

GX NETWORKS PLC Report and accounts **2002**



GX NETWORKS



“In the current climate of the telecommunications market, GX Networks stood out from its rivals on its ability to deliver services within the current project timescales and in line with our budget criteria. GX Networks was also one of the friendliest telecommunications companies I have ever dealt with, right from the initial sales contact, up to the board of directors.”

Neon Webservices

Contents

Chairman's Statement	2
Operational and Financial Review	4
Directors and Advisers	6
Board of Directors and Senior Management	7
Directors' Report	9
Corporate Governance	11
Board Report on Directors' Remuneration	13
Statement of Directors' Responsibilities	16
Report of the Independent Auditors to the Members of GX Networks plc	17
Consolidated Profit and Loss Account	18
Consolidated Balance Sheet	19
Company Balance Sheet	20
Consolidated Cash Flow Statement	21
Reconciliation of Movements in Shareholders' Funds	23
Notes to the Financial Statements	24
Special Business at Annual General Meeting	42
Notice of Annual General Meeting	44



Chairman's Statement

Overview

In October 2002, the Company completed the acquisition of Transigent Limited, the parent Company of GX Networks (formerly XO Limited) and subsequently, in March 2003 the Company changed its name from Zipcom plc to GX Networks plc.

Following the acquisition of GX Networks, the Company has moved from being a small service provider to a key supplier of telecommunications solutions to business customers.

As a Tier 1 Internet Service Provider, GX Networks has one of the UK's most extensive networks with over 80 Points of Presence (PoPs) nationwide. Today, the Company builds complex network solutions and provides a broad range of access, hosting, voice, security services and solutions including managed virtual private networks (VPNs) and firewalls.

Operational Review

With only two months of the combined operations included in the results for the year ended 31 December 2002, the full benefits of the merger are not reflected in the year-end results.

Turnover for the year was £8.0 million, including £3.0 million from Transigent Limited, up 142% on the previous year's total of £3.3 million. The annualised revenues of the combined business immediately following the acquisition were in excess of £20 million. Gross margin on sales was lifted by the acquisition to 24.5% from 20.8% last year, though this improvement does not include the benefit from the network savings subsequently achieved from rationalisation of the two operations.

The successful acquisition of Transigent Limited was completed for a consideration of £9.74 million by way of £6.25 million issued ordinary shares and £3.49 million of loan notes. At the same time the company raised an additional £4.0 million (net of expenses) in order to provide increased working capital for the business.

When assessing the proposed merger it became clear that the two companies had many synergies and would experience significant operational and product benefits.

Both companies had similar SME customer bases, but targeted complementary geographical areas. Additionally, Zipcom plc possessed a national network, while GX Networks had extensive connectivity to Europe and the USA, as well as a state of the art hosting facility.

The smooth integration of the two businesses, along with the change of the name to GX Networks plc provides a greater presence in our market.

The integration of the two businesses involved a significant restructuring, which has resulted in considerable rationalisation benefits in infrastructure and people costs, which in total amount to £7.0 million annually.

Financing

In addition to the £4.0 million raised in October 2002, GX Networks raised a further £5.0 million in March 2003 by way of a Placing. These funds have further strengthened the Company's balance sheet as it moves toward profitability and continues with its strategy of consolidation.

Despite unfavourable market conditions the Company is pleased to note that it has received additional funding from both existing and new institutional investors broadening the Company's shareholder base and reflecting confidence in the Company's strategy.

Network Overview

GX Networks has a scaleable, multi-layer national network based on optical fibre and microwave with CISCO carrier class switches. The majority of the optical fibre transmission network is provided by high capacity, 25 year IRUs (long term leases) that had been paid for in advance by XO Limited, with low annual maintenance costs.

The core network uses proven ATM and Frame Relay technologies, which can carry IP (Internet Protocol) services through four switching centres around the UK. Each of these switching centres has the choice of targeting one of three internet access sites based in the London Docklands. The heart of these sites is Telehouse, which provides our



connection to other ISPs either via the London internet eXchange (LINX) or through other partner internet transit providers.

Consequently, in the unlikely event of a problem in one or even two of the London sites, connectivity to the internet will be maintained. An independently provisioned fibre ring affords IP layer resilience between the three London sites.

Products

During the year GX Networks' product range has expanded significantly in both voice and data services.

In voice services, three non-geographic number ranges were launched including FreeCall 0800, LowCall 0845, and NationalCall 0870. The data services division was enhanced with the launch of two business broadband services: SDSL Access and SDSL Metro. Both provide reliable high speed internet access, and, with better performance than many competing providers, take up has been encouraging. A further growth area for the Company has been the provision of bespoke secure private networks for larger customers.

The acquisition of Transigent Limited has significantly broadened the Company's hosting capability through the integration of a 9,000 sq. ft. hosting facility at Harbour Exchange in the London Docklands, which has allowed a full range of hosting services to be offered.

Board and Senior Management appointments

It gives me great pleasure to welcome Peter Dubens and Laurence Blackall to the Board. Their commercial acumen and knowledge of the market will be extremely beneficial to the Company.

We were extremely pleased to be able to appoint Mike Read and Dominic Crolla, both of whom contributed

strongly to our performance during the integration period, to the positions of Managing Director and Group Commercial Director respectively.

Staff

The consolidation of the Transigent and Zipcom operations proceeded quickly and efficiently thanks largely to the efforts of the Company's staff. The quality of the management and employees serves as a real differentiator in our market place and I would like to thank them all for their very hard work and efforts throughout the year.

Outlook

The first quarter of 2003 has seen strong order growth and the integration of the two companies' customer bases provides many cross selling opportunities. Furthermore, the merger has brought cost efficiencies, which will continue to flow over the course of this year.

As we move into this year we have seen an improvement in our gross margin. This is largely due to cost efficiencies, but also reflects the introduction of higher value product offerings, such as the VPNs.

The board's strategy is to monitor opportunities for growth by acquisition, and with the recent fundraising complete, GX Networks is now ideally placed to capitalise on opportunities as they present themselves.

Grahame R Purvis

Chairman

19 June 2003

“With the support and excellent consultancy from GX Networks, we have been able to develop our ideas and drastically expand our business. GX Networks’ flexible approach to hosting, security and bandwidth provision has meant that there have been absolutely no boundaries to us achieving our goals.” *Metrodome Group*



Operational and Financial Review

Transient acquisition

On 23 October 2002 Zipcom acquired the entire share capital of Transigent Limited the parent company of GX Networks (formerly XO Limited). The consideration for the acquisition was £9.74 million (excluding capitalised costs of acquisition of £376,000) satisfied by the allotment of 277,777,778 ordinary shares at 2.25p per share and the issue of £3.49 million loan notes.

