited in October 2003 (for £57.4 million). This acquisition, and the realisation of cost synergies of the new enlarged group, enabled PIPEX to become EBITDA positive on a month-by-month basis by the year end. Gross margins also benefited, increasing to 43.5% from 24.5% in the year ended 31 December 2003. During the period the management team generated significant cost synergies from the enlarged group, resulting in cost savings of £15.2 million on an annualised basis. These are made up principally of staff savings (£9.5 million), network (£3.9 million) and property costs (£1.3 million).

The newly acquired businesses, as well as bringing their own very important infrastructure assets such as data centres and radio licences, have been integrated to benefit from PIPEX's national network, billing and finance as well as sales and marketing operations. From a product perspective, these acquisitions have enhanced our capabilities in the broadband and hosting sectors which we see as currently the most important and fastest growing in our market.

Operational performance

Turnover for the year was £35.2 million versus £8.1 million last year, with 48.7% of the growth a result of the acquisitions. We now have a balanced portfolio of products with a gross margin that has increased to 43.5% in the year ended 31 December 2003, up substantially from 24.5% in the prior year. We expect this balanced product portfolio to provide a stable foundation for our gross margin during the course of 2004. The increase in gross margin has been achieved through the attainment of scale and by a substantial restructuring of the business.

Network and products

We are now well positioned in the data services market, providing services across all market sectors from home users to large companies. Broadband is at the heart of our business, and we believe that we are the 5th largest supplier of ADSL in the United Kingdom. Broadband is the fastest growing area in the telecommunications sector and PIPEX has demonstrated that it has the infrastructure and team to deliver strong growth. PIPEX has an infrastructure "light" model and has over 100 network points of presence ("PoPs") in the United Kingdom on its long term IRU on the Fibernet network.

We acquired additional hosting capabilities during the year from two of our acquisitions and now have four data centres. We anticipate that the demand for hosting services will increase as broadband penetration rises. The additional hosting products that we now have will enhance our service mix and improve "stickiness" within our customer base.

PIPEX, with its broad product offering, is well positioned to develop its broad suite of "managed



services" for those of its customers looking to improve the efficiency of their businesses through outsourcing. PIPEX will be able to differentiate its products as it develops a greater portfolio of Internet Protocol ("IP") products including voice over IP ("VoIP"). As PIPEX delivers these products, customers will become increasingly linked to our business and this multi-strand connection will help grow and protect our revenues and margins.

Team

The integration of our businesses has been completed by an excellent team that has been led by Chief Executive Officer, Mike Read. Our team has worked tirelessly with our customers and suppliers to help us improve our business performance during the integration process. We would like to thank all our staff for their hard work during this period of acquisition and expansion.

Board changes

Following the successful integration of PIPEX Internet into the group, David Rickards, Chief Operating Officer, will be stepping down from the Board in order to spend more time with his family. The resignation is effective immediately. The Board wishes to thank David for his valuable contribution during his time with the company and wishes him well in the future.

Financing

We completed three institutional fundraisings totalling £43.2 million (net of expenses) during the year to finance the acquisitions and to strengthen our balance sheet. PIPEX remains an acquisitive business and we would return to the equities and/or debt markets in order to fund further consolidation in the sector.

Outlook

We are confident in our ability to increase revenues in 2004 – both organically and by acquisition.

- We remain committed to our business model with its low capital expenditure requirements
- We continue to focus on higher margin, lower churn products
- We will remain committed to the technical excellence and customer service on which our reputation is based and which has brought us so many industry awards.

Finally I would like to thank you, the shareholders, for your support over the past year which has been such a major contribution to our success.

Peter Dubens

Chairman

1 April 2004

Chief Executive Officer – Business Review



Gameplay GB
 “PIPEX offered Gameplay GB a secure environment to host our infrastructure and some great opportunities to expand our services in the future.”

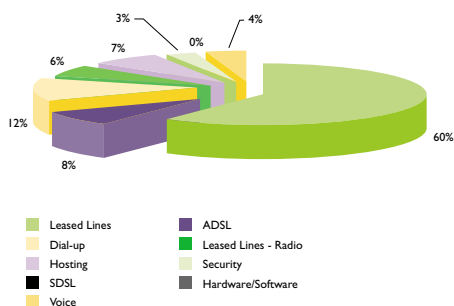
Welcome to our first annual report as PIPEX Communications plc. I am delighted that you join me in reflecting upon our commercial success over the last year, which saw us achieve a turnover in excess of £35 million.

As many of you will already know, PIPEX Communications today is the result of the combination of PIPEX Internet Limited with five established business telecom providers; Zipcom plc, GX Networks, Compulink Information eXchange Limited (CIX) and XTML Limited (which were previously part of the Telenor Group) and Firstnet Services Limited. These acquisitions have been completed against the backdrop of consolidations in the telecommunications market, which we expect to continue throughout the remainder of 2004 and into 2005.

As well as giving the group critical mass, these acquisitions have significantly extended the physical infrastructure of the group; they have broadened the service portfolio and extended the geographical reach of the business. Most importantly, perhaps, each acquisition has brought incremental efficiencies and economies of scale to the group.

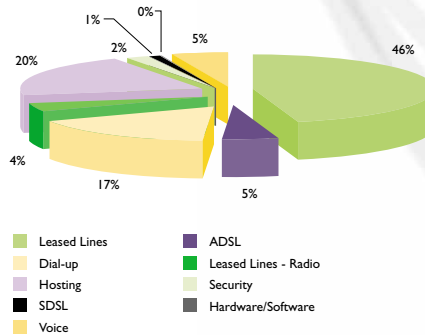
The GX/Zipcom merger saw:

- Decreasing dependence on highly price sensitive leased line revenue
- Launch of SDSL in 2003
- Voice revenues building
- Dial-up benefiting from higher revenue share from network operators.



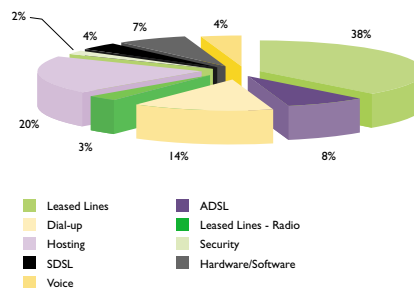
The CIX/XTML acquisition saw:

- Leased line dependence further reduced
- Hosting revenues accounting for 20% of the product mix (from 7%)
- The introduction of Oracle expertise.



The Firstnet acquisition saw the:

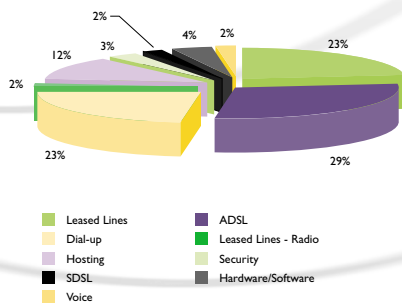
- Product portfolio becoming much more balanced with leased lines only accounting for 38% of revenues
- Introduction of a DSL wireless product
- Hosting maintained at 20%
- Introduction of new hardware and ASP software products.





PIPEX acquisition introduced:

- Over 140,000 customers
- A balancing of product portfolio
- “Dial-up” benefiting from higher revenue share from network operators
- Greater opportunity to cross sell to much larger customer base
- The opportunity to change our Company brand from GX Networks to PIPEX.



PIPEX Internet Limited, established in 1991, was one of the UK's first commercial ISPs. Its primary focus was DSL services which are forecast to be one of the fastest growing connectivity technologies over the coming years. There were immediate efficiencies to be achieved by migrating our existing GX Networks dial and DSL business onto the PIPEX Internet Limited network and service platform. Longer term benefits will also come from the consolidation of our financial, sales, marketing and other operational functions.

PIPEX today

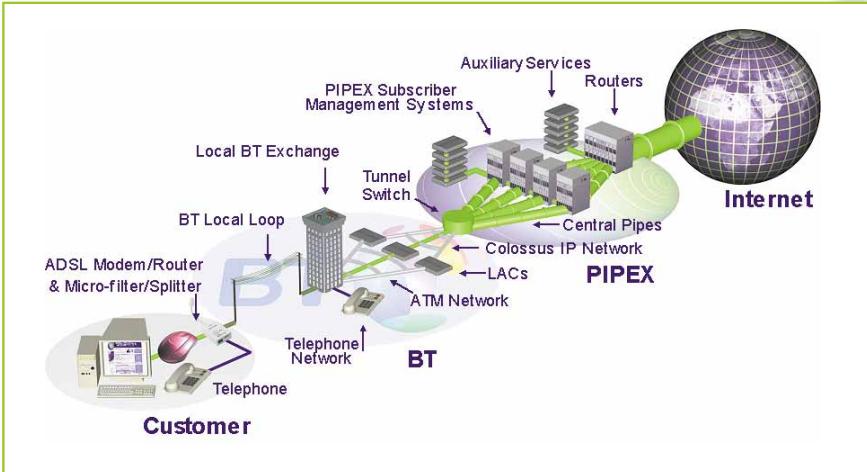
PIPEX today is set up to deliver affordable, high speed, high quality and reliable corporate Internet access and Hosting services. Honouring the same fundamental company values today, we remain committed to delivering to our customers solutions that are easy to use and are designed for businesses and professionals who appreciate that affordable, mission-critical quality and reliability have a value. Indeed, over the last eight months we have shared ideas and processes from each of the six organisations amalgamated under the PIPEX brand to enable us to replicate the best processes, support and services for the benefit of all our customers.

Unlike some other Service Providers, the PIPEX range of one-stop business-class communications solutions is about delivering genuine business benefits, rather than just technology solutions designed to help customers increase productivity and profitability.

With our Tier I status, proven track record, breadth of services and industry defining accreditations, PIPEX is a provider for a number of the Times' Top 100 UK Companies and tens of thousands of SMEs.

Ultimately it is the strength of the PIPEX network that is responsible for our overwhelming success, with nearly 50% of new Broadband customers joining as a result of recommendations from existing users.

Chief Executive Officer – Business Review continued



The infrastructure that PIPEX broadband customers utilise is unparalleled, with a total of more than 3.5 GBps of capacity already deployed, and an equal amount on order:

For our Access and Hosting customers we manage and monitor a network that has over 100 Points of Presence (PoPs) nationwide. This network is based on proven technologies such as ATM and MPLS and is able to provide Virtual Private Networking (VPN) as well as Internet connectivity.

