

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt about the contents of this document, you are recommended to seek your own personal financial advice from a stockbroker, solicitor, accountant or other independent financial adviser duly authorised under the Financial Services and Markets Act 2000 who specialises in advising on the acquisition of shares and other securities.

Applications under the Open Offer may only be made on the accompanying Application Form, which is personal to the Shareholder(s) named thereon and cannot be sold, assigned, transferred or split except to satisfy *bona fide* market claims. If you have sold or otherwise transferred all of your Ordinary Shares prior to the "ex" date, please forward this document together with the accompanying Application Form and Form of Proxy as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was effected, for onward delivery to the purchaser or transferee, except that the accompanying Application Form should not be forwarded or transmitted into the United States, Canada, Australia, the Republic of Ireland or Japan or their respective territories or possessions. If you have sold or transferred only part of your holding of Ordinary Shares you should consult your stockbroker, bank or other agent through whom the sale or transfer was effected and refer to the instructions regarding split applications set out in the Application Form.

A copy of this document, which comprises a prospectus relating to IQE plc, prepared in accordance with the Public Offers of Securities Regulations 1995 as amended and the AIM Rules, has been delivered to the Registrar of Companies in England and Wales for registration in accordance with regulation 4(2) of those regulations.

The Directors of the Company, whose names appear on page 4 of this document, accept responsibility for the information contained in this document. To the best of their knowledge the information contained in this document is in accordance with the facts and makes no omission likely to affect the import of such information.

Evolution Beeson Gregory, which is authorised and regulated by the Financial Services Authority, is acting exclusively for IQE plc and no-one else in relation to the matters described in this document and will not be responsible to any other person for providing the protections afforded to customers of Evolution Beeson Gregory or for advising any such person on the contents of this document or any matter referred to herein. Evolution Beeson Gregory's responsibilities as the Company's nominated adviser are owed solely to the London Stock Exchange and are not owed to the Company or to any Director or to any other person, whether in respect of any decision to acquire New Ordinary Shares in reliance on any part of this document or otherwise. No representation or warranty, express or implied, is made by Evolution Beeson Gregory to the contents of this document (without limiting the statutory rights of any person to whom this document is issued).

IQE plc

(Incorporated in England and Wales under the Companies Act 1985 with registered number 3745726)

Issue of 125,000,000 New Ordinary Shares at 15 pence per New Ordinary Share

Notice of Extraordinary General Meeting

Nominated Adviser, Broker and Underwriter

EVOLUTION BEESON GREGORY LIMITED

Application has been made to the London Stock Exchange for the New Ordinary Shares to be admitted to trading on the Alternative Investment Market of the London Stock Exchange. It is expected that the New Ordinary Shares will be admitted to trading on AIM on 5 November 2003.

AIM is a market designed primarily for emerging or smaller companies to which a higher investment risk tends to be attached than to larger or more established companies. AIM securities are not admitted to the Official List of the UK Listing Authority. A prospective investor should be aware of the risks of investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with an independent financial adviser. The London Stock Exchange has not itself examined or approved the contents of this document.

The Open Offer expires at 3.00 p.m. on 31 October 2003. The procedure for application and payment is set out in Part 2 of this document and in the Application Form which accompanies this document. To be valid, duly completed Application Forms must be returned with the appropriate remittance so as to reach Capita IRG Plc, PO Box 166, Corporate Actions, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TH as soon as possible and, in any event, so as to be received no later than 3.00 p.m. on 31 October 2003.

The New Ordinary Shares have not been, nor will be, registered under the United States Securities Act of 1933 (as amended) or under the securities laws of any state of the United States or qualify for distribution under any of the relevant securities laws of Canada, Australia, the Republic of Ireland or Japan, nor has any prospectus in relation to the New Ordinary Shares been lodged with or registered by the Australian Securities and Investments Commission. Accordingly, subject to certain exceptions, the New Ordinary Shares may not be, directly or indirectly, offered, sold, taken up, delivered or transferred in or into the United States, Canada, Australia, the Republic of Ireland or Japan or their respective territories or possessions. Overseas Shareholders and any person (including, without limitation, nominees and trustees) who have a contractual or other legal obligation to forward this document into a jurisdiction outside the UK should seek appropriate advice before taking any action. Overseas Shareholders are referred to paragraph 7 of Part 2 of this document.

Notice of an Extraordinary General Meeting of IQE plc, to be held at its registered office being Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG at 2.30 p.m. on 3 November 2003, is set out at the end of this document. The enclosed Form of Proxy for use in connection with the meeting should be completed and returned as soon as possible and, in any event, so as to reach the Company's Registrars, Capita Registrars not later than 2.30 p.m. on 1 November 2003. Completion and return of Forms of Proxy will not preclude Shareholders from attending and voting at the Extraordinary General Meeting should they so wish.

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Expected timetable of principal events

	<i>2003</i>
Record date for the Open Offer	3 October
Latest time and date for splitting Application Forms (to satisfy <i>bona fide</i> market claims only)	3.00 p.m. on 29 October
Latest time for receipt of completed Application Forms and payment in full in respect of the Open Offer	3.00 p.m. on 31 October
Latest time for receipt of Proxy Forms	2.30 p.m. on 1 November
Extraordinary General Meeting	2.30 p.m. on 3 November
Dealings commence in New Ordinary Shares on AIM	8.00 a.m. on 5 November
Delivery in CREST of New Ordinary Shares to be held in uncertificated form	8.00 a.m. on 5 November
Despatch of definitive share certificates in respect of New Ordinary Shares to be held in certificated form	12 November

If you have any queries on the procedure for acceptance and payment or on the procedure for splitting Application Forms (to satisfy *bona fide* market claims only), you should contact Capita IRG Plc, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TH (telephone no: 0870-162-3100 or if calling from outside the UK + 44(0)20-8639-2157).