At the same time, Zipcom raised £4.0 million net of expenses by way of a placing which comprised of 146,500,000 shares at 2p per share and £1,570,000 convertible unsecured loan stock. The funds were raised to provide additional working capital for the enlarged group.

In view of its size, the acquisition constituted a reverse takeover which required the Company's enlarged share capital to be re-admitted on AIM which took place on 23 October 2002.

The book value of Transigent's net assets at the acquisition date was £4,904,000 which has been reduced by fair value adjustments of £4,018,000 giving rise to goodwill on acquisition of £9,230,000. The fair value adjustments arose principally from the revaluation of certain fixed assets (£2,652,000) and from providing for the future cost of onerous lease obligations relating to two vacant properties (£658,000). The goodwill is being amortised over 10 years to reasonably reflect the economic life of the acquired business.

Immediately after the acquisition, the Company set about a comprehensive integration and rationalisation programme for the businesses. The main elements of this were the integration of the enlarged group's networks and back office

systems and the elimination of duplicated or overlapping infrastructure and overhead costs. By the end of March 2003 this programme had been largely completed, though the benefit of some of the cost saving measures had yet to be felt because of existing contractual arrangements. The total cost of the rationalisation was approximately £1.1 million, of which the most significant element was the cost associated with staff redundancies. At the acquisition date the total headcount in the combined business was 311 and by 31 March 2003 this had been reduced to 210. With total annualised cost savings of approximately £7 million, headcount savings contribute around £5 million.

Performance

Turnover for the year was £8,059,000 (2001: £3,320,000). Of the increase, £3,026,000 was contributed by Transigent and existing operations benefited from a full year's trading from the 2001 HighwayOne acquisition.

Cost of sales increased broadly in line with turnover giving rise to a gross profit of £1,976,000 (2001: £691,000). This represents a margin on sales of 24.5%, an improvement from 2001 of 3.7 percentage points. The overall margin was lifted by the Transigent acquisition which contributed £1,143,000 to gross profit, at a margin of 37.8%. Whilst the gross profit from existing operations grew to £833,000 (2001: £691,000) the gross margin percentage fell to 16.6% (2001: 20.8%) primarily because of the impact of customer churn in the first half of the year.

Operating expenses increased in the year by £5,351,000 to £13,728,000 though this represented a significant improvement when measured as a percentage of turnover. As stated above, 2002 operating expenses have borne the full cost of the rationalisation programme following the



Transient acquisition, amounting to £1.1 million. In addition, given the timing of the acquisition, there is very little benefit incorporated in the 2002 numbers from cost savings subsequently realised from the programme. Operating expenses from continuing operations also carries a full year's overheads relating to HighwayOne.

Net interest fell from a receivable in 2001 of £207,000 to a payable of £10,000 in 2002, the biggest contributor to the fall being lower receipts derived from lower average cash balances in the year.

The loss for the year was £11,762,000 (2001: £7,479,000) including losses arising in Transient in the post acquisition period of £2,931,000.

Cash flow

Cash balances, including short term deposits, at the end of the year amounted to £5.4 million (2001: £10.5 million). Cash outflow from operating activities in the year was £7.4 million, including a net inflow of working capital of £2.4 million. The cash outflow before financing has been offset by inflows from financing activities, particularly the placing in October which raised £4.0 million net of expenses.

Whilst the group has no bank debt, there is a total of £2.8 million outstanding on the balance sheet in respect of finance leases. The group also has loan notes outstanding at the balance sheet date of £3,490,000.

On 25 March 2003 the Company announced that it had conditionally placed 236,667,000 shares at a price of 2.125p to raise £5.03 million (before expenses) (£4.8 million net). The new shares were admitted to AIM on 31 March 2003. The proceeds of the placing are to be used to strengthen the Company's balance sheet and to better position the Company to continue with its strategy of making targeted acquisitions.

Treasury

The group uses financial instruments to raise finance for its operations and to manage the risks arising from those operations. The group does not undertake any speculative trading in financial instruments. Details of financial instruments used by the group are given in note 16 to the financial statements.

Stewart Porter
Chief Financial Officer

19 June 2003

“We were looking for an ISP who could provide us with a trouble free connection, and that was what we received from GX Networks. They provided a one stop shop, we could have everything we wanted or as little as we needed, it was as simple as that.”

Sony Professional Audio Research and Development

Directors and Advisers

Directors

Grahame Purvis

Chairman and Chief Executive

Stewart Porter

Chief Financial Officer

Jon Richards

Non Executive Director

Peter Dubens

Non Executive Director

Laurence Blackall

Non Executive Director

Registered Office

Carlton House
27A Carlton Drive
London
SW15 2BS

Registered Number

3974683

Auditors

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8 Salisbury Square
London
EC4Y 8BB

Stockbrokers

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

Solicitors

Mayer Brown Rowe & Maw
11 Pilgrim Street
London
EC4V 6RW

Registrar

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

Bankers

HSBC Bank plc
26 Broad Street
Reading
Berkshire
RG1 2BU

Board of Directors and Senior Management

Grahame Purvis, Chairman & Chief Executive

Grahame Purvis, an economics graduate, started his career in the oil industry as a marketing executive with BP. Grahame has 14 years experience in the high technology and telecommunications sector. He has held senior board appointments in Blick plc, Cable and Wireless plc and Mercury Communications. At Mercury he was responsible for the initial commercial service launch and subsequently, as the first general manager, for generating the early rapid growth in revenue and profits. He was appointed to the management board in 1990 and the group executive committee in 1992. He is experienced in high tech start-up businesses from his three-year spell as Managing Director of Mercury Enterprises, where he was responsible for managing and developing the group's portfolio of value-added businesses. During this time he was also Chairman of Mercury's mobile businesses. Prior to founding Zipcom (now GX Networks), Grahame was a main board Director of Blick plc and Managing Director of its main UK business for 2½ years.

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 GX Networks) 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 and 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 and Wireless.

Jon Richards, Non Executive Director

Jon Richards is Chairman of Ramesys Ltd a privately owned Software Services company. Jon works with a number of other companies as a Non Executive Director or Chairman, including Belle Associates Ltd, Interactive 1 Ltd, and MM Group Ltd. Jon has a wealth of relevant experience in the UK IT industry and was Chief Executive Officer of Anite Group Plc from 1989 to 1997. He also served as Chairman of the National Council for Education & Technology, reporting to the Minister of State from 1992 to 1995.

Peter Dubens, Non Executive Director

Peter Dubens has experience in the start-up, development and acquisition of businesses both in the public and private sectors. He is a founding director of both ukbetting plc and Paradigm Media Investments plc and a non-executive director of Stirling Group plc. He is also a co-founder of Avocet Capital Management Ltd, a European technology hedge fund management business, and a director of a number of privately held companies.