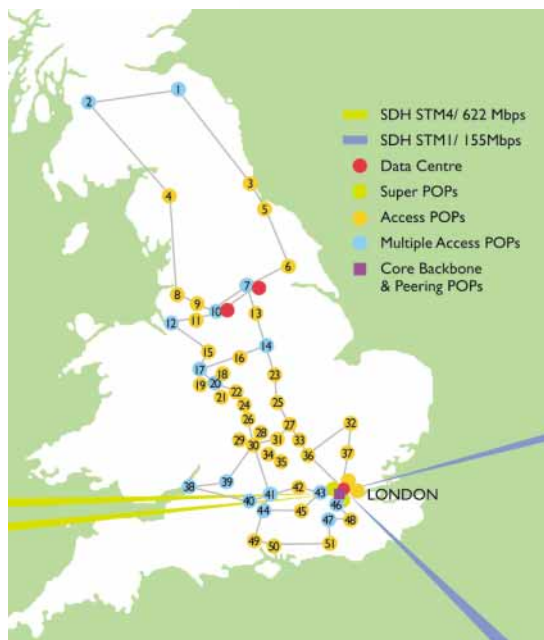
Our networking and systems mission here is simple: minimise downtime and maximise performance. We achieve this by investing and managing a multi-layer national network based on optical fibre and microwave with CISCO BPX and IGX carrier class switches. The network is designed to be:

- Scalable – providing the ability to increase capacity and extend geographical reach
- Resilient – delivering mission-critical data safely and securely
- Reliable – utilising carrier class equipment and redundancy to maintain service.

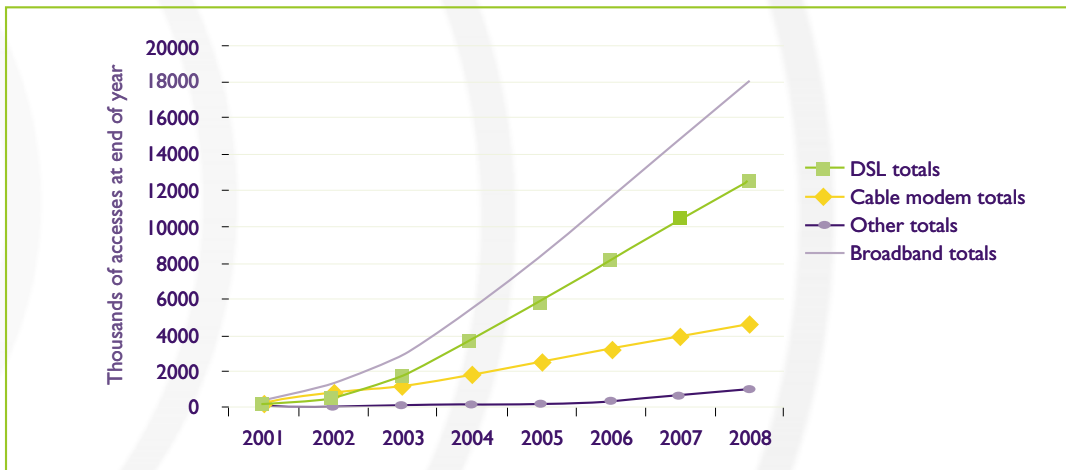
We have added data centres in London, Manchester and Leeds to our communication networks, enabling us to become one of the very few ISPs who can provide truly resilient local hosting facilities, and geographic disaster recovery. We are particularly proud that our Leeds data centre has been awarded the prestigious BS7799 accreditation, which is a demonstration of our ability to meet the highest levels of security in terms of people, physical infrastructure and processes. We have also achieved ISO 9001; 2000,

acknowledging our continued commitment to ensuring that we follow the best processes and practices in the industry.

As business becomes 24/7, the need for a secure and resilient data centre to house valuable web, email and other servers becomes more critical. PIPEX is well equipped to meet this challenge. All our data centres are highly secure and have strictly vetted access. Proactive controls are built in to ensure that any potential problems are rectified before they impact on customers. Uninterruptible Power Supplies (UPS) and environmental controls mean that whilst not totally



Projected growth of UK Broadband



eradicating, such threats are kept to a minimum. If they do arise, contingency plans are in place to manage the threat and ensure that normal business is resumed quickly.

Such commitment to support is reflected by prestigious industry awards, including Best Broadband ADSL ISP of the Year 2002 at the ISP Review Awards, Best Business ISP at the Practical Internet Magazine Readers Awards 2003 and Best Consumer Broadband ISP at the ISPA Internet Awards 2003.

PIPEX continues to build complex network solutions and to provide a range of Internet access, hosting, voice, Oracle and security services and solutions, including managed virtual private networks (VPNs) and firewalls.

We are therefore better placed than ever to target all public and private market sectors and cover the spectrum of customers from professional home users to large corporates such as Kellogg's, Sony, John Lewis and Littlewoods Gaming. By building a high quality customer base and extending it from 25,000 last year to over 150,000 today, and generating rapid revenue growth, we have an excellent opportunity to capture market share.

There are currently approximately 45,000 new DSL connections purchased each week, 78% of which are provided by the top 5 broadband providers. PIPEX is connecting one in every 12 of all non-BT owned DSL lines, and over 95% of these customers are new to PIPEX. Systems are now in place to provide high quality customer service, and this has led to over 95% of new customers signing-up on-line.

Ovum projects over 8m Broadband DSL Lines in the UK by 2006

We remain clearly focused on business broadband solutions to both businesses and prosumers, whilst educating the consumer about the technology and its benefits. We are committed to next generation technological advances, positioning ourselves as a driving force behind the UK's business broadband revolution.

Combining the best infrastructure, services and support with highly sophisticated, low touch back office systems, and employing over 400 very talented people, the result has been the emergence of PIPEX Communications as not only one of the UK's leading telecom network operators, but also as the UK's fifth largest provider of broadband solutions.

The outlook for PIPEX Communications is very promising. With the Government pledging to make broadband accessible to all by 2008, 2004 is clearly the year of broadband and will be the year of PIPEX Communications' broadband offering.

We understand the telecommunications market is competitive, but our strong business model means we are now well positioned to further develop our business through both acquisition and organic growth during 2004.

Mike Read

Chief Executive Officer

1 April 2004

Financial Review



Datasharp

“Over the past few years, PIPEX have proven to be flexible to our ever growing business needs. Today they provide us with the support and delivery of a breadth of Internet services.”

Transactions

Placing

On 31 March 2003 the Company placed 236,667,000 shares with institutional investors at 2.125p to raise £5.03 million (£4.8 million net of expenses). The new shares were admitted to AIM on 31 March 2003.

XTML and CIX acquisition

On 18 July 2003 the Company acquired XTML Limited and Compulink Information eXchange Limited which had previously formed part of the Telenor Group. The total consideration payable in respect of these acquisitions was £1.0 million, which was satisfied entirely by the allotment of 20,366,599 shares at a price of 4.91p.

Net liabilities acquired were £0.7 million giving rise to goodwill of £1.7 million.

Firstnet acquisition

On 28 August 2003 the Company acquired Firstnet Services Limited for a total consideration (excluding acquisition costs) of £6.6 million. This was satisfied by £4.1 million in cash and a further £2.5 million to be issued as ordinary shares contingent on recovering a specified proportion of acquired trade debtors. The effective cash consideration was £3.2 million as £0.9 million of the consideration was used by the vendors to repay an intercompany debt due to Firstnet. Allotment of the shares was deferred until no sooner than April 2004.

After fair value adjustments, Firstnet had net assets on the acquisition date of £0.9 million giving rise to goodwill of £6.2 million.

At the same time, the Company raised £12.4 million (£12.0 million net of expenses) through an institutional placing of 261,894,737 new ordinary shares at a placing price of 4.75p per share.

PIPEX Internet acquisition

On 28 October 2003 the Company acquired PIPEX Internet Limited for a consideration (excluding acquisition costs) of £54.9 million. The consideration was satisfied by the allotment of 80,000,000

consideration shares and the payment of £49.9 million in cash on completion. The consideration shares had a value of £5.0 million for the purposes of the acquisition agreement (valuing each consideration share at 6.25p, the same value as in the accompanying placing). At the allotment date the share price had risen to 7.5p, producing a valuation of the consideration shares for cost of investment purposes of £6.0 million.

The cash consideration was financed through a placing, a new debt facility and from the existing cash resources of the enlarged group. The placing raised £27.7 million (gross) from the issue of 443,200,000 shares at a price of 6.25p per share. The new debt facility provided £15.0 million by way of a term loan, repayable over 4 years. Following a financial assistance whitewash under Sections 151 to 158 of the Companies Act 1985, £10.0 million from existing PIPEX Internet Limited cash resources was used to fund both the balance of the cash consideration and the cost of the acquisition.

Net assets acquired were £8.1 million giving rise to goodwill of £49.3 million.

Performance

Profit and Loss

Turnover for the year was £35.2 million, representing an increase of 337% over 2002. Of this turnover, 22.0 million was derived from existing operations and £13.2 million from the four acquisitions completed in the second half of 2003. Given the timing of the acquisitions, the revenues they contribute will be very much higher in 2004.

Gross profit was £15.3 million (2002: £2.0 million), providing a margin of 43.5% (an increase of 19 percentage points over the previous year).

The gross profit for existing operations was £9.3 million, a margin of 42.3% which compares to the total gross margin in 2002 of 24.5%. Cost of sales in 2003 benefited from the network rationalisation plan implemented following the acquisition of Transigent in October 2002. Acquisitions contributed gross profit of £6.0 million at a margin of 45.6%.

Operating expenses increased in the year by £11.1 million to £24.8 million, an increase of 81%, although, measured against the growth in turnover, this is a considerable improvement. Excluding depreciation and amortisation, operating expenses were £19.4 million (2002: £11.8 million) including £5.0 million in the acquired businesses. Operating expenses (excluding depreciation and amortisation) as a percentage of turnover in existing operations were 65% which compares very favourably with 146% for 2002. This reflects the success of the programme introduced towards the end of 2002 to reduce costs through the integration of back office systems and the elimination of duplicated or overlapping overheads, as reported in our 2002 Report & Accounts. Operating expenses (excluding depreciation and amortisation) in the acquired businesses were 38% of turnover. Similar integration programmes were introduced following each of the more recent acquisitions and these have progressively delivered cost benefits in the post acquisition periods in 2003 and into 2004.

As part of the PIPEX Internet transaction it was agreed that certain directors and senior managers would be granted share options and warrants at the placing price of 6.25p. The grants were made on dates adjacent to the date of placing by which time the share price had moved up by 1.12p. Under UITF 17 the Company is required to account for the notional increase in value through the Profit and Loss account, apportioning the charge across the estimated vesting period, giving rise to a charge in 2003 of £577,000 and an estimated charge for 2004 of £942,000.

As a result of cost savings and acquisitions, EBITDA losses better than halved from £9.8 million in 2002 to £4.0 million in 2003. Acquisitions contributed positive EBITDA of £1.0 million. The full year benefit of many of the cost savings described above will not be felt until 2004.

There was an increase in the depreciation charge of £1.7 million over the previous year of which depreciation of tangible assets as a result of the acquisitions accounted for £0.9 million and the effect of a full year's charge for Transigent's assets the majority of the balance. Goodwill amortisation rose very steeply from a small negative number in 2002 (£0.1 million) to positive charge of £1.7 million in 2003. This reflects a full year charge for goodwill arising on the Transigent acquisition and part-year charges against goodwill on the 2003 purchases. Cost of goodwill in the year-end balance sheet was £64.7 million and is written off over 10 years, except for the small amount of negative goodwill which arose on the HighwayOne acquisition, amounting to £0.9 million, which is amortised over 4 years. It follows, given the significant cost of purchased goodwill, that the amortisation charge will increase significantly in 2004.