Placing and Open Offer statistics

Issue Price	15 pence
Net proceeds of the Placing and Open Offer	£17.9 million
Number of New Ordinary Shares being issued pursuant to the Placing and Open Offer	125,000,000
Number of Ordinary Shares in issue following the Placing and Open Offer	313,963,640
Market capitalisation of IQE at the Issue Price following completion of the Placing and Open Offer	£47.1 million
New Ordinary Shares expressed as a percentage of the Existing Ordinary Shares	66.2%

DIRECTORS, SECRETARY AND ADVISERS

Directors: Dr Godfrey Howard Harrison Ainsworth
Dr Andrew William Nelson OBE
Dr Michael Darak Scott
Martin Steven Mark Lamb
Simon John Gibson OBE

Secretary: James Leslie Coventry

**Registered Office and
Headquarters:** Pascal Close
Cypress Drive
St Mellons
Cardiff CF3 0EG

**Nominated Adviser and
Stockbroker:** Evolution Beeson Gregory Limited
100 Wood Street
London EC2V 7AN

Auditors: Deloitte & Touche LLP
Blenheim House
Fitzalan Court
Newport Road
Cardiff CF24 0TS

Solicitors to the Company: M and A Solicitors
Kenneth Pollard House
5-19 Cowbridge Road East
Cardiff CF11 9AB

**Solicitors to the Nominated
Adviser and Stockbroker:** K Legal
1-2 Dorset Rise
London EC4Y 8EN

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

Receiving Agent: Capita IRG Plc
PO Box 166
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TH

Definitions

The following definitions apply throughout this document, unless the context requires otherwise:

“Admission”	admission of the New Ordinary Shares to trading on AIM becoming effective in accordance with the AIM Rules
“AIM”	the Alternative Investment Market of the London Stock Exchange
“AIM Rules”	the rules of the London Stock Exchange governing the admission to, and operation of, companies on AIM
“AmberWave”	AmberWave Systems Corporation
“Application Form”	the application form for use by Qualifying Shareholders in connection with the Open Offer which accompanies this document
“Articles”	the Articles of Association of the Company
“Companies Act” or “Act”	the Companies Act 1985 (as amended)
“Company” or “IQE”	IQE plc, a public limited company incorporated in England and Wales, under company number 3745726 whose registered office is at Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG
“CREST”	the relevant system (as defined in the Regulations) in respect of which CRESTCo Limited is the operator (as such is defined in the Regulations) in accordance with which quoted securities may be held and transferred in uncertificated form
“Directors” or “Board”	the directors of the Company
“Evolution Beeson Gregory”	Evolution Beeson Gregory Limited
“Executive Directors”	Messrs. Nelson, Scott and Lamb
“Existing Ordinary Shares”	the 188,963,640 Ordinary Shares in issue immediately prior to the date of this document
“Extraordinary General Meeting” or “EGM”	the Extraordinary General Meeting of the Company which has been convened for 2.30 p.m. on 3 November 2003, notice of which is set out at the end of this document
“Form of Proxy”	the form of proxy accompanying this document for use by Shareholders in connection with the Extraordinary General Meeting
“FSMA”	the Financial Services and Markets Act 2000 (as amended)
“Group”	the Company and its subsidiaries
“ICTA 1988”	the Income and Corporation Taxes Act 1988 (as amended)
“IQE Europe” or “Europe”	IQE (Europe) Limited, a wholly owned subsidiary of the Company incorporated in England and Wales under company number 2107558
“IQE Inc”	IQE Inc. a wholly owned subsidiary of the Company incorporated in the state of Delaware, US
“IQE Silicon Compounds”	IQE Silicon Compounds Limited, a wholly owned subsidiary of the Company incorporated in England and Wales under company number 3986643

“Issue Price”	15 pence per New Ordinary Share
“London Stock Exchange”	London Stock Exchange plc
“Money Laundering Regulations”	the Money Laundering Regulations 1993 (as amended)
“Nasdaq Europe” or “Nasdaq EuropeSM”	Nasdaq Europe SA/NV or the system operated by Nasdaq Europe SA/NV (formerly known as EASDAQ) as the context requires
“New Ordinary Shares”	125,000,000 new Ordinary Shares to be issued pursuant to the Placing
“Official List”	the Official List of the UK Listing Authority
“Open Offer”	the conditional offer made by Evolution Beeson Gregory on behalf of the Company to Qualifying Shareholders to subscribe for their entitlement of New Ordinary Shares on the terms and conditions set out in this document and in the Application Form
“Open Offer Shares”	the New Ordinary Shares to be issued under the Open Offer
“Ordinary Shares”	ordinary shares of 1p each in the capital of the Company
“Overseas Shareholders”	Shareholders on the register of members of the Company on the Record Date who have registered addresses in, or who are citizens or residents of, countries other than the United Kingdom
“Placing”	the conditional placing by Evolution Beeson Gregory on behalf of the Company of the New Ordinary Shares at the Issue Price pursuant to the Placing and Open Offer Agreement
“Placing and Open Offer Agreement” or “Underwriting Agreement”	the conditional agreement dated 7 October 2003 between the Company, the Directors and Evolution Beeson Gregory relating to the Placing and Open Offer, further details of which are set out in paragraph 11 of Part 6 of this document
“Qualifying Shareholders”	Shareholders on the register of members of the Company at the Record Date, other than certain Overseas Shareholders who are not entitled to participate in the Open Offer, as described in paragraph 7 of Part 2 of this document
“Receiving Agent”	Capita IRG Plc
“Record Date”	close of business on 3 October 2003, being the record date for the Open Offer
“Registrars” or “Capita”	Capita Registrars
“Regulations”	the Uncertificated Securities Regulations 2001 (SI 2001 No 3755)
“Resolutions”	the resolutions to, <i>inter alia</i> , approve the Placing set out in the notice of Extraordinary General Meeting at the end of this document
“RF”	radio frequency
“Securities Act”	the United States Securities Act of 1933, as amended
“Shareholders”	the persons who are registered as holders of Existing Ordinary Shares on the Record Date

“Share Option Schemes”	the share option schemes described in paragraph 9 of Part 6 of this document
“subsidiary”	a subsidiary undertaking, in each case as defined by the Act
“UK Listing Authority”	the Financial Services Authority, acting in its capacity as the competent authority for the purposes of Part VI of FSMA and in the exercise of its functions other than in accordance with Part VI of FSMA
“United Kingdom” or “UK”	the United Kingdom of Great Britain and Northern Ireland
“United States” or “US”	the United States of America, its territories and possessions and any state of the United States
“Wafer Technology”	Wafer Technology Limited, a wholly owned subsidiary of the Company incorporated in England and Wales under company number 1829722

PART 1

LETTER FROM THE CHAIRMAN

IQE plc

(Registered in England and Wales no. 3745726)

Directors

Dr Godfrey Howard Harrison Ainsworth (*Chairman, Non-executive Director*)
Dr Andrew William Nelson OBE (*President and Chief Executive Officer*)
Dr Michael Darak Scott (*Sales & Marketing Director*)
Martin Steven Mark Lamb (*Managing Director Wafer Technology Limited*)
Simon John Gibson OBE (*Non-executive Director*)

Registered and Head Office

Pascal Close
Cypress Drive
St Mellons
Cardiff
CF3 0EG

7 October 2003

To the Shareholders and, for information only, to holders of options under the Share Option Schemes.