Board of Directors and Senior Management (continued)

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 businesses, which was then acquired by Zipcom PLC and then became GX Networks plc.

Senior Management Team

Mike Read, Managing Director

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 out of 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.

Dominic Crolla, Commercial Director

Prior to joining the Company Dominic spent 9 years in senior finance roles with Cable & Wireless. After executing a number of large structured finance transactions and cross border M&A deals, Dominic led Cable & Wireless' privatisation bid for the Panamanian state owned telco, negotiating the regulatory framework and new telco licences in the process. The successful bid led to an appointment as the CFO for Cable & Wireless Panama where he introduced a strong cash management philosophy. He later moved back to the UK as Finance Director of Cable & Wireless Global Network, responsible for setting up the finance function of the Global Network and overseeing the finances of a number of European subsidiary companies. Dominic joined GX Networks in 2001 as Chief Financial Officer.

With considerable experience of international telecommunications, fixed mobile and data businesses Dominic is well placed to use his financial expertise to develop the new commercial opportunities for the business and to enhance existing customer and supplier relationships.

Directors' Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

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 to 3 and the operational and financial review on pages 4 to 5.

Financial results and dividends

The results for the group for the year are shown in the profit and loss account on page 18.

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:

Grahame Purvis	Chairman and Chief Executive
Stewart Porter	Chief Financial Officer
Colin McKee	Technical Director (resigned 21 March 2002)
Paul Maher	Non Executive (resigned 27 September 2002)
Jon Richards	Non Executive
Peter Dubens	Non Executive (appointed 23 October 2002)

Laurence Blackall joined the Board as a non executive director on 3 March 2003.

Peter Dubens and Laurence Blackall, both 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.

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

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 13 to 15.

Stewart Porter resigned as Company Secretary on 27 January 2003 and Christina Kennedy was appointed as Company Secretary on the same date.

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.

Substantial shareholdings

As of 17 June 2003, the latest practicable date prior to the publication of this report, the company had been notified of the following significant shareholdings:

	%
UBS Warburg	20.5
P Dubens	14.7
L Blackall	14.7
Throgmorton Trust	5.0
C McKee	3.5
Jupiter Asset Management	3.3

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 2002 as a proportion of amounts invoiced by suppliers during the period represent 48 days (2001: 48 days) for the existing business and 68 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 it 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 14 August 2003 at 10.30 a.m. at 25 St James's Street, London SW1A 1HA. Details of the Special Business to be conducted thereat are located on pages 42 and 43.

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 19 June 2003.

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

Stewart Porter

Chief Financial Officer

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 recognises the importance of, and is committed to, ensuring that effective corporate governance procedures are in place.

The Board and Committees

At 1 January 2002 the Board comprised three executive directors (G Purvis, S Porter and C McKee) and two non-executive directors (P Maher and J Richards). C McKee resigned on 21 March 2002 and P Maher resigned on 27 September 2002. P Dubens was appointed to the Board on 23 October 2002 as a non executive director. L Blackall was appointed to the Board on 3 March 2003 as a non executive director. J Richards is considered the only independent non-executive director.

The Board, which meets at least seven 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.

The Board is chaired by Grahame Purvis who also acts as the Company's Chief Executive Officer. Due to the size of the business the Company did not segregate these two roles in the period under review.

The Remuneration Committee, until 27 September 2002, consisted of J Richards and P Maher. P Maher resigned from the Committee on 27 September 2002. P Dubens was appointed to the Committee on 23 October 2002. The Committee is chaired by J Richards. The report on directors' remuneration on pages 13 to 15 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 2002 the Audit Committee comprised G Purvis, J Richards and P Maher. P Maher resigned on 27 September 2002 and Peter Dubens was appointed on 1 November 2002. 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. 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.

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.gxn.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 separate notice sent to all shareholders on pages 42 to 45.

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 main elements of the internal control system are:

- The results of operating units are reported monthly and reviewed by the Board at its regular meetings.
- Management reports are tailored to the business and the needs of management performance, indicators are regularly reviewed and addressed.
- In addition to monthly reporting, certain management information is reported more frequently where considered appropriate.
- Annual budgets are prepared for all operating units which are reviewed by the Board.

In the case of Transigent Limited, acquired in October 2002, the internal controls in place have been reviewed against the group's existing controls. There is therefore a period post acquisition where the internal controls are incomplete. However the directors have addressed this and have integrated the group's controls into Transigent.

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. These risks are assessed on a regular basis and may be associated with a variety of internal or external sources, including control breakdowns, disruption in information systems, competition, human resource issues and regulatory requirements. This is carried out through board meetings and monthly reviews with group senior management.

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 concluded that due to the size of the group, this is not necessary 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 18 to 41.

Board Report on Directors' Remuneration

Remuneration Committee

The Remuneration Committee, until 27 September 2002, consisted of J Richards and P Maher. P Maher resigned from the Committee on 27 September 2002. P Dubens was appointed to the Committee on 23 October 2002. The Committee is chaired by J Richards.

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. Employees throughout the group, including executive directors, have performance reviews annually. The main components of the executive directors' and senior managers' remuneration are:

- a base salary
- an annual performance bonus
- pension provision
- benefits in kind
- share options

The group operates a Discretionary Bonus Scheme. Payments may be made annually.

For the year under review, salaries were again held at existing levels and no payments were made under the Discretionary Bonus Scheme.

The group makes contributions to money purchase personal pension schemes on behalf of all 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 17 to the financial statements.

Set out below are the total remuneration, shareholdings and option interests of the directors for the year:

Directors' remuneration

	Salaries & Fees £000	Benefits £000	Bonus £000	Compensation for loss of office £000	Total 2002 £000	Total 2001 £000	Pension 2002 £000	Pension 2001 £000
Executive								
G Purvis	135	12	–	–	147	155	24	23
S Porter	135	11	–	–	146	151	24	23
C McKee	24	2	–	175	201	151	4	21
Non-executive								
P Nelson	–	–	–	–	–	75	–	–
P Maher	15	–	–	–	15	20	–	–
J Richards	20	–	–	–	20	17	–	–
P Dubens	4	–	–	–	4	–	–	–
	333	25	–	175	533	569	52	67

Board Report on Directors' Remuneration (continued)

Directors' shareholdings

	1p ordinary shares at 31 December 2002	1p ordinary shares at 31 December 2001 or on appointment
G Purvis	6,175,000	6,175,000
S Porter	174,500	174,500
J Richards	–	–
P Dubens	138,888,889	–

Laurence Blackall held 138,888,889 1p ordinary shares in the Company at 31 December 2002 and was subsequently appointed to the Board on 3 March 2003.