The rise in net interest payable to £0.4 million (2002: nil) reflects the cost of the £15.0 million senior debt facility in place from 28 October 2003, lower average cash balances in the year compared to 2002 and costs arising from debt in the acquired businesses, particularly a property mortgage in Firstnet and finance leases in both Firstnet and XTML.

The loss for the year was £9.9 million (2002: £11.8 million) including £1.1 million of losses arising in the acquisitions.

Balance Sheet

At the end of December 2003 fixed assets were £79.5 million, a rise of £58.5 million over 2002, mainly due to goodwill arising on the 2003 acquisitions.

The net book value of goodwill at the year end was £63.2 million (2002: £8.5 million). Of this, £48.5 million relates to the acquisition of PIPEX Internet Limited.

Current assets have grown to £22.7 million compared to £8.4 million at the end of 2002. The major contributors to this growth are trade debtors, which have increased by £4.6 million in line with the increase in turnover, and cash at bank which has increased by £7.9 million.

The increase in creditors falling due within one year arises principally from the balance sheet liabilities in the acquired businesses (amounting to £21.4 million on the acquisition dates, after fair value adjustments). There is also an amount of £3 million of the term loan repayable in 2004 and the consideration loan notes issued in connection with the Transigent purchase in 2002, amounting to £3.5 million, now falling due within one year (in 2002 these fell due after one year).

In the year, all of the issued convertible loan stock, (£1.6 million in total), converted to 57,090,909 ordinary shares at 2.75p. Other long term creditors were also reduced by the switch to short term liabilities of part of the debt and consideration loan notes above. Of the term loan, £12.0 million was payable after one year.

Cash Flow

Cash balances, including short-term deposits at the end of the year amounted to £13.3 million, (2002: £5.4 million). The company raised £43.3 million in the year through placings (net of expenses) and a further £15m from a bank loan. Purchase of the four subsidiaries in 2003 cost £39.7 million in net cash terms. Lease payments amounted to £1.4 million, capital expenditure was £1.2 million and interest payments £0.2 million.

Net debt at the year end was £11.7 million (2002: £2.5 million) comprising cash balances of £13.3 million less; the term loan £15.0 million; consideration loan notes of £3.5 million; outstanding lease obligations of £4.6 million; and a property mortgage of £1.9 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, see note 18.

Early in 2004 approximately half of the forward interest payment obligations with respect to the £15.0 million bank loan were swapped from variable rate to fixed rate.

Stewart Porter

Chief Financial Officer

1 April 2004

Directors and Advisors

Directors

Peter Dubens

Chairman

Mike Read

Chief Executive Officer

Stewart Porter

Chief Financial Officer

Christina Kennedy

Non Executive Director

Laurence Blackall

Non Executive Director

Registered Office

Carlton House
27A Carlton Drive
London
SW15 2BS

Registered Number

3974683

Auditors

KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

Stockbrokers

Collins Stewart Limited
9th Floor
88 Wood Street
London
EC2V 7QR

Solicitors

SJ Berwin
222 Gray's Inn Road
London
WC1X 8XF

Addleshaw Goddard
25 Cannon Street
London
EC4M 5TB

Registrar

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Bankers

Bank of Scotland
110 Queen Street
Glasgow
G1 3BY

Board of Directors

Peter Dubens, Chairman

Peter Dubens has experience in the start-up, development and restructuring of business both in the public and private sectors. He has led the consolidation strategy that has built PIPEX Communications plc to where it is today. Peter Dubens is also Executive Vice Chairman of ukbetting plc, the largest UK online sports content and gaming company. He is also the co-founder of Palmer Capital Management, a hedge fund introductory business, and a number of other privately held companies.

Mike Read, Chief Executive Officer

Mike has 30 years experience in the Communications and Internet Industry. He started his career in British Telecom where he gained considerable experience in international activities including: Product Management, Product Development, Engineering & Planning, Marketing and Advertising. This culminated in him working in the USA in the joint venture with MCI where he led the operational and engineering aspects of Concert. He later returned to the UK to become 'Chief of Global Engineering' which covered all engineering aspects of BT worldwide (with the exception of the UK).

During the initial 'launch phase' of the internet Mike left BT and joined ANS in the USA – one of the first internet companies which had just been purchased by AOL. His responsibilities covered Sales, Marketing, Product Management and Business Development.

In 1998 he moved to Florida to become CEO of Pacer International, a company that designed and built communication networks and systems for clients worldwide. Mike was headhunted by Pacer to run as President and COO of a consumer ISP 'roll up' in the USA called One Main. During the first 18 months over 30 companies were purchased and rolled into one company.

In 2000 Mike moved back to the UK to become CEO/MD of XO Europe, the UK arm of which was acquired by GX Networks in October 2002.

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 PIPEX 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 8 years in a number of senior financial positions, most recently as Director of Finance and Business Development in Global Markets, the business unit responsible for serving the multinational customers of Cable & Wireless.

Christina Kennedy, Non Executive Director

Christina Kennedy has a Masters Degree in Business Administration and is a Fellow of the Chartered Institute of Secretaries. For the past 20 years she has been working 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.

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. During 2001 to 2002 she 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

A former Chairman of the Internet Service Providers Association (ISPA), Laurence Blackall has a Masters degree in Marketing and over 20 years experience in 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 was then acquired by Zipcom plc and then became GX Networks plc then PIPEX Communications plc.

Directors' Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2003.

Principal activity and business review

The principal activity of the group during the period was the supply of telecommunication services. A detailed review of the business is set out in the Chairman's statement on pages 2 and 3 and the business review on pages 4 to 7 and the financial review on pages 8 and 9.

Financial results and dividends

The results for the group for the year are shown in the profit and loss account on page 21.

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 (until 3 September a non executive director)
Michael Read	Chief Executive Officer (appointed 9 September 2003)
Stewart Porter	Chief Financial Officer
David Rickards	Chief Operating Officer (appointed 28 October 2003, resigned 1 April 2004)
Christina Kennedy	Non Executive (appointed 9 September 2003)
Laurence Blackall	Non Executive (appointed 3 March 2003)
Grahame Purvis	Chairman and Chief Executive Officer (resigned 9 September 2003)
Jon Richards	Non Executive (resigned 9 September 2003)

Michael Read and Christina Kennedy, having been appointed since the last Annual General Meeting, retire in accordance with the articles of association and, being eligible, offer themselves for re-election.

Stewart Porter retires by rotation in accordance with the articles of association and being eligible, offers himself for re-election.

The directors' remuneration and the interests of the directors in the share capital of the Company are detailed in the report on directors' remuneration on pages 16 to 18.

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 maintain and develop 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.

Directors' Report (continued)

Substantial shareholdings

As of 31 March 2004, the latest practicable date prior to the publication of this report, the Company had been notified of the following significant shareholdings:

	%
UBS Warburg	16.77
P Dubens	7.66
L Blackall	7.66
Chase Nominees Limited	6.24
Clydesdale Bank	5.15
D Rickards	4.41

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 2003 as a proportion of amounts invoiced by suppliers during the period represent 45 days (2002: 48 days) for the existing business and 49 days for the acquired business. The Company has no material trade creditors.

Environmental policy

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

Annual General Meeting

The Annual General Meeting will be held on 26 May 2004 at 11.00 a.m. at 25 St James's Street, London SW1A 1HA.

Auditors

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

This report was approved by the Board on 1 April 2004.

Stewart Porter

Chief Financial Officer

Corporate Governance

Although the Company is not required to comply with the provisions of the Combined Code, the directors have decided to provide the following voluntary corporate governance disclosures. 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.

This statement considers how the relevant principles of the Combined Code on Corporate Governance ("the Code") have been applied by the Company during the year to 31 December 2003. The Board have also considered the Revised Combined Code ("the Revised Combined Code") which was effective for accounting periods beginning on or after 1 November 2003. The Revised Combined Code will be applied by the Company in the year to 31 December 2004.

The Board and Committees

At 1 January 2003 the Board comprised two executive directors (G Purvis and S Porter) and two non-executive directors (J Richards and P Dubens). G Purvis resigned and P Dubens was appointed Executive Chairman on 9 September 2003. M Read was appointed Chief Executive Officer on the same date. On 28 October D Rickards was also appointed to the Board as an executive director. L Blackall and C Kennedy were appointed to the Board on 3 March 2003 and 9 September 2003 respectively as non-executive directors, whilst J Richards resigned on 9 September 2003. At 31 December 2003 the Board therefore comprised four executive and two non-executive directors. The Board considers that the current composition provides a reasonable balance of independence. L Blackall, while a substantial shareholder, brings an independent view of the telecoms industry to Board discussions. The Board however accepts that C Kennedy is considered to be the only current independent non-executive director as defined under the Code.

An evaluation of Board performance has not been relevant due to the recent changes in the Board.

The Board, which meets on average six times a year, 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.

Following the resignation of G Purvis on 9 September 2003, the roles of Chairman and Chief Executive Officer have been separated.

The Board does not consider it necessary to appoint a senior independent director.

The Remuneration Committee consisted of J Richards, L Blackall and P Dubens until 3 September 2003. The Committee currently comprises C Kennedy and L Blackall only and is chaired by C Kennedy. The report on directors' remuneration on pages 16 to 18 contains a detailed description of remuneration and applicable policies.

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.

At 1 January 2003 the Audit Committee comprised G Purvis and J Richards. Following the Board changes noted above, from 9 September the Audit Committee comprised 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 auditors, and the executive directors present by invitation only. 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.

Corporate Governance (continued)

Relations with shareholders

The Company encourages the participation of both institutional and private investors. Communication with private individuals is maintained through the Annual General Meeting (AGM), and annual and interim reports. In addition further details on the strategy and performance of the Company can be found at its website (www.pipexcommunications.net) which includes copies of the Company's press releases.

The Chairman will be available to answer questions at the AGM. Details of the resolutions to be proposed at the AGM are set out in the notice sent to all shareholders on page 50.

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 mis-statement 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 are responsible for the identification and evaluation of key risks applicable to their areas of business.

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.

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

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 21 to 49.

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
- 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 19 to the financial statements.