Dear Shareholders

Issue of 125,000,000 New Ordinary Shares at 15 pence per New Ordinary Share

Introduction

The Board of IQE today announced proposals to raise £18.75 million (before expenses) by means of a Placing of 125,000,000 New Ordinary Shares at a price of 15p per share.

99,804,848 of the New Ordinary Shares have been placed firm, primarily with institutional investors and the balance of 25,195,152 New Ordinary Shares has been placed subject to clawback under the Open Offer whereby Qualifying Shareholders are invited to apply for New Ordinary Shares on the basis of 2 New Ordinary Shares for every 15 Ordinary Shares held on the Record Date.

Of the 25,195,152 New Ordinary Shares which are subject to clawback under the Open Offer, 6,572,202 New Ordinary Shares, representing 86.1 per cent. of the Directors' total aggregate entitlement under the Open Offer and which they have irrevocably undertaken not to take up, have been placed firm with institutions, making a total firm placing mainly with institutions of 106,377,050 New Ordinary Shares.

The Placing and Open Offer has been fully underwritten by Evolution Beeson Gregory.

The Board believes that the recent improvements in the semiconductor industry are likely to lead to increased demand for the Group's products. The purpose of the Placing and Open Offer is to provide the Group with additional working capital resources to respond to the anticipated upturn in demand for its products.

The net proceeds of the Placing and Open Offer will strengthen the Company's balance sheet, thereby giving increased confidence to customers that it has the appropriate financial resources to enter into significant long term contracts. This is considered by the Board to be strategically important as the semiconductor sector recovers, particularly as the Directors believe that the Group's model of outsourced manufacture should be well-placed to be a beneficiary of the recovery. In particular, the net proceeds of the Placing and Open Offer should allow the Company to negotiate from a position of increased strength and security in relation to exploiting its position with strained silicon, which the Board expects to be a major area for development and growth in the semiconductor industry. Finally, the Company intends to accelerate the strengthening of its sales capability in the Far East.

Because of its size, the Placing and Open Offer is conditional upon the approval of Shareholders, which is to be sought at the Extraordinary General Meeting, notice of which is set out at the end of this document. The purpose of this document is to provide you with details of, and the background to, the Placing and Open

Offer, to explain why the Board believes it is in the best interests of the Company and to recommend that you vote in favour of the Resolutions to be proposed at the Extraordinary General Meeting.

The attention of Qualifying Shareholders is drawn to the "Risk Factors" set out in Part 5 of this document which provides a discussion of certain factors to be considered by them in connection with an investment in the New Ordinary Shares. In addition, Shareholders should read the whole of this document and not just rely on the key or summarised information in this letter.

On 20 August 2003, the Company announced its interim results for the six months ended 30 June 2003 the full text of which is set out in Part 3 of this document.

The full text of the Company's statutory accounts for each of the three years ended 31 December 2002, 2001 and 2000 is set out in the Appendices to this document.

Background to and reasons for the Placing and Open Offer

The Group is a leading global outsource manufacturer of bespoke wafer products and services to the semiconductor device manufacturing industry. The Group operates four separate and independent subsidiary businesses:

- IQE Inc, which supplies wafer products to the wireless sector, is a qualified supplier to several of the world's top RF component companies. In the first half of 2003, IQE Inc had turnover of approximately £5,502,000 and, in view of increasing customer demand, the Directors expect it to become cashflow positive next year;
- IQE Europe supplies products into the optoelectronics market. In the first half of 2003, Europe had turnover of approximately £2,023,000 and the Directors believe that Europe, now having lower operating costs and significant production capacity, should benefit significantly from a number of new product developments which are expected to become qualified with major customers over the next 12 months;
- IQE Silicon Compounds develops products specifically for the silicon market and the Directors believe it has established a leading position in the area of strained silicon, with samples now shipping and in qualification with several potential key customers. In the first half of 2003, IQE Silicon Compounds had turnover of approximately £274,000. The Directors expect strained silicon to form an increasingly significant part of the Group's business and the Directors believe that IQE Silicon Compounds' position in strained silicon is being validated through a number of leading industry players currently evaluating formal, long term agreements with the Group as a means of securing their own position in this technology; and
- Wafer Technology supplies substrates to the compound semiconductor industry. In the first half of 2003 it had revenues of approximately £2,258,000 and, due to sustained demand for its range of Gallium Arsenide and Indium Phosphide materials, is now trading at close to cash breakeven.

The semiconductor industry has been severely depressed during the last two years, with the compound semiconductor segment of the industry experiencing its first ever downturn. The Group's focus during those two years has therefore had to adapt from trading through a time of exceptionally high growth to dealing with the difficulties of a severely depressed marketplace. Whilst there still remains a certain lack of visibility in the sector as a whole, the last few months have seen a marked increase in interest in a number of products and key technologies provided by the Group, together with a steady flow of more positive news from the sector.

The wireless business has witnessed increasing demand for products albeit at the expense of reduced average selling prices. Encouragingly, the Group has been able to offset the impact of this to a large extent through a combination of greater production efficiencies, lower operating costs and reduced raw materials prices. The optoelectronics business has also seen some signs of recovery with an increasing number of new products in qualification with major customers. The substrate business remains stable, whilst interest in strained silicon, in which IQE Silicon Compounds has significant expertise, continues to step up with the product featuring as a key material on the 2002/3 International Technology Roadmap for Semiconductors.

IQE Silicon Compounds has established a leading position in strained silicon technology both in collaboration and separately by developing its own stand-alone, proprietary process. IQE Silicon Compounds' own process for producing strained silicon was showcased at Semicon West in San Francisco in July 2003 and generated significant interest amongst potential customers. Samples are being shipped and are in qualification with a number of potential customers and the Directors believe the Group to be the first commercial epi-source for this material worldwide.