Directors' share options

	Note	Number of options at 1 Jan 2002	Awarded during the year	Number of options at 31 Dec 2002	Exercise price (p) at 1 Jan 2002	Exercise period
G Purvis	(i)	989,130	–	989,130	1.00p	20 November 2001 to 19 November 2011
	(ii)	4,058,008	–	4,058,008	1.00p	20 November 2001 to 19 November 2011
	(iii)	5,253,000	–	5,253,000	5.50p	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	8.00p	27 December 2001 to 26 December 2011
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	5.50p	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	8.00p	27 December 2001 to 26 December 2011
J Richards	–	–	–	–		
P Dubens	–	–	–	–		

(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 million.

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. The 5.50p shares are only exercisable once the Company's market capitalisation reaches £25 million. The other options have no performance criteria attached.

Board Report on Directors' Remuneration (continued)

Also on 20 February 2003 the Remuneration Committee approved further option grants to Grahame Purvis and Stewart Porter. Each of them was granted 10,697,280 options over 1p ordinary shares at an exercise price of 2.25p with an exercise period of 20 February 2003 to 19 February 2013. These options may not be exercised until the Company's share price is 3.00p or above.

In addition, each was granted a further 10,697,280 options over 1p ordinary shares at an exercise price of 2.25p with an exercise period of 20 February 2004 to 19 February 2013. These options may not be exercised until the Company's share price is 5.00p or above.

No directors exercised options during the year.

The mid-market price for the Company's shares at 31 December 2002 was 2.25p. The high and low mid-market prices of the ordinary shares during the year to 31 December 2002 were 5.50p and 2.00p respectively.

Service contracts

Following their renewal on 24 September 2002 both Mr Purvis and Mr Porter have service contracts for a term of two years from that date. The contracts revert to a period of 12 months notice from 25 September 2004. Whilst the Combined Code suggests there is a strong case for setting such terms at one year or less, the Board deemed it necessary to offer lengthened terms to secure the continued services of both directors through this vital period in the Company's development. It should be noted that both Mr Purvis and Mr Porter are well qualified for their respective roles with many years experience relevant to the Company's business.

On behalf of the Board

Stewart Porter

Chief Financial Officer

19 June 2003

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 GX Networks plc

KPMG Audit Plc
PO Box 695
8 Salisbury Square
London EC4Y 8BB
United Kingdom

We have audited the financial statements on pages 18 to 41.

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 16 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, 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 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 2002 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

19 June 2003

Consolidated Profit and Loss Account

for the year ended 31 December 2002

	Note	Continuing Operations		Total 2002 £000	2001 £000
		2002 £000	Acquisitions 2002 £000		
Turnover	1, 2	5,033	3,026	8,059	3,320
Cost of sales		(4,200)	(1,883)	(6,083)	(2,629)
Gross profit		833	1,143	1,976	691
Operating expenses		(9,654)	(4,074)	(13,728)	(8,377)
Operating loss	3	(8,821)	(2,931)	(11,752)	(7,686)
Net interest (payable)/receivable	5	(10)	–	(10)	207
Loss on ordinary activities before taxation		(8,831)	(2,931)	(11,762)	(7,479)
Tax on loss on ordinary activities	6	–	–	–	–
Loss for the financial year		(8,831)	(2,931)	(11,762)	(7,479)
Loss per ordinary share – basic	24			3.2p	4.7p

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 historical cost basis for both periods is the same as the results reported above.

Consolidated Balance Sheet

at 31 December 2002

	Note	2002 £000	2002 £000	2001 £000	2001 £000
Fixed assets					
Intangible assets					
Positive goodwill	7	9,078		–	
Negative goodwill	7	(544)		(770)	
			8,534		(770)
Tangible assets	8		12,445		4,890
			20,979		4,120
Current assets					
Debtors	10	3,016		1,906	
Cash at bank and in hand	11	5,368		10,503	
		8,384		12,409	
Creditors: amounts falling due within one year	12	(16,194)		(5,266)	
Net current (liabilities)/assets			(7,810)		7,143
Total assets less current liabilities			13,169		11,263
Creditors: amounts falling due after one year (including convertible debt)	13		(6,166)		(1,906)
Provisions for liabilities and charges	14		(752)		(47)
Net assets			6,251		9,310
Capital and reserves					
Called up share capital	17		7,100		2,857
Share premium account	20		17,583		16,595
Capital reserve	20		207		207
Other reserves	20		3,472		–
Profit and loss account	20		(22,111)		(10,349)
Equity shareholders' funds			6,251		9,310

The accounts on pages 18 to 41 were approved by the Board of Directors on 19 June 2003 and were signed on its behalf by:

Grahame Purvis
Chairman and Chief Executive

Stewart Porter
Chief Financial Officer

Company Balance Sheet

at 31 December 2002

	Note	2002 £000	2002 £000	2001 £000	2001 £000
Fixed assets					
Investments	9		10,116		740
Current assets					
Debtors	10	49		91	
Cash at bank and in hand	11	3,668		8,973	
		3,717		9,064	
Creditors: amounts falling due within one year	12	(2,189)		(15)	
Net current assets			1,528		9,049
Total assets less current liabilities			11,644		9,789
Creditors: due after more than one year (including convertible debt)	13		(5,060)		–
Net assets			6,584		9,789
Capital and reserves					
Called up share capital	17		7,100		2,857
Share premium account	20		17,583		16,595
Other reserves	20		3,472		–
Profit and loss account	20		(21,571)		(9,663)
Equity shareholders' funds			6,584		9,789

The accounts on pages 18 to 41 were approved by the Board of Directors on 19 June 2003 and were signed on its behalf by:

Grahame Purvis
Chairman and Chief Executive

Stewart Porter
Chief Financial Officer

Consolidated Cash Flow Statement

for the year ended 31 December 2002

	Note	2002 £000	2001 £000
Cash outflow from operating activities	21	(7,407)	(4,150)
Returns on investment and servicing of finance			
Interest received		202	459
Interest element of finance lease payment		(190)	(133)
		12	326
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(480)	(452)
Proceeds from disposals of tangible fixed assets		64	–
		(416)	(452)
Acquisitions			
Purchase of subsidiary undertakings		168	–
Purchase of business assets and contracts		–	(931)
Cash inflow/(outflow) in respect of acquisitions		168	(931)
Cash outflow before management of liquid resources and financing		(7,643)	(5,207)
Management of liquid resources			
Cash withdrawn from/(placed on) term deposit		6,041	(8,769)
Financing			
Issue of ordinary share capital		2,930	5,998
Expenses on issue of ordinary share capital		(477)	(242)
Issue of convertible loan stock		1,570	–
Cash inflow from asset financing		–	589
Capital element of finance lease payments		(1,515)	(714)
Net cash inflow from financing		2,508	5,631
Increase/(decrease) in cash in the period		906	(8,345)

Consolidated Cash Flow Statement (continued)