Set out below are the details of total remuneration of the directors for the year:

Directors' remuneration

	Salaries & Fees £'000	Benefits £'000	Bonus £'000	Compensation for loss of office £'000	Total 2003 £'000	Total 2002 £'000	Pension 2003 £'000	Pension 2002 £'000
Executive								
M Read	66 ¹	11	28	–	105	–	2	–
S Porter	153	5	125	–	283	146	24	24
P Dubens	67	–	275	–	342	4	–	–
D Rickards	27 ²	–	–	–	27	–	–	–
G Purvis	113	3	–	168	284	147	29	24
C McKee	–	–	–	–	–	201	–	4
Non-executive								
J Richards	18	–	–	20	38	20	–	–
L Blackall	18 ³	–	–	–	18	–	–	–
C Kennedy	17 ⁴	–	–	–	17	–	–	–
P Maher	–	–	–	–	–	15	–	–
	<u>479</u>	<u>19</u>	<u>428</u>	<u>188</u>	<u>1,114</u>	<u>533</u>	<u>55</u>	<u>52</u>

¹ Appointed as a director on 9 September 2003

² Appointed as a director on 28 October 2003

³ Appointed as a director on 3 March 2003

⁴ Appointed as a director on 9 September 2003

Board Report on Directors' Remuneration (continued)

While a non executive director P Dubens received fees of £13,000 in respect of his services (included in salaries and fees above).

The bonus received by M Read was in respect of services as a director since appointment on 9 September 2003.

The bonus received by S Porter was in respect of services during the year:

The bonus received by P Dubens in the year comprised £200,000 in respect of fundraising associated with the acquisition of PIPEX Internet Limited and £75,000 in respect of services as a director since appointment as an executive director on 3 September 2003.

Shareholdings and option interests of the directors in office at 31 December 2003 are as follows:

Directors' shareholdings

	1p ordinary shares at 31 December 2003	1p ordinary shares at 31 December 2002 or on appointment
M Read	–	–
S Porter	174,500	174,500
P Dubens	138,888,889	138,888,889
D Rickards	80,000,000	80,000,000
L Blackall	138,888,889	138,888,889
C Kennedy	125,000	–

Directors' share options

	Note	At 1 Jan 2003	Awarded during the year	Cancelled during the year	At 31 Dec 2003	Exercise price	Exercise period
S Porter	(i)	989,130	–	–	989,130	1.00p	20 November 2001 to 19 November 2011
	(ii)	2,693,583	–	–	2,693,583	1.00p	20 November 2001 to 19 November 2011
	(iii)	5,253,000	–	–	5,253,000	4.50p	27 December 2001 to 26 December 2011
	(i)	750,000	–	(750,000)	–	5.75p	20 November 2001 to 19 November 2011
	(ii)	2,602,440	–	–	2,602,440	3.00p	27 December 2001 to 26 December 2011
	(i)	–	3,455,313	–	3,455,313	2.25p	20 February 2003 to 19 February 2013
	(iv)	–	17,939,247	–	17,939,247	2.25p	20 February 2003 to 19 February 2013
M Read	(ii)	–	750,000	–	750,000	3.00p	20 February 2003 to 19 February 2013
	(v)	–	1,600,000	–	1,600,000	6.25p	24 October 2003 to 23 October 2013
P Dubens	(ii)	–	9,650,000	–	9,650,000	6.25p	24 October 2003 to 23 October 2013
	(v)	–	1,600,000	–	1,600,000	6.25p	24 October 2003 to 23 October 2013
L Blackall		–	–	–	–		
C Kennedy		–	–	–	–		
D Rickards		–	–	–	–		

(i) EMI scheme – no performance criteria attached

(ii) Unapproved scheme – no performance criteria attached

(iii) Unapproved scheme – only exercisable once the Company's market capitalisation reaches £25.0 million.

(iv) Unapproved scheme – 10,697,280 are only exercisable when the Company's share price reaches 5.00p and it is EBITDA positive measured on a monthly basis. The remaining 7,236,967 are only exercisable once the Company's share price reaches 3.00p and the Company is EBITDA positive measured on a monthly basis.

(v) EMI scheme – only exercisable once the Company's share price reaches 9.00p and the Company is EBITDA positive measured on a monthly basis.

No directors in office at 31 December 2003 exercised any share options during the year.

Board Report on Directors' Remuneration (continued)

On 20 February 2003 the Remuneration Committee approved a repricing of options held by Grahame Purvis and Stewart Porter. Options previously carrying an exercise price of 5.50p were repriced to carry an exercise price of 4.50p. Options previously carrying an exercise price of 5.75p or 8.00p were repriced to carry an exercise price of 3.00p. The exercise periods on all of these options are unchanged.

At 31 December 2003 directors of the Company held the following warrants over ordinary shares in the Company:

	Warrants	Exercise price
M Read	15,000,000	6.25p
D Rickards	10,000,000	6.25p
P Dubens	50,000,000	6.25p

The above warrants can only be exercised after 1 January 2005, when the Company is EBITDA positive for a twelve month period and the Company's share price has reached 12p.

The mid-market price for the Company's shares at 31 December 2003 was 7.38p. The high and low mid-market prices of the ordinary shares during the year to 31 December 2003 were 8.25p and 2.12p respectively.

On behalf of the Board

Stewart Porter

Chief Financial Officer

1 April 2004

Statement of Directors' Responsibilities

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They 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.

Report of the Independent Auditors to the Members of PIPEX Communications plc

KPMG Audit Plc
8 Salisbury Square
London EC4Y 8BB
United Kingdom

We have audited the financial statements on pages 21 to 49.

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 the 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 are responsible for preparing the Annual Report and Accounts. As described on page 19 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

We read the other information contained in the Annual Report and Accounts, including the Corporate Governance 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 mis-statements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the group as at 31 December 2003 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor

1 April 2004

Consolidated Profit and Loss Account

for the year ended 31 December 2003

	Note	Continuing Operations		Total 2003 £'000	2002 £'000
		Existing 2003 £'000	Acquisitions 2003 £'000		
Turnover	1,2	22,004	13,214	35,218	8,059
Cost of sales		(12,699)	(7,194)	(19,893)	(6,083)
Gross profit		9,305	6,020	15,325	1,976
Operating expenses		(17,869)	(6,959)	(24,828)	(13,728)
Operating loss	3	(8,564)	(939)	(9,503)	(11,752)
Other interest receivable and similar income	5	79	–	79	202
Interest payable and similar charges	6	(335)	(134)	(469)	(212)
Loss on ordinary activities before taxation		(8,820)	(1,073)	(9,893)	(11,762)
Tax on loss on ordinary activities	7	–	–	–	–
Loss for the financial year		(8,820)	(1,073)	(9,893)	(11,762)
Loss per ordinary share – basic	27			0.9p	3.2p
– diluted	27			0.9p	3.2p

There are no recognised gains or losses other than the loss for the financial year and accordingly no Statement of Total Recognised Gains and Losses has been produced.

The loss on a historic cost basis is the same as the results reported above.

Consolidated Balance Sheet

at 31 December 2003

	Note	2003 £'000	2003 £'000	2002 £'000	2002 £'000
Fixed assets					
Intangible assets					
Positive goodwill	8	63,522		9,078	
Negative goodwill	8	(319)		(544)	
Patents	8	9		–	
Tangible assets	9		63,212		8,534
			16,264		12,445
			79,476		20,979
Current assets					
Stock	11	218		–	
Debtors	12	9,264		3,016	
Cash at bank and in hand	13	13,267		5,368	
			22,749	8,384	
Creditors: amounts falling due within one year	14	(36,476)		(16,194)	
Net current liabilities			(13,727)		(7,810)
Total assets less current liabilities			65,749		13,169
Creditors: amounts falling due after one year (including convertible debt)	15		(13,541)		(6,166)
Provisions for liabilities and charges	16		(828)		(752)
Net assets			51,380		6,251
Capital and reserves					
Called up share capital	19		18,141		7,100
Share capital to be issued	23		2,540		–
Share premium account	23		52,451		17,583
Other reserves	23		10,252		3,679
Profit and loss account	23		(32,004)		(22,111)
Equity shareholders' funds			51,380		6,251

The accounts on pages 21 to 49 were approved by the Board of Directors on 1 April 2004 and were signed on its behalf by:

Peter Dubens
Chairman

Stewart Porter
Chief Financial Officer

Company Balance Sheet

at 31 December 2003

	Note	2003 £'000	2003 £'000	2002 £'000	2002 £'000
Fixed assets					
Investments	10		18,099		10,116
Current assets					
Debtors	12	56,807		49	
Cash at bank and in hand	13	5,932		3,668	
		62,739		3,717	
Creditors: amounts falling due within one year	14	(27,395)		(2,189)	
Net current assets			35,344		1,528
Total assets less current liabilities			53,443		11,644
Creditors: due after more than one year	15		(12,000)		(5,060)
Provisions for liabilities and charges	16		(287)		–
Net assets			41,156		6,584
Capital and reserves					
Called up share capital	19		18,141		7,100
Share capital to be issued	23		2,540		–
Share premium account	23		52,451		17,583
Other reserves	23		10,045		3,472
Profit and loss account	23		(42,021)		(21,571)
Equity shareholders' funds			41,156		6,584

The accounts on pages 21 to 49 were approved by the Board of Directors on 1 April 2004 and were signed on its behalf by:

Peter Dubens
Chairman

Stewart Porter
Chief Financial Officer

Consolidated Cash Flow Statement

for the year ended 31 December 2003

	Note	2003 £'000	2002 £'000
Cash outflow from operating activities	24	(7,553)	(7,407)
Returns on investment and servicing of finance			
Interest (paid)/received		(4)	202
Interest element of finance lease payment		(217)	(190)
		(221)	12
Taxation		(344)	–
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(1,245)	(480)
Proceeds from disposals of tangible fixed assets		93	64
		(1,152)	(416)
Acquisitions			
Purchase of subsidiary undertakings	21	(39,745)	168
Cash outflow before management of liquid resources and financing		(49,015)	(7,643)
Management of liquid resources			
Cash withdrawn from deposits		304	6,041
Financing			
Issue of ordinary share capital		45,169	2,930
Expenses on issue of ordinary share capital		(1,933)	(477)
Exercise of share options		99	–
Issue of convertible loan stock		–	1,570
Repayment of loan		(40)	–
Drawdown of new loan		15,000	–
Capital element of finance lease payments		(1,381)	(1,515)
Net cash inflow from financing		56,914	2,508
Increase in cash in the period		8,203	906

Consolidated Cash Flow Statement (continued)

Reconciliation of net cash flow to movement in net debt for the year ended 31 December 2003

	2003 £'000	2002 £'000
Increase in cash in period	8,203	906
Net movement in liquid resources	(304)	(6,041)
Cash inflow from issue of convertible loan stock	–	(1,570)
Drawdown of new loan	(15,000)	–
Repayment of loan	40	–
Cash outflow from lease financing	1,381	1,515
Change in net debt resulting from cash flows	(5,680)	(5,190)
Finance leases acquired with subsidiary	(3,126)	(1,113)
Conversion of loan stock	1,570	–
Loans acquired with subsidiary	(1,919)	–
Issue of loan notes	–	(3,490)
Movement in net debt	(9,155)	(9,793)
Opening net debt	(2,500)	7,293
Closing net debt	(11,655)	(2,500)

Analysis of net debt at 31 December 2003

	At 1 January 2003 £'000	Cashflow £'000	Acquisitions (excluding cash) £'000	Other £'000	At 31 December 2003 £'000
Cash	2,639	8,203	–	–	10,842
Short term deposits	250	(250)	–	–	–
Restricted deposits	2,479	(54)	–	–	2,425
Cash at bank and in hand per balance sheet	5,368	7,899	–	–	13,267
Bank loans	–	(14,960)	(1,919)	–	(16,879)
Finance leases	(2,808)	1,381	(3,126)	–	(4,553)
Debt due in more than one year					
Convertible loan stock	(1,570)	–	–	1,570	–
Loan notes	(3,490)	–	–	–	(3,490)
Net debt	(2,500)	(5,680)	(5,045)	1,570	(11,655)

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 December 2003

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Loss for the financial year	(9,893)	(11,762)	(20,450)	(11,908)
New share capital subscribed (net of issue costs)	51,905	8,703	51,905	8,703
Share capital to be issued	2,540	–	2,540	–
Granting of options	577	–	577	–
Net increase/(reduction) in shareholders' funds	45,129	(3,059)	34,572	(3,205)
Opening shareholders' funds	6,251	9,310	6,584	9,789
Closing shareholders' funds	51,380	6,251	41,156	6,584

Notes to the Financial Statements

I Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the group's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention.