The Group is experiencing an increased level of interest for its existing products and those in qualification, especially in the Far East. As a result, the Directors believe the time is now right to accelerate the growth of its sales and marketing operations in that region to exploit this opportunity. The Group anticipates increasing its sales force through the recruitment of additional direct sales support staff to assist and bolster the existing sales agents during the coming months.

In anticipation of the market for the Group's products improving, the net proceeds from the Placing and Open Offer will enable the Company:

- to retain its infrastructure and intellectual property created and to strengthen the Group's balance sheet, providing increased confidence to customers who are proposing to enter into significant long term contracts;
- to exploit fully its available options in negotiating agreements for the commercialisation of its position in strained silicon;
- to accelerate the growth of the Group's sales force, particularly in the Far East; and
- to bolster the Group's working capital resources to ensure that it is well positioned to capitalise quickly on the anticipated increase in demand for its products.

The net proceeds of the Placing and Open Offer are not anticipated to be used for material research and development activities, major capital expenditure or for acquisition purposes.

Strategy

The Group's goal is to maintain and further strengthen its position as a leading global outsource supplier of bespoke wafer products and services to the semiconductor device manufacturing industry.

The Group's strategy is to increase its market share through penetrating in-house services by offering cost effective materials expertise and access to new and established technologies across a range of production platforms. As demand for end user products recovers, the Directors firmly believe that the trend towards outsourcing will increase further, particularly as some of the more mature products become commoditised and access to replacement technologies becomes critical.

Since there are considerable barriers to entry, both in terms of production know-how and capital investment, which is also encouraging in-house producers to look externally, the Directors believe a shift to outsourcing is gathering momentum in the industry which they believe should significantly benefit the Group in the future.

Interim results, current trading and prospects

The full text of the interim announcement of the unaudited results for the six months ended 30 June 2003, announced on 20 August 2003, are included at Part 3 of this document. The Group reported sales of £10.0 million and a loss before taxation of £6.8 million for the six month period. The Group's cost base has been greatly reduced over the period with the second quarter of the year producing a loss before tax of £3.0 million on sales of £5.1 million. Cash at the period end stood at £10.7 million. In the second half of the current financial year, the Group anticipates reporting broadly flat sales on the first half. However, with an increasing number of qualifications across IQE's product ranges due to complete later this year, the Directors expect tangible signs of trading improvement to become visible from the beginning of the next financial year onward.

Shareholders and potential Shareholders are recommended to read the whole of the unaudited interim results for the six months ended 30 June 2003 set out in Part 3 of this document.

Transfer to AIM

The Directors consider that the transfer to AIM from the Official List, which was effected on 30 September 2003, is in the best interests of the Company and Shareholders as a whole and believe that it has a number of advantages. The Board expects that trading on AIM is more likely to bring the Company to the attention of specialised smaller company investors. The Board also anticipates that, as an AIM company, savings will be made in the costs of administration and in effecting corporate transactions due to the less onerous regulations on AIM, with a consequential reduction in the costs associated with being a listed public company.

Details of the Placing and Open Offer

IQE proposes to raise approximately £17.9 million, net of expenses, by way of a Placing of 125,000,000 New Ordinary Shares at the Issue Price, being 15 pence per New Ordinary Share. The Issue Price represents a discount of 7.7 per cent. to the closing mid-market price per Ordinary Share of 16.25 pence, being the price immediately prior to the date of this document. 25,195,152 of the New Ordinary Shares placed are being made available for subscription by Qualifying Shareholders who are invited by Evolution Beeson Gregory to apply for New Ordinary Shares under the Open Offer on the basis of:

2 New Ordinary Shares for every 15 Ordinary Shares

held by them on the Record Date, and so in proportion to the number of Ordinary Shares then held. The Issue Price is payable in full on application. The New Ordinary Shares will, when issued and fully paid, rank *pari passu* in all respects with the existing Ordinary Shares including the right to all dividends and other distributions declared, made or paid following Admission.

Fractional entitlements to New Ordinary Shares will not be allotted to Qualifying Shareholders and no cash payment will be made in lieu of fractional entitlements which will be aggregated and sold and the proceeds retained for the benefit of the Company. Accordingly, the entitlements of Qualifying Shareholders will be rounded down to the nearest whole number of New Ordinary Shares.

The Ordinary Shares are in registered form and are capable of being held in certificated or uncertificated form.

Evolution Beeson Gregory has agreed, as agent for IQE, to procure subscribers for the New Ordinary Shares to be issued under the Placing. To the extent that it fails to procure subscribers and/or to the extent that the New Ordinary Shares offered under the Open Offer are not taken up by Qualifying Shareholders, Evolution Beeson Gregory has agreed to subscribe as principal at the Issue Price for the New Ordinary Shares which are to be issued in connection with the Placing and the Open Offer.

Qualifying Shareholders should be aware that the Open Offer is not a rights issue and that New Ordinary Shares not applied for under the Open Offer will not be sold in the market for the benefit of Qualifying Shareholders who do not apply for them under the Open Offer. Application Forms are personal to Shareholders and may not be transferred except to satisfy *bona fide* market claims.

The Board was advised by the Company's nominated adviser and stockbroker, Evolution Beeson Gregory, that it believed, in the light of the improving market conditions for companies in the semiconductor market, there would be some interest from new investors in making an investment in IQE. The Board, having regard to the opportunities that lie ahead, decided that it was in the best interests of the Company and its shareholders to take advantage of the opportunity. However, the Board is also cognisant of the desirability of giving some measure of pre-emption to the shareholders who have supported the Company during the recent difficult times. Accordingly approximately 20 per cent., or 25,195,152, of the New Ordinary Shares have been made available for clawback by existing shareholders under the Open Offer. The remaining 99,804,848 New Ordinary Shares together with the Directors' entitlements under the Open Offer which they have undertaken not to take up, being a further 6,572,202 New Ordinary Shares, have been placed firm with mainly institutional investors. The Board believes that this broader and stronger shareholder base will benefit the Company in the future.

The Placing and the Open Offer are conditional upon approval by Shareholders of the first of the Resolutions at the Extraordinary General Meeting to be held at 2.30 p.m. on 3 November 2003 and upon the Underwriting Agreement becoming unconditional in accordance with its terms and Admission occurring by no later than 8.00 a.m. on 5 November 2003, or such later date (being no later than 8.00 a.m. on 30 November 2003) as the Company and Evolution Beeson Gregory may decide.

Further Information on the Open Offer, including the terms and conditions thereof and the procedure for acceptance and payment, is set out in Part 2 of this document.