Reconciliation of net cash flow to movement in net funds for the year ended 31 December 2002

	2002 £000	2001 £000
Increase/(decrease) in cash in period	906	(8,345)
Net movement in liquid resources	(6,041)	8,769
Cash inflow from convertible loan stock	(1,570)	–
Cash outflow from lease financing	1,515	125
Change in net funds resulting from cash flows	(5,190)	549
Finance leases acquired	(1,113)	(2,439)
Issue of loan notes	(3,490)	–
New finance leases	–	(895)
Movement in net funds	(9,793)	(2,785)
Opening net funds	7,293	10,078
Closing net (debt)/funds	(2,500)	7,293

Analysis of net funds/(debt) at 31 December 2002

	At 1 January 2002 £000	Cashflow £000	Other £000	At 31 December 2002 £000
Cash	1,733	906	–	2,639
Short term deposits	8,323	(8,073)	–	250
Restricted deposits	447	2,032	–	2,479
Cash at bank and in hand per balance sheet	10,503	(5,135)	–	5,368
Finance leases	(3,210)	1,515	(1,113)	(2,808)
Debt due in more than 1 year				
Convertible loan stock	–	(1,570)	–	(1,570)
Loan notes	–	–	(3,490)	(3,490)
Net funds/(debt)	7,293	(5,190)	(4,603)	(2,500)

Acquisitions

The subsidiary undertaking acquired during the year accounted for £1,774,000 of the group's net operating cash outflows, received £2,000 in respect of interest, and utilised £47,000 for capital expenditure.

Loan notes issued during the year of £3,490,000 were issued as part of the consideration for the acquisition of Transigent Limited (see Note 19). No cash flow impact arose from the issue of these loan notes.

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 December 2002

	Group 2002 £000	Group 2001 £000	Company 2002 £000	Company 2001 £000
Loss for the financial year	(11,762)	(7,479)	(11,908)	(9,990)
New share capital subscribed (net of issue costs)	8,703	5,742	8,703	5,742
Net reduction in shareholders' funds	(3,059)	(1,737)	(3,205)	(4,248)
Opening shareholders' funds	9,310	11,047	9,789	14,037
Closing shareholders' funds	6,251	9,310	6,584	9,789

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.

The group has adopted FRS 19 "Deferred Tax" in these financial statements. There is no prior year adjustment in these financial statements as the amounts involved are not material.

Basis of preparation

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

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 2002. 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 GX Networks 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 2002 the group had cash of £5,368,000 (of which £2,479,000 was restricted). Subsequent to the year end the group raised £4,800,000, net of expenses. 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 December 2002.

Turnover

Turnover comprises the value of telecommunication services provided net of value added tax.

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.

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 (25 years)
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 against profit 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.

Intercompany balances

Provision is made to write down intercompany balances to the underlying net assets of the relevant subsidiary undertakings. These provisions have no impact on the consolidated financial statements and will be released when future profits are made.

Notes to the Financial Statements (continued)

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.

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

	2002	2001
	£000	£000
<i>Operating loss is stated after charging/(crediting):</i>		
Auditors' remuneration:		
– audit	75	25
– other services	35	8
Depreciation and other amounts written off tangible fixed assets:		
– owned assets	809	814
– under finance leases	1,230	567
– impairment charge	–	795
Amortisation of:		
– negative goodwill (see note 7)	(226)	(131)
– positive goodwill (see note 7)	152	–
Rentals payable under operating leases:		
– land and buildings	360	137
– other operating leases	545	64

Auditors' remuneration disclosed above includes £15,000 (2001: £5,000) in respect of the Company. In addition £140,000 was paid as part of the acquisition expenses for Transigent Limited, these are included in the cost of investment.

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 period was as follows:

	2002	2001
	Number	Number
Full time operations staff	123	51

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

	2002	2001
	£000	£000
Wages and salaries	6,907	2,899
Social security costs	612	146
Pension costs	193	151
	7,712	3,196

Remuneration of directors:

	2002	2001
	£000	£000
Emoluments for services as a director	533	569
Pension contributions	52	67
	585	636

Emoluments of the highest paid director (including compensation for loss of office but excluding pension contributions) were £201,000 (2001: £155,000). Amounts paid by the group in respect of his pension contributions were £4,000 (2001: £23,000).

Details of pension contributions are set out in note 18 to the accounts.

5 Interest

	2002	2001
	£000	£000
Interest payable on finance leases	(190)	(154)
Interest payable on loan notes	(22)	–
Bank deposit interest receivable	202	361
Net interest (payable)/receivable	(10)	207

Notes to the Financial Statements (continued)

6 Taxation

There is no charge to corporation tax due to the losses in each year. At 31 December 2002 there are unrelieved losses in the group of approximately £69,100,000 (including losses acquired on acquisition of Transigent Limited) (2001: £8,400,000).

Factors affecting the expected tax credit are as follows:

	2002	2001
	£000	£000
Loss on ordinary activities before tax	(11,762)	(7,479)
Loss on ordinary activities multiplied by standard rate of UK corporation tax (30%)	(3,529)	(2,243)
Effects of:		
Non-deductible amortisation	(22)	(39)
Depreciation in excess of capital allowances	709	525
Permanent disallowable items	63	212
Other timing differences, including unrelieved tax losses carried forward	2,779	1,545
	-	-

Deferred tax

The amounts of unrecognised deferred taxation assets comprise:

	2002	2001
	£000	£000
Accelerated capital allowances	9,399	805
Unrelieved tax losses	20,727	2,240
Other timing differences	457	-
	30,583	3,045

Notes to the Financial Statements (continued)

7 Intangible assets

	Positive goodwill £000	Negative goodwill £000	Total £000
Group			
Cost			
At 1 January 2002	–	(901)	(901)
Additions	9,230	–	9,230
At 31 December 2002	9,230	(901)	8,329
Amortisation			
At 1 January 2002	–	131	131
(Charge)/credit for the year	(152)	226	74
At 31 December 2002	(152)	357	205
Net book value			
At 31 December 2002	9,078	(544)	8,534
At 31 December 2001	–	(770)	(770)

Negative goodwill amortised during the year arose due to the acquisition of the business and assets of HighwayOne Corporation Limited in 2001. This negative goodwill is being amortised over four years. Positive goodwill arising in the year is due to the acquisition of Transigent Limited on 23 October 2002 (see note 19), and is being amortised over ten years.

The Company held no intangible assets at 31 December 2002 or at 31 December 2001.