The cost of acquisitions represents the cash value of the consideration and the market value of the shares issued on the date the offer became unconditional, plus expenses.

Basis of consolidation

The consolidated financial statements include the financial statements of the company and its subsidiary undertakings made up to 31 December 2003. Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired in the year are included in the consolidated profit and loss account from the date of acquisition.

The group financial statements consolidate the financial statements of PIPEX Communications plc and all its subsidiary undertakings. As permitted by Section 230 of the Companies Act 1985, a separate profit and loss account is not presented in respect of the Company.

Going concern

The group has financed its trading losses from cash raised from share placings. As at 31 December 2003 the group had cash of £13,267,000 including £2,425,000 of restricted cash. The directors continue to monitor the group's funding strategy and have prepared detailed forecasts for future periods. These forecasts underpin the going concern basis, which the directors have applied in the preparation of the financial statements for the year ended 31 December 2003.

Turnover

Turnover comprises the value of telecommunication and related services provided net of value added tax. Income is recognised in the period in which the service is provided.

Goodwill

When the fair value of the consideration for an acquired undertaking exceeds the fair value of its separable net assets, the difference is treated as purchased goodwill and is capitalised and amortised through the profit and loss account over its estimated useful life. The economic life of goodwill has been estimated by the directors to be 10 years.

Where the fair value of the separable net assets exceeds the fair value of the consideration for an acquired undertaking the difference is treated as negative goodwill and is capitalised and amortised through the profit and loss account in the period in which the non-monetary assets acquired are recovered. In the case of fixed assets this is the period over which they are depreciated and, in the case of current assets, the period over which they are sold or otherwise realised. The economic life of negative goodwill has been estimated by the directors to be 4 years.

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

Patents purchased by the group are amortised to nil by equal annual instalments over their useful economic lives.

Notes to the Financial Statements (continued)

Tangible fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Network infrastructure	2 to 10 years
Indefeasible rights of use	Life of the contract
Office equipment	3 to 5 years
Leasehold improvements	Life of the lease
Plant and machinery	3 to 5 years

Where assets are financed under finance leases the cost is written off over the shorter of the lease term and the remaining useful economic life.

Investment in subsidiary undertakings

Investments in subsidiary undertakings are initially 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 adjustment is made.

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 ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Pension costs

The pension costs charged in the Profit and Loss Account represent the amounts of contributions payable to the group's defined contribution pension schemes in the accounting period.

Share options

The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employee's related performance.

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.

Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand. Cash for the purpose of the balance sheet includes short-term deposits and restricted deposits.

Liquid resources comprise current asset investments held as readily disposable stores of value as defined by Financial Reporting Standard 1 (Revised 1996) Cash Flow Statements. Liquid resources held in both the current and preceding year include restricted bank deposits.

Notes to the Financial Statements (continued)

2 Segmental information

The group had a single class of business during all periods reported on, and consequently does not present a segmental analysis.

The net assets of the group at the end of each period were all attributable to the United Kingdom.

The loss before tax of the group during each period was attributable to the United Kingdom.

3 Operating loss

	2003	2002
	£'000	£'000
<i>Operating loss is stated after charging/(crediting):</i>		
Auditors' remuneration:		
– audit	120	75
– other services	40	35
Depreciation and other amounts written off tangible fixed assets:		
– owned assets	1,729	809
– under finance leases	2,007	1,230
Loss on disposal of fixed assets	15	–
Amortisation of		
– negative goodwill (see note 8)	(225)	(226)
– positive goodwill (see note 8)	1,950	152
– patents (see note 8)	1	–
Rentals payable under operating leases		
– land and buildings	1,120	360
– other operating leases	1,455	545
UITF 17 charge	577	–

The auditors' remuneration includes £17,500 (2002: £15,000) for the company. Remuneration for non audit services represents fees for tax compliance and advice. In addition £165,000 of fees were paid to the auditors in connection with the acquisition expenses for PIPEX Internet Limited, these are included in the cost of investment.

The UITF 17 charge relates to the PIPEX Internet transaction when it was agreed that certain directors and senior managers would be granted share options and warrants at the placing price of 6.25p. The grants were made on dates adjacent to the date of placing by which time the share price had moved up by 1.12p.

Notes to the Financial Statements (continued)

4 Staff numbers and costs

The average number of persons (including executive directors) employed by the group during each year was as follows:

	2003	2002
	Number	Number
Full time operations staff	219	91
Executive and administrative	71	32
	<u>290</u>	<u>123</u>

The aggregate payroll costs (including directors' remuneration) were as follows:

	2003	2002
	£'000	£'000
Wages and salaries	11,317	6,907
Share related awards	577	–
Social security costs	1,329	612
Pension costs	343	193
	<u>13,566</u>	<u>7,712</u>

Remuneration of directors:

	2003	2002
	£'000	£'000
Emoluments for services as a director	926	358
Compensation for loss of office	188	175
Pension contributions	55	52
	<u>1,169</u>	<u>585</u>

Emoluments of the highest paid director (excluding pension contributions) were £342,000 (2002: £201,000). Amounts paid by the group in respect of their pension contributions were £nil (2002: £4,000).

Details of pension contributions are set out in note 20 to the accounts. See the Board Report on Directors' Remuneration on pages 16 to 18 for further details.

5 Other interest receivable and similar income

	2003	2002
	£'000	£'000
Bank interest receivable	79	202
	<u>79</u>	<u>202</u>

Notes to the Financial Statements (continued)

6 Interest payable and similar charges

	2003	2002
	£'000	£'000
Interest payable on finance leases	217	190
Bank interest payable	196	–
Convertible loan note interest payable	56	22
	469	212

7 Taxation

There is no charge to corporation tax due to the losses incurred in each year. At 31 December 2003 there are unrelieved losses in the group of approximately £70,400,000 (2002: £69,100,000).

Factors affecting the expected tax credit are as follows:

	2003	2002
	£'000	£'000
Loss on ordinary activities before tax	(9,893)	(11,762)
Loss on ordinary activities at standard rate of UK corporation tax of 30% (2002: 30%)	(2,968)	(3,529)
Non deductible amortisation	518	(22)
Capital allowances in excess of depreciation	(151)	709
Permanent disallowable items	401	63
Other timing differences, including unrelieved tax losses carried forward	2,200	2,779
	–	–

Deferred tax

The amounts of unrecognised deferred taxation assets comprise:

	2003	2002
	£'000	£'000
Unclaimed capital allowances	893	2,820
Unrelieved tax losses	22,927	20,727
Other timing differences	–	457
	23,820	24,004

The above figures are subject to the agreement of corporation tax computations with the relevant tax authorities.

Notes to the Financial Statements (continued)

8 Intangible fixed assets

	Positive goodwill £'000	Negative goodwill £'000	Patents £'000	Total £'000
Group				
Cost				
At 1 January 2003	9,230	(901)	–	8,329
Arising on acquisition (see note 21)	–	–	10	10
Additions	57,162	–	–	57,162
Fair value adjustments (see note 22)	(768)	–	–	(768)
At 31 December 2003	65,624	(901)	10	64,733
Amortisation				
At 1 January 2003	152	(357)	–	(205)
Charge for the year	1,950	(225)	1	1,726
At 31 December 2003	2,102	(582)	1	1,521
Net book value				
At 31 December 2003	63,522	(319)	9	63,212
At 31 December 2002	9,078	(544)	–	8,534

Negative goodwill amortised during the year arose due to the acquisition of HighwayOne Corporation Limited in 2001.

This negative goodwill is being released over the related period of expense of the non-monetary assets acquired, that being a four year period. Positive goodwill arising in the year is due to the acquisitions during the year of XTML, Compulink Information eXchange Limited, Firstnet Limited and PIPEX Internet Limited (see note 21), and is being amortised over ten years.

The Company held no intangible fixed assets at 31 December 2003 or 31 December 2002.

Notes to the Financial Statements (continued)

9 Tangible fixed assets

	Freehold buildings £'000	Leasehold improvements £'000	Network infrastructure £'000	Office equipment £'000	Plant and machinery £'000	Total £'000
Group						
Cost						
At 1 January 2003	–	698	15,737	193	11	16,639
Acquisitions (see note 21)	1,968	887	3,294	209	60	6,418
Additions	119	40	1,084	2	–	1,245
Disposals	–	(83)	(137)	–	–	(220)
At 31 December 2003	2,087	1,542	19,978	404	71	24,082
Depreciation						
At 1 January 2003	–	119	3,937	131	7	4,194
Charge for the year	32	179	3,464	56	5	3,736
Disposals	–	(52)	(60)	–	–	(112)
At 31 December 2003	32	246	7,341	187	12	7,818
Net book value						
At 31 December 2003	2,055	1,296	12,637	217	59	16,264
At 31 December 2002	–	579	11,800	62	4	12,445

Included in the total net book value of Network Infrastructure is £2,746,000 (2002: £2,258,000) in respect of assets held under finance leases. Depreciation for the year on these assets was £2,007,000 (2002: £1,230,000).

The Company held no tangible fixed assets at 31 December 2003 or 31 December 2002.

Notes to the Financial Statements (continued)

10 Fixed asset investments

Company	Interest in subsidiary undertakings £'000
Cost	
1 January 2003	10,856
Additions	65,348
Transfer to subsidiary undertaking	(57,365)
	<hr/>
At 31 December 2003	18,839
	<hr/>
Amounts provided	
1 January 2003	740
	<hr/>
At 31 December 2003	740
	<hr/>
Net book value	
At 31 December 2003	18,099
	<hr/>
At 31 December 2002	10,116
	<hr/>

On 31 December 2003 the Company transferred PIPEX Networks Limited (at that time PIPEX Internet Limited) to PIPEX Internet Limited (at that time Zipcom Telecommunications Limited), at a book value of £47,500,000 realising a book loss of £9,865,000.