Application has been made to the London Stock Exchange for the New Ordinary Shares to be admitted to trading on AIM.

Share Certificates and CREST

Definitive share certificates in connection with the Placing and Open Offer are expected to be despatched by the Company's Receiving Agents, Capita IRG Plc, 7 days after Admission. It is expected that where Existing Ordinary Shares are held in a CREST account, the Open Offer Shares subscribed for under the Open Offer by the holder(s) of such shares will be credited to such CREST account on 5 November 2003.

Overseas Shareholders

The attention of Overseas Shareholders and to those Qualifying Shareholders who are citizens, nationals or residents of countries other than the United Kingdom or who are incorporated or organised under the laws of a country other than the United Kingdom is drawn to the section headed "Overseas Shareholders" in Part 2 of this document.

Taxation

Information on United Kingdom taxation as at the date of this document with regard to the Placing and Open Offer is set out in paragraph 10 of Part 6 of this document. This information is intended only as a general guide to the current law and should not be relied upon. If Qualifying Shareholders are in any doubt as to their tax position, they should consult their own independent professional advisers without delay.

Extraordinary General Meeting

A notice of an Extraordinary General Meeting to be held at 2.30 p.m. on 3 November 2003 at IQE plc, Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG is set out at the end of this document. At this meeting, the following Resolutions will be proposed to:

- (i) enable the Placing and Open Offer to proceed by:
 - (a) increasing the Company's authorised share capital from £3,000,000 to £5,000,000 by the creation of an additional 200,000,000 new Ordinary Shares;
 - (b) authorising the Directors to allot up to an aggregate nominal amount of £1,250,000 in connection with the Placing and Open Offer; and
 - (c) disapplying Shareholders' statutory pre-emption rights in relation to the Placing and Open Offer;
- (ii) authorise the Directors to allot up to an aggregate nominal amount equal to one third of the issued share capital of the Company immediately following completion of the Placing and Open Offer;
- (iii) disapply Shareholders' statutory pre-emption rights in relation to the allotment for cash up to an aggregate nominal amount equal to 10 per cent. of the issued share capital of the Company immediately following completion of the Placing and Open Offer.

The second and third Resolutions update the general authorities already in place with regard to the allotment and issue of Ordinary Shares following the enlargement of the Company's issued Ordinary Share capital pursuant to the Placing and the Open Offer.

Action to be taken

Extraordinary General Meeting

A Form of Proxy is enclosed for use by Shareholders in relation to the Extraordinary General Meeting. Whether or not Shareholders intend to be present at the Extraordinary General Meeting, they are requested to complete, sign and return the Form of Proxy to the Registrars as soon as possible but, in any event, so as to arrive no later than 2.30 p.m. on 1 November 2003. The completion and return of a Form of Proxy will not preclude a Shareholder from attending the Extraordinary General Meeting and voting in person should he/she subsequently wish to do so.

Open Offer

Qualifying Shareholders wishing to apply for New Ordinary Shares under the Open Offer must complete the enclosed Application Form, in accordance with the instructions thereon and in the letter from Evolution Beeson Gregory in Part 2 of this document, and return the Application Form with the appropriate payment by post or by hand, to Corporate Actions, Capita IRG Plc, PO Box 166, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TH so as to arrive no later than 3.00 p.m. on 31 October 2003. As more fully explained in Part 2 of this document and subject to the information contained therein, certain Overseas Shareholders will not be entitled to participate in the Open Offer and this document has been forwarded to them for the sole purpose of giving them notice of and information regarding the Extraordinary General Meeting referred to herein.

Further information

Your attention is drawn to the further information set out in Parts 2 to 6 of this document and in the accompanying appendices.

Directors' undertakings and recommendations

All of the Directors hold or are beneficially interested in Ordinary Shares (save for Simon Gibson), and therefore have entitlements under the Open Offer in respect of those holdings of Ordinary Shares, together totalling 7,592,488 New Ordinary Shares. The Directors have irrevocably undertaken to take up their entitlements under the Open Offer in respect of, in aggregate, 1,020,286 New Ordinary Shares representing 13.4 per cent. of their entitlement and irrevocably undertaken not to take up their entitlements in respect of the balance of 6,572,202 New Ordinary Shares, which have been placed firm by Evolution Beeson Gregory.

The non-executive Directors fees of Mr Gibson are paid to his employer, Wesley Clover Wales Limited ("Wesley Clover"), which holds 306,052 Ordinary Shares. Wesley Clover has entitlements under the Open Offer in respect of its holding of Ordinary Shares totalling 40,806 New Ordinary Shares. Wesley Clover has irrevocably undertaken to take up its entitlements under the Open Offer in respect of 40,806 New Ordinary Shares, representing 100 per cent. of its entitlement.

The Board considers the Placing and Open Offer to be in the best interests of the Company and its Shareholders as a whole. Accordingly, the Directors unanimously recommend Shareholders to vote in favour of the Resolutions to be proposed at the EGM, as they have irrevocably undertaken to do in respect of their own shareholdings of 56,943,673 Ordinary Shares in aggregate, representing approximately 30.1 per cent. of the Company's issued ordinary share capital. In addition, Wesley Clover has irrevocably undertaken to vote in favour of the Resolutions in respect of its shareholding of 306,052 Ordinary Shares.

Yours faithfully

Dr Godfrey H H Ainsworth
Chairman

PART 2

LETTER FROM EVOLUTION BEESON GREGORY RELATING TO THE OPEN OFFER



*Evolution Beeson Gregory Limited, registered in England with number 2316630
Registered address: 100 Wood Street, London EC2V 7AN*

7 October 2003

To Qualifying Shareholders and, for information only, to non-qualifying shareholders and holders of options under the Share Option Schemes.

Dear Sir or Madam

Proposed Placing and Open Offer

1. Introduction

The letter from the Chairman, which appears in Part I of this document, explains the background to the Board's proposal to raise £18.75 million (before expenses) by way of a Placing of 125,000,000 New Ordinary Shares at a price of 15 pence per New Ordinary Share. The New Ordinary Shares have been placed by Evolution Beeson Gregory as agent of the Company with institutional investors (or, failing which, themselves) at 15 pence per New Ordinary Share, subject to the rights of Qualifying Shareholders under the Open Offer. Details of the arrangements relating to the Open Offer are set out below.