Notes to the Financial Statements (continued)

8 Tangible fixed assets

Group	Leasehold improvement £000	Network infrastructure £000	Office equipment £000	Plant and machinery £000	Total £000
Cost					
At 1 January 2002	199	6,657	160	65	7,081
Acquisitions (see note 19)	499	8,608	25	–	9,132
Additions	–	472	8	–	480
Disposals	–	–	–	(54)	(54)
At 31 December 2002	698	15,737	193	11	16,639
Depreciation					
At 1 January 2002	54	2,072	44	21	2,191
Charge for year	65	1,865	87	22	2,039
Disposals	–	–	–	(36)	(36)
At 31 December 2002	119	3,937	131	7	4,194
Net book value					
At 31 December 2002	579	11,800	62	4	12,445
At 31 December 2001	145	4,585	116	44	4,890

Included in the total net book value of Network infrastructure is £2,258,000 (2001: £3,357,000) in respect of assets held under finance leases. Depreciation for the year on these assets was £1,230,000 (2001: £567,000)

Notes to the Financial Statements (continued)

9 Fixed asset investments

Company	Shares in Group undertakings £000
Cost	
1 January 2002	740
Additions	10,116
At 31 December 2002	10,856
Amounts provided	
1 January 2002	–
Provided in the year	740
At 31 December 2002	740
Net book value	
At 31 December 2002	10,116
At 31 December 2001	740

The principal subsidiary undertakings of the group are as follows:

Name	Class of share capital held	Proportion held	Nature of business/activity
Zipcom Telecommunications Limited *	Ordinary shares	100%	Telecommunications
HighwayOne Limited	Ordinary shares	100%	Telecommunications
Transigent Limited *	Ordinary shares	100%	Telecommunications
GXN Limited	Ordinary shares	100%	Telecommunications
GX Networks Services Limited	Ordinary shares	100%	Telecommunications
GX Networks UK Limited	Ordinary shares	100%	Telecommunications
GX Networks Nine Limited	Ordinary shares	100%	Telecommunications

* directly held by the Company

Notes to the Financial Statements (continued)

10 Debtors

<i>Debtors due within one year</i>	Group	Group	Company	Company
	2002	2001	2002	2001
	£000	£000	£000	£000
Trade debtors	1,177	639	–	–
Amounts owed by group undertakings	–	–	–	84
Other debtors	382	461	49	7
Prepayments and accrued income	1,457	806	–	–
	3,016	1,906	49	91

Included in prepayments and accrued income are rent deposits of £230,000 (2001: £118,000) which are recoverable after more than one year.

Amounts owed by group undertakings are considered to be due after one year.

11 Cash at bank and in hand

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

Included in group cash at bank and in hand are funds of £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 13).

Also included within cash at bank and in hand is £490,000 (2001: £447,000) 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:

	2002	2001
	£000	£000
Less than one year	296	213
One to two years	68	40
Two to five years	126	194
	490	447

Group cash at bank and in hand includes short term deposits of £0.25 million (2001:£8.3 million) realisable between two weeks and six months.

The balance of group cash at bank and in hand, being £2.64 million, 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 £1,989,000 held in a restricted deposit account (see above) and £1,679,000 held in current accounts, overnight money market accounts and no notice deposit accounts.

Notes to the Financial Statements (continued)

12 Creditors: amounts falling due within one year

	Group	Group	Company	Company
	2002	2001	2002	2001
	£000	£000	£000	£000
Trade creditors	5,331	2,338	57	15
Amounts owed to group undertakings	–	–	2,132	–
Taxation and social security	703	184	–	–
Other creditors	30	1	–	–
Accruals and deferred income	8,428	1,439	–	–
Lease creditors	1,702	1,304	–	–
	16,194	5,266	2,189	15

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

	Group	Group	Company	Company
	2002	2001	2002	2001
	£000	£000	£000	£000
Convertible loan stock	1,570	–	1,570	–
Loan notes	3,490	–	3,490	–
Obligations under finance leases	1,106	1,906	–	–
	6,166	1,906	5,060	–

The convertible loan stock is unsecured and is redeemable at par on 31 December 2012. Interest is payable at a rate of 7.5% per annum in two half yearly instalments on 30 June and 31 December each year.

Conversion to ordinary shares is at the option of the loan stock holder at a rate of 2.75p of loan stock per ordinary share.

Conversion at the option of the Company may also take place after 1 January 2005 if the mid market price of ordinary shares as shown in the daily official list of the London Stock Exchange exceeds 5.5p for 20 consecutive business days. Conversion is at a rate of 2.75p of loan stock per ordinary share.

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 of a rate of 0.5% below base lending rate.

Second consideration loan note – £1,501,000

The second consideration loan note carries interest at 3%.

Neither loan note can be redeemed prior to 31 January 2004.

Notes to the Financial Statements (continued)

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

The maturity of obligations under finance leases is as follows:

	2002	2001
	£000	£000
Group		
Within one year	1,702	1,304
In the second to fifth years	1,106	1,906
Over five years	–	–
	<hr/> 2,808 <hr/>	<hr/> 3,210 <hr/>

The Company does not hold any assets under finance leases.

14 Provisions for liabilities and charges

	£000
Group	
At 1 January 2002	47
Arising on the acquisition of a subsidiary undertaking	658
Arising during the year	81
Released during the year	(34)
	<hr/> 752 <hr/>
At 31 December 2002	

The provision brought forward at 1 January 2002 relates to the National Insurance payable on exercise of share options according to UITF 25. Additional provisions arising during the year relate to onerous leases upon acquisition.

Notes to the Financial Statements (continued)

15 Operating leases

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

	Short leasehold property 2002 £000	Other 2002 £000	Short leasehold property 2001 £000	Other 2001 £000
Within one year	–	1,144	80	–
Within two to five years	467	770	173	64
After five years	187	–	–	–
	654	1,914	253	64

In addition to the above, the group had an annual commitment in respect of telecom circuits of £4,571,000 (2001: £1,464,000). Typically these leases are twelve months in length and cancellable at 7 days notice following the end of the initial twelve month period.

16 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 all following disclosures.

16 Financial instruments (continued)

(i) Interest rate risk

The group financed its operations throughout the year from bank deposits. The group does not consider that its current exposure to movements in interest rates is sufficient to necessitate hedging. The interest rate exposure of the financial assets of the group as at 31 December was:

	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
	<hr/> 2,479	<hr/> 2,488	<hr/> 401	<hr/> 5,368
	Fixed 2001 £000	Floating 2001 £000	Nil 2001 £000	Total 2001 £000
Sterling	8,884	1,188	205	10,277
US\$	–	–	226	226
	<hr/> 8,884	<hr/> 1,188	<hr/> 431	<hr/> 10,503

(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 and loan stock.