The Company's principle subsidiary undertakings included in the financial statements are as follows:

Name	Proportion of ordinary share capital held	Nature of business/activity
PIPEX Internet Limited (i) (iii) (formerly Zipcom Telecommunications Limited)	100%	Telecommunications
HighwayOne Limited	100%	Telecommunications
Transigent Limited (i)	100%	Holding Company
GXN Limited	100%	Holding Company
PIPEX Communications Services Limited	100%	Telecommunications
PIPEX Communications UK Limited	100%	Telecommunications
GX Networks Nine Limited	100%	Telecommunications
GX Networks Ten Limited	100%	Telecommunications
PIPEX Networks Limited (ii) (formerly PIPEX Internet Limited)	100%	Telecommunications
Compulink Information eXchange Limited	100%	Telecommunications
XTML Limited	100%	Telecommunications
PIPEX Communications Business Solutions Limited (i) (iv)	100%	Telecommunications

(i) directly held by the Company

(ii) On 27 January 2004 the name of the company was changed from PIPEX Internet Limited

(iii) On 27 January 2004 the name of the company was changed from Zipcom Telecommunications Limited

(iv) On 18 November 2003 the name of the company was changed from Firstnet Services Limited

All subsidiary undertakings are registered in England and Wales with the exception of GXN Limited which is registered in Scotland. A full list of the company's subsidiaries will be given in the next annual return.

Notes to the Financial Statements (continued)

11 Stock

	Group	Group	Company	Company
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Finished goods for sale	218	–	–	–

12 Debtors

	Group	Group	Company	Company
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Trade debtors	5,747	1,177	–	–
Amounts due from subsidiary undertakings	–	–	56,787	–
Corporation tax	178	–	–	–
Taxation and social security	–	–	20	–
Other debtors	843	382	–	49
Prepayments and accrued income	2,496	1,457	–	–
	9,264	3,016	56,807	49

Included in group prepayments and accrued income are rent deposits of £117,000 (2002: £230,000) which are recoverable after more than one year.

13 Cash at bank and in hand

Cash at bank and in hand comprises cash in hand and deposits repayable on demand and restricted deposit accounts.

Included in group cash at bank and in hand are funds of £2,024,000 (2002: £1,989,000) held in a restricted deposit account in respect of a guarantee over the first loan note due on 31 January 2004 (see note 14).

Also included within cash at bank and in hand are £80,000 (2002: nil) of deposits with a credit card company. This balance cannot be accessed within 12 months.

Also included within cash at bank and in hand are £321,000 (2002: £490,000) of funds in restricted deposit accounts. These amounts relate to lease contracts over telecommunications equipment. These deposits may be realised in accordance with the terms of the related leases and have the following profile:

	2003	2002
	£'000	£'000
Less than one year	248	296
One to two years	73	68
Two to five years	–	126
	321	490

Group cash at bank and in hand includes short term deposits of £nil (2002: £250,000) realisable between two weeks and six months. The balance of group cash at bank and in hand, being £10,842,000 (2002: £2,640,000) is held in current accounts, overnight money market accounts and no notice deposit accounts.

Cash at bank and in hand per the Company balance sheet comprises £2,024,000 (2002: £1,989,000) held in a restricted deposit account (see above) and £3,908,000 (2002: £1,679,000) held in current accounts, overnight money market accounts and no notice deposit accounts.

The Company has no restricted funds at 31 December 2003 (2002: nil).

Notes to the Financial Statements (continued)

14 Creditors: amounts falling due within one year

	Group	Group	Company	Company
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Bank loans (see notes 15,18)	4,879	–	3,000	–
Loan notes (see note 18)	3,490	–	3,490	–
Obligations under finance leases (see note 15)	3,012	1,702	–	–
Trade creditors	14,272	5,331	–	57
Amounts owed to group undertakings	–	–	20,620	2,132
Taxation and social security	822	703	–	–
Other creditors	269	30	–	–
Accruals and deferred income	9,732	8,428	285	–
	36,476	16,194	27,395	2,189

Loan notes issued in respect of the acquisition of Transigent Limited are as follows:

First consideration loan note – £1,989,000

The first consideration loan note is fully guaranteed and carries interest at a rate of 0.5% below base lending rate. It is redeemable on or after 31 January 2004. At 1 April 2004 the loan note had not been redeemed.

Second consideration loan note – £1,501,000

The second consideration loan note carries interest at a rate of 3%. It is redeemable on or after 1 February 2004. At 1 April 2004 the loan note had not been redeemed.

15 Creditors: amounts falling due after one year (including convertible debt)

	Group	Group	Company	Company
	2003	2002	2003	2002
	£'000	£'000	£'000	£'000
Bank loan (see note 18)	12,000	–	12,000	–
Convertible loan notes	–	1,570	–	1,570
Loan notes	–	3,490	–	3,490
Obligations under finance leases	1,541	1,106	–	–
	13,541	6,166	12,000	5,060

Notes to the Financial Statements (continued)

15 Creditors: amounts falling due after one year (including convertible debt) (continued)

Bank loans are repayable as follows:

	2003 £'000	2002 £'000
Within one year	4,879	–
Between two and five years	12,000	–
	<u>16,879</u>	<u>–</u>

The bank loan of £15,000,000 carries interest at a rate of LIBOR +2.75%.

The bank loan of £1,879,000 carries interest at a rate of bank base rate +1.35%. As a result of the acquisition of Firstnet Services Ltd the loan became repayable within one year.

The maturity of obligations under finance leases is as follows:

	2003 £'000	2002 £'000
Group		
Within one year	3,012	1,702
In the second to fifth years	1,541	1,106
	<u>4,553</u>	<u>2,808</u>

The Company does not hold any assets under finance leases.

16 Provisions for liabilities and charges

Group

	Onerous leases £'000	Dilapidations £'000	UITF 25 £'000	Other £'000	Total £'000
At 1 January 2003	689	50	13	–	752
Arising on the acquisition of subsidiary undertakings	114	–	–	12	126
Arising during the year	218	–	274	–	492
Utilised during the year	(542)	–	–	–	(542)
At 31 December 2003	<u>479</u>	<u>50</u>	<u>287</u>	<u>12</u>	<u>828</u>

The UITF 25 provision relates to National Insurance payable on exercise of share options. This will be utilised as and when the share options are exercised. The onerous lease provision comprises £311,000 in respect of rental costs for a vacant property, which will be utilised up to the end of the lease in July 2005. The remaining onerous lease provision of £168,000 relates to the early termination of a telecommunications contract and will be utilised within one year. Dilapidations relate to a vacant property and will be released at the expiry of the lease, being July 2005.

Notes to the Financial Statements (continued)

16 Provisions for liabilities and charges (continued)

	2003
	£'000
Company	
At 1 January 2003	–
Arising during the year	287
	<hr/>
At 31 December 2003	287
	<hr/>

Provisions relate to the National Insurance payable on exercise of share options according to UITF 25.

17 Operating leases

The group had commitments to make annual payments under non-cancellable operating leases which expire as follows:

	Short leasehold		Short leasehold	
	property	Other	property	Other
	2003	2003	2002	2002
	£'000	£'000	£'000	£'000
Within one year	–	1,486	–	1,144
Within two to five years	957	71	467	770
After five years	436	–	187	–
	<hr/>	<hr/>	<hr/>	<hr/>
	1,393	1,557	654	1,914
	<hr/>	<hr/>	<hr/>	<hr/>

In addition to the above, the group had an annual commitment in respect of telecom circuits of £7,266,000 (2002: £4,571,000). Typically these leases are twelve months in length and cancellable at seven days notice following the end of the initial twelve month period.

18 Financial instruments

The group's financial instruments comprise cash and liquid resources, and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of the financial instruments is to provide finance for the group's operations.

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 and interest rate risks arising from the group's operations and its sources of finance.

It is the group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the group's financial instruments are interest rate risk, liquidity risk and foreign currency risk. The directors review and agree policies for managing each of these risks, and they are summarised below.

As permitted by Financial Reporting Standard 13, short-term debtors and creditors have been excluded from the following disclosures (with the exception of note (iii)).

Notes to the Financial Statements (continued)

18 Financial instruments (continued)**(i) Interest rate risk**

The group financed its operations throughout the year from bank deposits. Early in 2004 approximately half of the forward interest payment obligations with respect to the £15.0 million bank loan were swapped from variable rate to fixed rate.

The interest rate exposure of the financial assets of the group as at 31 December was:

	Fixed 2003 £'000	Floating 2003 £'000	Nil 2003 £'000	Total 2003 £'000
Sterling	2,104	11,037	–	13,141
US\$	79	47	–	126
	<u>2,183</u>	<u>11,084</u>	<u>–</u>	<u>13,267</u>

	Fixed 2002 £'000	Floating 2002 £'000	Nil 2002 £'000	Total 2002 £'000
Sterling	2,479	2,227	194	4,900
US\$	–	251	207	458
Euro	–	10	–	10
	<u>2,479</u>	<u>2,488</u>	<u>401</u>	<u>5,368</u>

The interest rate exposure of the financial liabilities of the group as at 31 December was:

	Fixed 2003 £'000	Floating 2003 £'000	Nil 2003 £'000	Total 2003 £'000
Sterling	<u>1,501</u>	<u>18,868</u>	<u>4,553</u>	<u>24,922</u>

	Fixed 2002 £'000	Floating 2002 £'000	Nil 2002 £'000	Total 2002 £'000
Sterling	<u>3,071</u>	<u>1,989</u>	<u>2,808</u>	<u>7,868</u>

Notes to the Financial Statements (continued)

18 Financial instruments (continued)

(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 in the current year through the issue of equity.

	Debt	Other	Total
	2003	financial	2003
	£'000	liabilities	£'000
		2003	£'000
		£'000	£'000
Financial liabilities maturing:			
in one year or less or on demand	8,369	3,012	11,381
in more than one year but not more than two years	3,750	756	4,506
in more than two years but not more than five years	8,250	308	8,558
after five years	–	477	477
	<u>20,369</u>	<u>4,553</u>	<u>24,922</u>

	Debt	Other	Total
	2002	financial	2002
	£'000	liabilities	£'000
		2002	£'000
		£'000	£'000
Financial liabilities maturing:			
in one year or less or on demand	–	1,702	1,702
in more than one year but not more than two years	3,490	740	4,230
in more than two years but not more than five years	–	366	366
after five years	1,570	–	1,570
	<u>5,060</u>	<u>2,808</u>	<u>7,868</u>

(iii) Foreign currency risk

The group has occasional transactional currency exposures. Such exposures mainly arise from purchases in dollars.