This document and the Application Form contain the formal terms and conditions of the Open Offer.

2. The Open Offer

Subject to and on the terms and conditions set out below and in the accompanying Application Form, Evolution Beeson Gregory as agent of the Company, hereby invites Qualifying Shareholders to apply for up to 25,195,152 New Ordinary Shares, at the Issue Price on the following basis:

2 New Ordinary Shares for every 15 Ordinary Shares

held by such Qualifying Shareholder on the Record Date and so in proportion for any other number of Ordinary Shares then held. Qualifying Shareholders will have their entitlement rounded down to the nearest whole number of New Ordinary Shares. Any resulting fractional entitlement of Qualifying Shareholders will not be allotted under the Open Offer but will be aggregated and allotted under the Placing for the benefit of the Company.

The Issue Price of 15 pence per New Ordinary Share is payable in full on application and such subscription is free of all UK expenses and stamp duties.

Qualifying Shareholders may apply for any number of New Ordinary Shares up to their maximum *pro rata* entitlement. No application in excess of the maximum will be met. Any Qualifying Shareholder so applying will be deemed to have applied only for his maximum entitlement and any monies paid in excess of the amount due in respect of any application made will be returned to the applicant without interest. Completed Application Forms accompanied by payment in full must be received by the Receiving Agent by 3.00 p.m. on 31 October 2003.

Qualifying Shareholders should be aware that the Open Offer is not a rights issue and that New Ordinary Shares will not be sold in the market for the benefit of those who do not apply under the

Open Offer. The Application Form is not a document of title and cannot be traded. Any New Ordinary Shares which are not applied for under the Open Offer will be taken up by placees in accordance with the their commitments under the Placing or, failing which, by Evolution Beeson Gregory themselves under the terms of the Underwriting Agreement.

The Placing and Open Offer is conditional upon approval of the first of the Resolutions by Shareholders at an Extraordinary General Meeting to be held at 2.30 p.m. on 3 November 2003 and upon the Underwriting Agreement becoming unconditional in accordance with its terms and Admission occurring by no later than 8.00 a.m. on 5 November 2003, or such later date (being no later than 8.00 a.m. on 30 November 2003) as the Company and Evolution Beeson Gregory may decide.

Application has been made to the London Stock Exchange for the New Ordinary Shares to be admitted to trading on AIM. It is expected that Admission will become effective and that dealings in the New Ordinary Shares will commence on AIM at 8.00 a.m. on 5 November 2003.

In addition, the Open Offer is not being made to certain Overseas Shareholders. Accordingly, New Ordinary Shares attributable to these Overseas Shareholders who are not Qualifying Shareholders will be placed pursuant to the Placing for the benefit of the Company. Overseas Shareholders should read the section headed "Overseas Shareholders" below in this Part 2 for more information regarding the foregoing.

The New Ordinary Shares will, when fully paid, rank *pari passu* in all respects with the Existing Ordinary Shares.

3. Procedure for application under the Open Offer

If you are in any doubt as to the action to be taken, you are recommended to seek your own personal financial advice from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser duly authorised under FSMA.

The Application Form accompanying this document shows the number of Ordinary Shares registered in your name on the Record Date and also shows your maximum pro-rata entitlement under the Open Offer. You may apply for up to your pro-rata entitlement or less should you so wish. Valid applications up to your pro-rata entitlement will be accepted in full. The instructions and other terms set out in the accompanying Application Form are part of the terms of the Open Offer.

If you wish to apply for all or any of your Open Offer Shares, you should complete the accompanying Application Form in accordance with the instructions thereon and return it, together with your payment for the full amount in accordance with the instructions on the Application Form, by hand or by post, to the Receiving Agents, Capita IRG Plc, Corporate Actions, PO Box 166, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TH, so as to arrive as soon as possible but in any event not later than 3.00 p.m. on 31 October 2003, after which time applications may not be valid. A reply paid addressed envelope is enclosed for your convenience. Applications, once made, will be irrevocable and will not be acknowledged. If you post your Application Form, you are recommended to allow at least four days for delivery. All documents and remittances sent by or to an applicant, or as the applicant may direct, will be sent through the post at the applicant's own risk.

Application may be made only on the accompanying Application Form, which represents a right (personal to the Qualifying Shareholder(s) named therein) to apply for Open Offer Shares. The Application Form is not a document of title and cannot be traded. It is transferable only to satisfy *bona fide* market claims in relation to purchases through the market of Existing Ordinary Shares, pursuant to the rules of the London Stock Exchange, prior to their being marked "ex" the entitlement to participation in the Open Offer. If you have sold some only of your existing Ordinary Shares, split applications are required to be received by not later than 3.00 p.m. on 29 October 2003. Qualifying Shareholders who have recently sold all or part of their registered shareholding of Existing Ordinary Shares are therefore advised to consult their stockbroker or other professional adviser authorised under FSMA as soon as possible, as the invitation to apply for Open Offer Shares may represent a benefit which can be claimed by purchasers under the rules of the London Stock Exchange. Your attention is drawn to paragraph 7 of this Part 2 regarding the forwarding of the Application Form to Overseas Shareholders.

Evolution Beeson Gregory and the Company reserve the right to treat an Application Form as valid and binding on the person(s) by whom or on whose behalf it is lodged, even if it is not completed in accordance with the relevant instructions or is not accompanied by the required remittance or a valid power of attorney (where required) or verification of identity satisfactory to Capita IRG Plc to ensure that the Money Laundering Regulations would not be breached by acceptance of the payment submitted in connection with the Application Form or if it otherwise does not strictly comply with the terms and conditions set out in this document or on the Application Form.

Evolution Beeson Gregory and the Company reserve the right, but shall not be obliged, to accept applications accompanied by the required remittance which are received after 3.00 p.m. on 31 October 2003 but not later than 8.00 a.m. on 5 November 2003, provided that the cover bears a legible post-mark not later than 3.00 p.m. on 31 October 2003. Evolution Beeson Gregory and the Company reserve the right, but shall not be obliged, to accept applications in respect of which remittances are received prior to 3.00 p.m. on 31 October 2003 from an authorised person (as that term is defined in FSMA) specifying the number of Open Offer Shares concerned and undertaking to lodge the relevant Application Form in due course.

If you do not wish to apply for Open Offer Shares please do not complete or return the Application Form. You are nevertheless requested to complete and return the Form of Proxy for use at the Extraordinary General Meeting. Completing and returning a Form of Proxy will not preclude you from attending and voting at the Extraordinary General Meeting if you so wish.