(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)

17 Called up share capital

Authorised and allotted share capital

	2002	2001
	£000	£000
Authorised		
Equity: 1,500,000,000 ordinary shares of 1p each	15,000	15,000
	2002	2001
	£000	£000
Allotted, called up and fully paid		
Equity: Ordinary shares of 1p each		
At 1 January 2002	2,857	1,523
Issued during year	4,243	1,334
At 31 December 2002	7,100	2,857

On 23 October 2002 Zipcom plc issued 277,777,778 ordinary shares at 2.25p per share to acquire Transigent Limited. On the same day a further 146,500,000 shares were issued by the Company via an institutional placing at 2p per share.

Share options

At 31 December 2002 rights to options over 28,030,731 ordinary shares of the Company were outstanding as follows:

	At 1 January 2002	Granted	Exercised/ Lapsed	At 31 December 2002	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	5.50p	27.12.2001 to 26.12.2011
	5,204,880	–	–	5,204,880	8.00p	27.12.2001 to 26.12.2011
EMI scheme	1,978,260	–	–	1,978,260	1.00p	20.11.2001 to 19.11.2011
	4,840,000	–	(1,250,000)	3,590,000	5.75p	20.11.2001 to 19.11.2011
	<u>29,280,731</u>	<u>–</u>	<u>(1,250,000)</u>	<u>28,030,731</u>		

At 31 December 2002 there were a further 59,254,205 shares available for grant under options.

18 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 £193,000 (2001: £151,000).

The outstanding contributions to the pension scheme were nil (2001: nil).

Notes to the Financial Statements (continued)

19 Acquisition

On 23 October 2002 the group acquired Transigent Limited and its subsidiaries ("Transigent") financed by the issue of ordinary share capital (£6.25 million) and issue of loan notes (£3.49 million), giving rise to total consideration of £9.74 million (excluding capitalised costs of acquisition). Costs of acquisition were £376,000.

The acquisition contributed turnover of £3,026,000 in the year; an operating loss of £2,931,000 (after allowing for goodwill amortisation of £152,000) and accounted for cash outflows from operating activities of £1,774,000. The acquisition has been accounted for using acquisition accounting principles.

The Company that heads the trading operations of Transigent is GXN Limited. The consolidated turnover and operating loss of GXN Limited between 1 January 2002 and 22 October 2002 were £19.1 million and £5.9 million respectively. The net assets of GXN Limited at 31 December 2001 were £9.5 million and operating losses for the year to 31 December 2001 were £44.4 million. The results of Transigent Limited itself for the above periods were not material.

Goodwill of £9.2 million on acquisition has been capitalised in full. Goodwill is being amortised over 10 years, the useful economic life of the business acquired.

The following table demonstrates how goodwill was calculated and how the consideration was satisfied:

	Net book value at 23 October 2002 £000	Fair value adjustments £000	Fair value £000
Fixed assets	11,784	(2,652)	9,132
Stock	61	–	61
Debtors	2,320	(254)	2,066
Cash	544	–	544
Creditors (falling due within one year)	(9,776)	(454)	(10,230)
Creditors (falling due after one year)	(29)	–	(29)
Provisions	–	(658)	(658)
Net assets	4,904	(4,018)	886
Goodwill			9,230
Consideration (including capitalised costs of acquisition)			10,116
Satisfied by:			
Loan notes of 1/2% below base lending rate (first loan note)			1,989
Loan notes of 3% (second loan note)			1,501
277,777,778 ordinary shares at market value of 2.25p each			6,250
Costs of acquisition			376
			10,116

Notes to the Financial Statements (continued)

19 Acquisition (continued)

Explanatory Notes:

Fixed assets

The figure for fair value adjustment reflects the directors' valuation of the main classes of fixed assets held by the acquired Company.

Debtors

Bad debt provision has been reviewed and adjusted as appropriate.

Creditors and provisions

Included in the total figure are provisions relating to the rent, rates and post year end reverse premiums pertaining to surplus properties and amounts relating to the under accrual of creditors prior to acquisition.

The above assessment of fair values for net assets acquired is still preliminary and will be reviewed by the directors at 31 December 2003.

20 Reconciliation of movements in shareholders' funds

	Share capital £000	Share premium account £000	Capital reserve £000	Other reserves £000	Profit and loss account £000	Total £000
Group						
At 1 January 2002	2,857	16,595	207	–	(10,349)	9,310
Issue of shares	4,243	1,465	–	3,472	–	9,180
Issue costs	–	(477)	–	–	–	(477)
Retained loss for the year	–	–	–	–	(11,762)	(11,762)
At 31 December 2002	7,100	17,583	207	3,472	(22,111)	6,251
Company						
At 1 January 2002	2,857	16,595	–	–	(9,663)	9,789
Issue of shares	4,243	1,465	–	3,472	–	9,180
Issue costs	–	(477)	–	–	–	(477)
Retained loss for the year	–	–	–	–	(11,908)	(11,908)
At 31 December 2002	7,100	17,583	–	3,472	(21,571)	6,584

The other reserves represent the premium on shares issued as part of the consideration for the acquisition of Transgent Limited (see note 19).

Notes to the Financial Statements (continued)

21 Reconciliation of operating loss to operating cash flows

	2002	2001
	£000	£000
Operating loss	(11,752)	(7,686)
Depreciation and impairment charges	2,039	2,176
Amortisation (credits)	(74)	(131)
Profit on sale of fixed assets	(46)	–
Decrease/(increase) in debtors	811	(856)
Increase in creditors	1,567	2,571
Non cash charge/(credit) in respect of provisions	48	(224)
Net cash outflow from operating activities	<u>(7,407)</u>	<u>(4,150)</u>

22 Related party disclosures

Paul Maher, a non-executive director of the Company who resigned during the year, is a Partner in Mayer, Brown, Rowe and Maw, the group's solicitor, who provided legal advice throughout the year. During the year Mayer, Brown, Rowe and Maw have provided services to the group to the value of £78,000 of which £4,000 was payable at 31 December 2002.

Included in long term creditors are amounts of £3,490,000 owed in equal share to Peter Dubens and Laurence Blackall, directors of the Company. These relate to loan notes issued on the acquisition of Transigent Limited by GX Networks plc. Additional disclosure in respect of the terms of these loan notes is included in note 13.

23 Contingent liabilities

The Company has guaranteed the rental payments of a tenant in respect of the sublease of one of its properties until 24 March 2004. The guaranteed amount of £203,000 represents the rental charge from the Balance Sheet date to the lease termination date.

Notes to the Financial Statements (continued)

24 Loss per share

	Year ended 31 December 2002	Year ended 31 December 2001
Loss for the financial period attributable to shareholders	£11,762,000	£7,479,000
Weighted average number of equity shares in issue	365,930,208	159,348,409
Basic loss per equity share	3.2p	4.7p

In accordance with Financial Reporting Standard 14 Earnings per share, diluted loss per share has not been disclosed, as the impact of potential shares is anti-dilutive.