Notes to the Financial Statements (continued)

18 Financial instruments (continued)

(iv) Fair values

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

	Book value	Fair value	Book value	Fair value
	2003	2003	2002	2002
	£'000	£'000	£'000	£'000
Primary financial instruments:				
Cash at bank and in hand	13,267	13,267	5,368	5,368
Bank loans	(16,879)	(16,879)	–	–
Convertible loan stock	–	–	(1,570)	(1,570)
Loan notes	(3,490)	(3,490)	(3,490)	(3,490)
Finance leases due within one year	(3,012)	(3,012)	(1,702)	(1,702)
Other creditors due after more than one year	(1,541)	(1,541)	(1,106)	(1,106)
	(11,655)	(11,655)	(2,500)	(2,500)

19 Called up share capital

Authorised and allotted share capital

	2003	2002
	£'000	£'000
Authorised		
Equity: 3,000,000,000 Ordinary shares of 1p each		
At 1 January 2003	15,000	15,000
Authorised during the year	15,000	–
At 31 December 2003	30,000	15,000
	2003	2002
	£'000	£'000
Allotted, called up and fully paid		
Equity: Ordinary shares of 1p each		
At 1 January 2003	7,100	2,857
Issued during the year	11,041	4,243
At 31 December 2003	18,141	7,100

On 27 October 2003 the authorised share capital was increased by 1,500 million shares.

Share capital issued at nominal value in the year relates to the exercise of share options (4,852,777 shares for consideration of £99,000), the conversion of loan stock (57,090,908 shares issued due to the conversion of £1,570,000 of loan stock), shares issued on acquisition of PIPEX Internet Limited (80,000,000 shares at a fair value of £6,000,000), shares issued on acquisition of XTML Limited and Compulink Information eXchange Limited (20,366,599 shares at a fair value of £1,000,000) and shares placed during the year (941,761,737 shares for cash consideration of £45,169,174).

Notes to the Financial Statements (continued)

19 Called up share capital (continued)

Share options

At 31 December 2003 rights to options over 115,469,408 ordinary shares of the Company were outstanding as follows:

	At 1 January 2003	Granted	Exercised/ Lapsed	Cancelled	At 31 December 2003	Exercise price	Exercise period
Unapproved scheme	6,751,591	–	–	–	6,751,591	1.00p	20.11.2001 to 19.11.2011
	10,506,000	–	–	–	10,506,000	4.50p	27.12.2001 to 26.12.2011
	5,204,880	–	–	–	5,204,880	3.00p	27.12.2001 to 26.12.2011
	–	1,500,000	–	–	1,500,000	3.00p	20.11.2001 to 19.11.2011
	–	35,878,494	–	–	35,878,494	2.25p	20.03.2003 to 19.03.2013
	–	27,374,000	–	–	27,374,000	6.25p	24.10.2003 to 23.10.2013
	–	10,000,000	–	–	10,000,000	6.25p	28.10.2003 to 27.10.2013
EMI Scheme	1,978,260	–	(989,130)	–	989,130	1.00p	20.11.2001 to 19.11.2011
	3,590,000	–	(865,000)	(2,725,000)	–	5.75p	20.11.2001 to 19.11.2011
	–	1,450,000	(800,000)	–	650,000	3.00p	20.02.2003 to 19.02.2013
	–	6,910,626	(3,455,313)	–	3,455,313	2.25p	20.02.2003 to 19.02.2013
	–	13,160,000	–	–	13,160,000	6.25p	24.10.2003 to 23.10.2013
	28,030,731	96,273,120	(6,109,443)	(2,725,000)	115,469,408		

Share warrants

On 28 October 2003 warrants to subscribe to up to 75,000,000 ordinary shares of the Company were issued and were outstanding at 31 December 2003. The warrants can only be exercised after January 2005, when the Company is EBITDA positive for the previous twelve months and the Company's share price has reached 12p.

Deferred consideration

There was deferred consideration in relation to the acquisition of Firstnet Services Limited in the form of 23,092,369 ordinary shares of the Company to be issued no sooner than April 2004. At 31 December 2003 these shares were outstanding.

Detailed below is the information regarding the conversion of the loan stock:

Converted allotted @ 2.75p	15/05/2003	1,818,182
Converted allotted @ 2.75p	02/06/2003	4,545,455
Converted allotted @ 2.75p	08/07/2003	7,272,727
Converted allotted @ 2.75p	18/07/2003	16,363,636
Converted allotted @ 2.75p	22/07/2003	3,636,363
Converted allotted @ 2.75p	08/09/2003	12,727,273
Converted allotted @ 2.75p	22/09/2003	181,818
Converted allotted @ 2.75p	25/09/2003	72,727
Converted allotted @ 2.75p	25/11/2003	10,472,727

Notes to the Financial Statements (continued)

20 Pension scheme

The group does not operate an occupational pension scheme but makes a percentage contribution of qualifying salary to certain employees' personal pension schemes. The amount charged to the profit and loss account in respect of such contributions was £343,000 (2002: £193,000).

The outstanding contributions to the pension scheme were nil (2002: nil).

21 Acquisitions

(i) Summary

Below is a summary of the acquisitions made by PIPEX Communications plc in the year ended 31 December 2003.

	2003
	£'000
Fair value of assets acquired	8,238
Goodwill	57,162
Consideration	65,400
Satisfied by:	
80,000,000 ordinary shares at market price of 7.5p	6,000
20,366,599 ordinary shares at market price of 4.91p	1,000
Contingent ordinary shares to be issued	2,540
Cash	54,032
Costs of acquisition	1,828
	65,400
Effects on group cash flow:	
Cash consideration	54,032
Costs of acquisition	1,828
Cash balances on acquisition	(6,115)
PIPEX Internet Limited cash used on acquisition	(10,000)
Net cash outflow	39,745

Notes to the Financial Statements (continued)

21 Acquisitions (continued)

(ii) XTML Limited and Compulink Information eXchange Limited

On 18 July 2003 the group acquired XTML Limited and Compulink Information eXchange Limited financed by the issue of ordinary share capital of £1,000,000. Costs of acquisition were £28,000.

The goodwill of £1,732,000 arising on the acquisition is being amortised over ten years, the useful life as estimated by the directors.

The acquisition contributed £4,592,000 of turnover in the year; an operating loss of £1,094,000 (after goodwill amortisation of £79,000) and accounted for cash outflows from operating cash activities of £1,880,000.

The turnover and operating losses of the companies between 1 January 2003 and 17 July 2003 were £6,651,000 and £1,364,000 respectively. The net liabilities of the companies at 31 December 2002 were £27,217,000 and operating losses for the year to 31 December 2002 were £4,210,000.

Details of the fair values of the assets and liabilities acquired are set out below:

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Fixed Assets	5,264	(2,933)	2,331
Stock	4	—	4
Debtors	2,112	(169)	1,943
Creditors (falling due within one year)	(4,206)	(776)	(4,982)
Net assets/(liabilities)	3,174	(3,878)	(704)
Goodwill			1,732
Consideration			1,028
Satisfied by:			
20,366,599 ordinary shares at market price of 4.91p			1,000
Costs of acquisition			28
			1,028
Effects on group cash flow:			
Cash consideration and costs			28
Cash balances on acquisition			—
Net cash outflow			28

Explanatory Notes:

Fixed assets

The fair value adjustments reflect the directors' valuation of the main classes of fixed assets held by the acquired entities. The adjustment includes £630,000 to write off obsolete computer equipment and a write down in leased network infrastructure assets of £2.1 million.

Debtors

The bad debt provision has been adjusted as appropriate.

Creditors (falling due within one year)

The fair value adjustments are to correctly reflect the outstanding finance lease commitments. Not included within fair value adjustments is £9,615,000 in respect of intercompany debt assigned to the group parent company on acquisition for £1.

Notes to the Financial Statements (continued)

21 Acquisitions (continued)

(iii) Firstnet Services Limited

On 28 August 2003 the group acquired Firstnet Services Limited financed by £4,085,000 of cash and deferred contingent ordinary share capital of £2,540,000. Costs of acquisition were £382,000.

The goodwill of £6,150,000 arising on the acquisition is being amortised over ten years, the useful life as estimated by the directors.

The acquisition contributed £2,490,000 of turnover in the year; an operating loss of £345,000 (after goodwill amortisation of £205,000) and accounted for cash outflows from operating cash activities of £598,000.

The turnover and operating loss of the Company between 1 January 2003 and 27 August 2003 were £2,472,000 and £534,000 respectively. The net assets of the Company at 31 December 2002 were £4,234,000 and operating loss for the year to 31 December 2002 was £10,009,000.

Details of the fair values of the assets and liabilities acquired are set out below:

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Intangible Fixed Assets	256	(246)	10
Fixed Assets	4,868	(2,220)	2,648
Stock	245	(80)	165
Debtors	3,267	(74)	3,193
Cash	284	–	284
Creditors (falling due within one year)	(4,869)	(562)	(5,431)
Provisions	(12)	–	(12)
Net assets	4,039	(3,182)	857
Goodwill			6,150
Consideration			7,007
Satisfied by:			
Contingent ordinary shares to be issued			2,540
Cash			4,085
Costs of acquisition			382
			7,007
Effects on group cash flow:			
Cash consideration and costs			4,467
Cash balances on acquisition			(284)
Net cash outflow			4,183

Explanatory Notes:

Fixed assets

The fair value adjustments reflect the directors' valuation of the main classes of fixed assets held by the acquired entities. The adjustment includes £953,000 to write freehold property down to a net realisable value of £2.0 million and an adjustment of £1.1 million in respect of network computer equipment.

Debtors

The bad debt provision has been adjusted as appropriate.

Creditors (falling due within one year)

The fair value adjustment has been made to accrue correctly for any outstanding liabilities. Included within creditors due within one year is a bank loan of £1,919,000.

Notes to the Financial Statements (continued)

21 Acquisitions (continued)

(iv) PIPEX Internet Limited

On 28 October 2003 the group acquired PIPEX Internet Limited financed by £49,947,000 of cash and the issue of ordinary share capital of £6,000,000. Costs of acquisition were £1,418,000.

The goodwill of £49,280,000 arising on the acquisition is being amortised over ten years, the useful life as estimated by the directors.

The acquisition contributed £6,133,000 of turnover in the year; an operating profit of £500,000 (after goodwill amortisation of £821,000) and accounted for cash outflows from operating cash activities of £4,622,000.

The turnover and operating profit of the Company between 1 January 2003 and 27 August 2003 were £28,328,000 and £1,712,000 respectively. The net assets of the Company at 31 May 2003 were £10,009,000 and operating profit for the year to 31 May 2003 was £10,140,000.

Details of the fair values of the assets and liabilities acquired are set out below:

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Fixed Assets	1,439	–	1,439
Stock	31	–	31
Debtors	11,841	–	11,841
Cash	5,831	–	5,831
Creditors (falling due within one year)	(10,943)	–	(10,943)
Provisions	(64)	(50)	(114)
Net Assets	8,135	(50)	8,085
Goodwill			49,280
Consideration			57,365
Satisfied by:			
80,000,000 ordinary shares at market price of 7.5p			6,000
Cash			49,947
Costs of acquisition			1,418
			57,365
Effects on group cash flow:			
Cash consideration and costs			51,365
Less PIPEX Internet cash used in acquisition (shown as an intercompany loan in debtors above)			(10,000)
Cash balances on acquisition			(5,831)
Net cash outflow			35,534

Notes to the Financial Statements (continued)

22 Goodwill on prior year acquisitions**Transient Limited**

	Provisional Fair Value to the group 2002 £'000	Adjustments 2003 £'000	Final Fair Value to the group 2003 £'000
Book and fair value of net assets acquired	886	768	1,654
Goodwill	9,230	(768)	8,462
Consideration	10,116	–	10,116

The adjustments to goodwill relate to previously overestimated creditor balances.