4. Procedure for Payment

All payments must be made in pounds sterling by cheque or banker's draft made payable to "Capita IRG Plc A/C IQE plc" and crossed "Account Payee". Cheques and banker's drafts must be drawn in sterling on an account at a branch (which must be in the United Kingdom, the Channel Islands or the Isle of Man) of a bank or building society which is either a settlement member of the Cheque and Credit Clearing Company Limited or the CHAPS Clearing Company Limited or a member or either of the committees of the Scottish or Belfast Clearing Houses or which has arranged for its cheques and banker's drafts to be cleared through the facilities provided by either of those companies or those committees (and must bear the appropriate sorting code number in the top right hand corner). An application may be rejected unless these requirements are fulfilled. Once submitted, applications cannot be withdrawn. Cheques and banker's drafts representing application monies will be presented for payment upon receipt and it is a term of the Open Offer that cheques shall be honoured on first presentation. If any cheque is not so honoured, the relevant application will be deemed invalid.

The Company and Evolution Beeson Gregory reserve the right to instruct the Receiving Agents to seek special clearance of cheques to allow IQE to obtain full value for remittances at the earliest opportunity. Any person returning an Application Form with a remittance in the form of a cheque warrants that the cheque will be honoured on first presentation. IQE and Evolution Beeson Gregory may elect at their sole discretion to treat as invalid any acceptance in respect of which the remittance is notified to it as not having been so honoured.

All enquiries in relation to the Application Form should be addressed to the Receiving Agents, Capita IRG Plc, Corporate Actions, PO Box 166, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TH, telephone number 0870-162-3100 or if calling from outside the UK +44 (0) 20-8639-2157.

Application monies will be held in a separate bank account pending fulfilment or waiver of the conditions of the Open Offer. If the conditions of the Open Offer are not fulfilled or waived (as the case may be) on or before 5 November 2003 or such later date as the Company and Evolution Beeson Gregory may agree, being not later than 30 November 2003, the Open Offer will lapse and all monies will be returned without interest to applicants as soon as possible and in any event within 21 days from that date. All documents or remittances sent by or to an applicant, or as he/she may direct, will be sent through the post at his/her own risk.

5. Money Laundering Regulations

It is a term of the Open Offer that, to ensure compliance with the Money Laundering Regulations, the Company's Receiving Agents, Capita IRG Plc, may require, at its absolute discretion, verification of identity from any person lodging an Application Form (which requirements are referred to below as "verification of identity requirements"). The person (the "Acceptor") who, by lodging an Application Form with payment, as described above, applies for Open Offer Shares shall thereby be deemed to agree to provide the Receiving Agent and/or the Company with such information and other evidence as they or either of them may require to satisfy the verification of identity requirements. If it appears to the Receiving Agent that the Acceptor is acting on behalf of some other person, verification of the identity of any person on whose behalf the Acceptor appears to acting may be required.

If the Receiving Agent determines that the verification of identity requirements apply to any application, the Receiving Agent may in their absolute discretion (notwithstanding any other term of the Open Offer) retain an Application Form lodged by an Acceptor and/or the cheque or other remittance relating thereto and/or not enter the Open Offer Shares to which it relates in the register of members or issue any share certificates in respect of them. If, within a reasonable period of time following a request for verification of identity and in any event before 3.00 p.m. on 31 October 2003, the Receiving Agent has not received evidence satisfactory to it as aforesaid, the Company may (at its absolute discretion) elect to treat as invalid the relevant application in which case the monies payable by the applicant will be returned without interest to the drawee bank or building society from which such monies were originally debited.

By lodging an Application Form with the appropriate remittance, the Acceptor undertakes that the Money Laundering Regulations will not be breached by the acceptance of the remittance and the Acceptor undertakes to provide such evidence of identity at the time of lodging or, in the absolute discretion of the Company, within a reasonable time thereafter (to be determined at the discretion of the Company) as may be requested to ensure compliance with the Money Laundering Regulations.

If the verification of identity requirements apply, failure to provide the necessary evidence of identity may result in your acceptance being treated as invalid or in delays in the despatch of certificates for Open Offer Shares, or in crediting your CREST stock account.

The verification of identity requirements may not apply if:

- (a) the Acceptor is authorised to carry on regulated activities under FSMA, or is an intermediary acting as agent (but not merely as an introducing broker) and in either case is itself subject to the Money Laundering Regulations or the Money Laundering Sourcebook of the Financial Services Authority; or
- (b) the Acceptor is a credit institution or other financial institution required to comply with the EU Money Laundering Directive (the Council Directive on prevention of the use of the financial system for the purpose of money laundering (91/308/EEC)); or
- (c) the Acceptor makes payment from an account in the name of such Acceptor held at an institution which is a credit institution, as defined in article 1(1) of the Banking Consolidation Directive or a firm authorised by the Financial Services Authority to accept deposits and the payment has been or will be sent or confirmed by post or electronically. Where payment is made by building society cheque or bankers' draft, the building society or bank should endorse the cheque or draft with the Acceptor's name and the number of an account held in the Acceptor's name at such building society or bank, such endorsement being validated by a stamp and authorised signature; or
- (d) the aggregate subscription price for the relevant Open Offer Shares is less than €15,000 (£10,635).

In order to confirm the acceptability of any written assurance required in order to satisfy the identification verification requirements, the Acceptor should contact the Receiving Agent.

The Receiving Agent is entitled, in its absolute discretion, to determine whether the verification of identity requirements apply to any Acceptor and whether such requirements have been satisfied. The nature of the information required in order to satisfy the identification verification requirements may vary depending upon whether the Acceptor is, among others, a private individual or a corporate entity.

Neither the Company, nor the Receiving Agent nor Evolution Beeson Gregory shall be responsible for or have any liability for any loss or damage (whether actual or alleged) arising from the election by the Company to treat an Application Form lodged by an Acceptor as invalid, as a result of the Receiving Agent not having received from the Acceptor evidence reasonably satisfactory to it as to the identity of the person(s) lodging the Application Form within a reasonable period of the time of request for such, but in any event not later than 3.00 p.m. on 31 October 2003.