25 Post balance sheet events

On 31 March 2003, the Company placed 236,667,000 new ordinary shares of 1p each at a price of 2.125p per share on AIM. The placing raised £5.03 million (before expenses) (£4.8 million net) for the Company.

On 15 May 2003 £50,000 of Unsecured Convertible Redeemable 7.5% 2012 Loan Stock was converted to 1,818,182 ordinary shares of 1p each at 2.75p.

On 2 June 2003 £125,000 of Unsecured Convertible Redeemable 7.5% 2012 Loan Stock was converted to 4,545,455 ordinary shares of 1p each at 2.75p.

The total ordinary shares of 1p each in issue at 17 June 2003 was 953,032,687.

Shareholder approval will be sought at the Annual General Meeting, as special business, to the Resolutions numbered 6, 7 and 8 as set out in the Notice of Annual General Meeting on pages 44 and 45 and summarised below.

Resolutions numbered 6 and 7 – Authority to allot shares and disapplication of pre-emption rights

Under the Companies Act 1985, the directors of the Company may only allot unissued shares if authorised to do so by the shareholders in a general meeting. Article 8.2.1 of the Company's Articles of Association contains a general authority for the Directors to allot shares in the Company for a period (not exceeding 5 years) (the "prescribed period") and up to a maximum aggregate nominal amount (the "Section 80 amount") approved by a Special or Ordinary Resolution of the Company. In addition Article 8.2.2 empowers the directors, during the prescribed period, to allot shares for cash in connection with a rights issue, to meet certain practical difficulties which may arise in connection with fractional entitlements or in respect of overseas shareholders as a result of local laws and which prevent shares from being issued pro rata, and also to allot shares in any other circumstances up to a maximum aggregate nominal amount approved by a Special Resolution of the Company (the "Section 89 amount"). Ordinary Resolution 6, which will be proposed as an Ordinary Resolution, replaces the directors' existing authority and provides for the Section 80 amount to be £3,176,775, representing one third of the Company's issued ordinary share capital at the date of this notice.

If new shares are to be issued pursuant to the authority set out in Resolution 6, and are to be paid for in cash, the Companies Act 1985 requires that they must first be offered to existing shareholders, unless the approval of shareholders is given to disapply the relevant provisions of the Act. Resolution 7, which will be proposed as a Special Resolution, will only be effective if Resolution 6 is passed. It replaces the directors' existing authority granted by Special Resolution on 3 March 2003 and provides for the Section 89 amount to be £3,176,775, representing one third of the Company's issued ordinary share capital at the date of this notice.

These authorities replace the previous authorities granted at the Extraordinary General Meeting on 3 March 2003. The previous authorities were fully utilised when the Company placed 236,667,000 Ordinary Shares with institutional investors on 25 March 2003 to raise £5.03 million (before expenses). The Company's strategic objectives remain as stated in the notice convening the Extraordinary General Meeting referred to above. In particular, the Company needs to maintain the necessary framework to enable it to consider making acquisitions in exchange for shares and/or to strengthen further the Company's balance sheet by raising additional capital. For this reason shareholder approval to the renewal of these authorities is now sought. They will expire 15 months after the passing of the Resolutions or at the conclusion of the next Annual General Meeting whichever is the sooner, at which time the directors intend to seek renewal of the authorities.

Resolution number 8 – Repurchase of shares

The directors seek renewal of the authority granted at the Extraordinary General Meeting on 3 March 2003 for the Company to purchase its own ordinary shares of 1p each ("Ordinary Shares"). At the present time, the directors have no wish to exercise the power to purchase any of the issued Ordinary Shares of the Company. However, they consider it is appropriate to have the flexibility to do so. Accordingly, they recommend that power in certain circumstances to buy in and cancel Ordinary Shares up to a maximum prescribed limit be granted for a limited period. The directors will only implement such purchases, which will reduce the issued share capital of the Company, if they are satisfied, after careful consideration, that these are in the best interests of the Company and all its shareholders and would result in an increase in expected earnings per share. Furthermore, account will be taken of the overall financial implications for the Company.

Special Business at Annual General Meeting (continued)

Resolution 8, which will be proposed as a Special Resolution, authorises the directors to purchase up to a maximum of ten per cent of the issued share capital of the Company as at the date of this notice, and provides that the maximum price per Ordinary Share payable on any exercise of the authority shall not be more than 5 per cent above the average of the middle market quotations for the Ordinary Shares as derived from the Daily Official List of the London Stock Exchange for the 5 business days prior to making any purchase. The minimum price payable shall be 1p per Ordinary Share, being the nominal value of an Ordinary Share. For this purpose both the maximum and minimum prices permitted to be paid are exclusive of expenses. The authority will expire on 14 August 2004 or at the conclusion of the next Annual General Meeting, whichever is the sooner.

In the event that the authority is exercised, any right to adjustment of the holdings of Unsecured Convertible Redeemable 7.5% 2012 Loan Stock will be taken into consideration.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of GX NETWORKS PLC will be held at the Economist Building, 25 St James's Street, London SW1A 1HA on Thursday 14 August 2003 at 10.30 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 2002 together with the report of the auditors thereon.
2. To re-elect Grahame Purvis as a director, who retires pursuant to Article 102 of the Company's Articles of Association.
3. To re-elect Peter Dubens as a director, who retires pursuant to Article 102 of the Company's Articles of Association.
4. To re-elect Laurence Blackall 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 Resolutions of which Resolution 6 will be proposed as an Ordinary Resolution and Resolutions 7 and 8 will be proposed as Special Resolutions:

6. That:
 - (i) the authority to allot relevant securities and equity securities conferred on the directors by Article 8.2 of the Company's Articles of Association be and is hereby granted for the period ending on the date falling 15 months after the passing of this resolution or at the conclusion of the next Annual General Meeting of the Company to be held after the date of the passing of this Resolution whichever is the earlier (the "prescribed period"), and for that period the Section 80 amount shall be £3,176,775; and
 - (ii) all previous authorisations given by the Company in general meeting or otherwise pursuant to Section 80 of the Companies Act 1985 (the "Act") be and are hereby revoked to the extent not previously exercised.
7. That subject to the passing of Resolution 6 above, the power to allot relevant securities and equity securities conferred on the directors by Article 8.2 of the Company's Articles of Association be and is hereby granted for the prescribed period (as defined in Resolution 6 above) and for that period the Section 89 amount shall be £3,176,775. This authority and power shall revoke to the extent not previously exercised the power granted in this regard by the Company at the Extraordinary General Meeting held on 3 March 2003.
8. That the Company be and is hereby granted general and unconditional authority (pursuant to Section 166 of 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

Notice of Annual General Meeting (continued)

- (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 14 August 2004 (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

Christina Kennedy – *Secretary*

19 June 2003

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.



GX NETWORKS

GX Networks

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