23 Reserves

	Share capital £'000	Shares to be issued £'000	Share premium account £'000	Other reserves £'000	Profit and Loss account £'000	Total £'000
Group						
At 1 January 2003	7,100	–	17,583	3,679	(22,111)	6,251
Issue of shares	11,041	–	36,801	5,996	–	53,838
Shares to be issued	–	2,540	–	–	–	2,540
Issue costs	–	–	(1,933)	–	–	(1,933)
Grant of options	–	–	–	577	–	577
Retained loss for the year	–	–	–	–	(9,893)	(9,893)
At 31 December 2003	18,141	2,540	52,451	10,252	(32,004)	51,380
Company						
At 1 January 2003	7,100	–	17,583	3,472	(21,571)	6,584
Issue of shares	11,041	–	36,801	5,996	–	53,838
Shares to be issued	–	2,540	–	–	–	2,540
Issue costs	–	–	(1,933)	–	–	(1,933)
Grant of options	–	–	–	577	–	577
Retained loss for the year	–	–	–	–	(20,450)	(20,450)
At 31 December 2003	18,141	2,540	52,451	10,045	(42,021)	41,156

Notes to the Financial Statements (continued)

23 Reserves (continued)

Other reserves consist of the following:

	Merger reserve £'000	Capital reserve £'000	UITF 17 reserve £'000	Other reserves £'000	Total £'000
Group					
At 1 January 2003	–	207	–	3,472	3,679
Issue of shares	5,996	–	–	–	5,996
Grant of options	–	–	577	–	577
At 31 December 2003	5,996	207	577	3,472	10,252
Company					
At 1 January 2003	–	–	–	3,472	3,472
Issue of shares	5,996	–	–	–	5,996
Grant of options	–	–	577	–	577
At 31 December 2003	5,996	–	577	3,472	10,045

The other reserves represent the premium on shares issued as part of the consideration for the acquisition of Transigent Limited.

The UITF 17 reserve arose at the time of the PIPEX Internet transaction when it was agreed that certain directors and senior managers would be granted share options and warrants at the placing price of 6.25p. The grants were made on dates adjacent to the date of placing by which time the share price had moved up by 1.12p.

The merger reserve represents share premium on shares issued to acquire XTML Ltd, Compulink Information eXchange Ltd and PIPEX Internet Ltd.

24 Reconciliation of operating loss to operating cash flows

	2003 £'000	2002 £'000
Operating loss	(9,503)	(11,752)
Depreciation and impairment charges	3,736	2,039
Amortisation charge/(credits)	1,726	(74)
Loss/(profit) on sale of fixed assets	16	(46)
UITF 17 charge	577	–
Increase in stock	(17)	–
Decrease in debtors	841	811
(Decrease)/increase in creditors	(4,878)	1,567
(Decrease)/increase in provisions	(51)	48
Net cash outflow from operating activities	(7,553)	(7,407)

Notes to the Financial Statements (continued)

25 Related party disclosures

Peter Dubens, an executive director of the Company, is a director of the following companies:

Oakley Capital Limited which provided services to the group of £21,000 (2002: nil) of which nil (2002: nil) was outstanding at the year end.

ukbetting plc, a customer of PIPEX, which accounted for sales of £24,000 (2002: nil), of which £2,000 was outstanding at the year end.

Avocet Capital Management Ltd, a customer of PIPEX, which accounted for sales of £24,000 (2002: nil) of which nil was outstanding at the year end (2002: nil)

David Rickards, an executive director of the Company, is also a director of Waycourt Estates Limited, which charged £74,000 (2002: nil), for the rental of premises occupied by a group company. At the year end this sum was still outstanding.

26 Contingent Liabilities

The Company has guaranteed the rental over one of its properties until 24 March 2004. The guaranteed amount of £41,000 (2002: £203,000) represents the rental charge from the Balance Sheet date to the lease termination date.

27 Loss per share

	Year ended 31 December 2003	Year ended 31 December 2002
Loss for the financial year attributable to shareholders	£9,893,000	£11,762,000
Weighted average number of equity shares in issue	1,106,864,224	365,930,208
Basic/diluted loss per equity share*	0.9p	3.2p

* Since the conversion of potential ordinary shares to ordinary shares would decrease the net loss per share they are not dilutive. Accordingly diluted loss per share is the same as basic loss per share.

Notice of Annual General Meeting

Notice is hereby given that the 2004 Annual General Meeting of PIPEX Communications plc will be held at the Economist Building, 25 St James's Street, London SW1A 1HA on Wednesday 26 May 2004 at 11.00 am for the following purposes:

As ordinary business to consider and, if thought fit, pass Resolutions 1 to 5 inclusive below which will be proposed as Ordinary Resolutions:

1. To receive, approve and adopt the report of the directors and the financial statements of the Company for the financial year ended 31 December 2003 together with the report of the auditors thereon.
2. To re-elect Stewart Porter as a director, who retires by rotation pursuant to Article 102 of the Company's Articles of Association.
3. To elect Christina Kennedy as a director, who retires pursuant to Article 102 of the Company's Articles of Association.
4. To elect Michael Read as a director, who retires pursuant to Article 102 of the Company's Articles of Association.
5. To re-appoint KPMG Audit Plc as auditors to the Company to hold office from the conclusion of the meeting until the conclusion of the next Annual General Meeting and to authorise the directors to fix their remuneration.

As special business to consider and, if thought fit, pass the following Resolution which will be proposed as a Special Resolution:

- 6 That the Company be and is hereby granted general and unconditional authority (pursuant to Section 166 of the Companies Act 1985 ("the Act") and the authorities contained in its Articles of Association) to make market purchases (as defined in Section 163 of the Act) of up to in aggregate 10% of its own ordinary shares of 1p each in the capital of the Company ("Ordinary Shares") provided that
 - (i) the maximum price which may be paid for an Ordinary Share is an amount equal to not more than 5% above the average of the middle market quotations for the Ordinary Shares taken from the Daily Official List of the London Stock Exchange for the five business days before the day on which the purchase is made, and the minimum price which may be paid for an Ordinary Share is 1p, in each case exclusive of expenses payable by the Company; and
 - (ii) the authority conferred by this resolution shall expire on the conclusion of the next Annual General Meeting of the Company held after the passing of this resolution, or 26 May 2005 (whichever shall first occur), except that the Company may, before such expiry, enter into a contract for the purchase of its own Ordinary Shares which would or may require to be completed or executed wholly or partly after the expiration of this authority as if the said authority had not expired.

By order of the Board

Stewart Porter
Company Secretary

30 April 2004

Registered Office:
Carlton House
27A Carlton Drive
London
SW15 2BS

Registered in England No: 3974683

Notes:

- (1) Any member entitled to attend and vote at the Annual General Meeting convened by this notice may appoint one or more proxies to attend and, on a poll, to vote instead of him. A proxy need not be a member of the Company.
- (2) To appoint a proxy, the form enclosed with this Notice should be completed and deposited at the offices of the Company's registrars not less than 48 hours before the meeting time of the Annual General Meeting specified above.
- (3) In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, the Company gives notice that only those shareholders entered on the relevant register of members (the "Register") for certificated or uncertificated shares of the Company (as the case may be) at 48 hours before the meeting time (the "Specified Time") will be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the Register after the Specified Time will be disregarded in determining the rights of any person to attend or vote at that meeting. Should the meeting be adjourned to a time not more than 48 hours after the Specified Time, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned meeting. Should the meeting be adjourned for a longer period, then to be so entitled, members must be entered on the Register at the time which is 48 hours before the time fixed for the adjourned meeting or, if the Company gives notice of the adjourned meeting, at the time specified in the notice.
- (4) Copies of all the Articles of Association, together with directors' service contracts or memoranda of the terms thereof (other than contracts expiring or determinable by the employing company without compensation within one year) and the register of interests of directors (and their families) in shares of the Company kept in accordance with section 325 of the Act will be available for inspection at the registered office of the Company during usual business hours on any weekday (Saturdays and public holidays excluded) from the date of this notice until the close of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

PIPEX Communications plc

Form of Proxy

I/We (See Note (1) below)
 BLOCK CAPITALS PLEASE

.....
 being (a) member(s) of the above-named Company, hereby appoint the Chairman of the Meeting or

.....
 (See Note (2) below) as my/our proxy to attend and vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held at The Economist Building, 25 St. James's Street, London SW1A 1HA on Wednesday 26 May 2004 at 11.00 a.m. and at any adjournment thereof.

In respect of the following Resolutions (as set out in the Notice of meeting) my proxy is instructed to vote as shown by "X" below. See Note (3) below.

ORDINARY RESOLUTIONS	FOR	AGAINST	ABSTAIN
Resolution No. 1 To receive the report and accounts			
Resolution No. 2 To re-elect as director Mr Stewart Porter			
Resolution No. 3 To elect as director Mrs Christina Kennedy			
Resolution No. 4 To elect as director Mr Michael Read			
Resolution No. 5 To re-appoint KPMG Audit plc			
SPECIAL RESOLUTION			
Resolution No. 6 Authority to buy back shares			

Dated 2004

Signature or seal See Note (4) below

Name(s)
 BLOCK CAPITALS PLEASE

Address:

.....
 See Note (5) below

Notes:

- (1) In the case of joint shareholders all should be named but the signature of only the first named holder on the Register is required.
- (2) If any other proxy is preferred, please insert the name of the proxy desired in the space provided, delete the words "the Chairman of the Meeting" and initial the alteration. Such other proxy need not be a shareholder.
- (3) Please indicate with an "X" in the space provided how you wish your votes to be cast in respect of the Resolutions to be proposed. Unless expressly instructed otherwise in the form as to how the proxy is to vote on any particular matter, the proxy will vote or abstain at his/her discretion.
- (4) In the case of a corporation, this form of proxy must be under its Common Seal or under the hand of an officer or attorney duly authorised in writing. In the case of joint shareholders the signature of any one of them will suffice, but the names of joint holders should be stated.
- (5) To be valid this form of proxy and the Power of Attorney or other authority (if any) under which it is signed or a notorially certified copy thereof must be returned to the Company's Registrar, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU so as to arrive not later than 48 hours before the time appointed for the Meeting.



SECOND FOLD

BUSINESS REPLY SERVICE
Licence No. MB 122

2



Capita Registrars (Proxies)
The Registry
PO Box 25
Beckenham
Kent
BR3 4BR

FIRST FOLD

THIRD FOLD



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