6. CREST

Although the Open Offer will be processed outside CREST, for the purpose of calculating entitlements under the Open Offer, CREST and non-CREST shareholdings will be treated independently and separate Application Forms will be issued in respect of each. If a Qualifying Shareholder has both a certificated and an uncertificated shareholding in the Company, there will be two separate Application Forms despatched in respect of such holdings.

Qualifying Shareholders holding their Existing Ordinary Shares in certificated form will be allotted all Open Offer Shares to which they are entitled (and for which they validly apply) in certificated form to the extent their entitlement arises as a result of their holding of Ordinary Shares in certificated form. Qualifying Shareholders holding their Ordinary Shares in uncertificated form will be allotted all Open Offer Shares to which they are entitled (and for which they validly apply) in uncertificated form to the extent that their entitlement arises as a result of their holding Ordinary Shares in uncertificated form.

Qualifying Shareholders who currently hold their Existing Ordinary Shares in certificated form but who wish to hold all or part of their holding of Existing Ordinary Shares in uncertificated form will need to comply separately with the relevant CREST procedures for conversion of such shares into uncertificated form following receipt of their certificates.

Notwithstanding any other provision of this document or of the Application Form, the Company reserves the right to allot and/or issue any Open Offer Shares in certificated form. In normal circumstances, this right is only likely to be exercised in the event of any interruption, failure or break down of CREST (or any part of CREST), or in the part of the facilities and/or systems operated by the Company's Registrars in connection with CREST. This right may also be exercised if the correct details in respect of *bona fide* market claims (such as the Member Account ID and Participation ID details) are not provided as requested on the Application Form.

For more information as to the procedure for application in each case, Qualifying Shareholders are referred to the Application Form.

7. Overseas Shareholders

The making of the Open Offer to Overseas Shareholders may be affected by the laws or regulatory requirements of relevant jurisdictions.

No person receiving a copy of this document and/or Application Form in any territory other than the UK may treat the same as constituting an offer or invitation to him or her to subscribe for Open Offer Shares, nor should he or she in any event use such Application Form, unless in the relevant territory such an offer or invitation could lawfully be made to him or her and such Application Form could lawfully be used without compliance with any unfulfilled registration or other legal or regulatory requirements.

Receipt of an Application Form and/or copy of this document will not constitute an invitation or offer to Overseas Shareholders in those jurisdictions in which it would be illegal to make such an invitation or offer and in such circumstances this document (except for the Notice of EGM) and the Application Form are being sent for information only.

Any person (including, without limitation, nominees and trustees) outside the UK wishing to apply for Open Offer Shares must satisfy himself or herself as to the full observance of the laws of any relevant territory in connection therewith, including obtaining all requisite governmental or other consents, observing all other requisite formalities and paying all issue, transfer or other taxes due in such territory. Such Overseas

Shareholders should consult their professional advisers as to whether they require any governmental or other consents or need to observe any other formalities to enable them to apply for their entitlement to Open Offer Shares.

Persons (including, without limitation, nominees and trustees) receiving this document and/or an Application Form in connection with the Open Offer, must not distribute or send it into any jurisdiction where to do so would or might contravene local securities laws or regulations. If an Application Form is received by any person in any such jurisdiction or by the agent or nominee of such a person, he or she must not seek to apply for Open Offer Shares except pursuant to an express agreement with the Company. Any person who does forward this document or an Application Form into any such jurisdiction, whether pursuant to a contractual or legal obligation or otherwise, should draw the attention of the recipient to the contents of this paragraph 7. Evolution Beeson Gregory and the Company reserve the right to reject an application from or in favour of Shareholders in any such jurisdiction or persons who are acquiring Open Offer Shares for resale in or into any such jurisdiction.

Evolution Beeson Gregory and the Company reserve the right to treat as invalid any application for Open Offer Shares which appears to the Company, Evolution Beeson Gregory or their respective agents to have been executed, effected or despatched in a manner which may involve a breach of the securities laws of any jurisdiction or if they believe the same may violate applicable legal or regulatory requirements or if it provides an address for the delivery of definitive share certificates for the Open Offer Shares in the United States, Canada, South Africa, the Republic of Ireland, Australia or Japan, or any other jurisdiction outside the UK in which it would be unlawful to deliver such definitive share certificates. The attention of Shareholders who are not resident in, or who have registered addresses outside, the UK is drawn to subparagraphs (a) to (f) below.

Notwithstanding the provisions set out in this paragraph 7, the Company and Evolution Beeson Gregory reserve the right, but shall not be obliged, to accept applications from Overseas Shareholders if the applicant is able to demonstrate that all applicable laws and regulations have been complied with without observance by IQE of any requirement which it (in its absolute discretion) regards as unduly burdensome.

Overseas Shareholders who wish, and are permitted, to take up their entitlement should note that payments must be made in pounds sterling.

Specific restrictions relating to certain jurisdictions are set out below.

(a) United States and Canada

The Open Offer Shares have not been nor will be registered under the United States Securities Act 1933 (as amended), or under the securities law of any state of the United States and no securities commission or similar regulatory authority of any province of Canada has reviewed or passed upon this document or the merits of the Open Offer Shares and such Open Offer Shares have not been and are not expected to be qualified under a prospectus qualified in any province of Canada. The Open Offer Shares may not be offered, sold, taken up, delivered, or transferred directly or indirectly in or into the United States or Canada or to or for the account of any person in the United States or Canada, except in certain transactions exempt from any prospectus and registration requirement. The distribution of Application Forms will not be made pursuant to a prospectus in Canada nor, except in certain limited cases, pursuant to any applicable prospectus or registration exemptions under the securities legislation of any province of Canada.

Accordingly, no offer of Open Offer Shares is being made by means of this document to any Shareholder with a registered address in the United States or Canada and Application Forms will not be sent to, and applications will not be accepted from, any Shareholders with registered addresses in the United States and Canada. Subject as provided below, the Company reserves the right to treat as invalid any application that appears to the Company or its agents to have been executed in or despatched from the United States or Canada, or that provides an address in the United States or Canada for the delivery of definitive certificates for Open Offer Shares or which does not make the warranty set out in the Application Form to the effect that the person making the application does not

have a registered address (and is not otherwise located) in the United States or Canada and is not acquiring rights to Open Offer Shares with a view to the offer, sale, resale, transfer, delivery, or distribution directly or indirectly of any such Open Offer Shares in the United States or Canada.

(b) Australia

No prospectus in relation to the Open Offer Shares has been or is intended to be lodged with, or registered by, the Australian Securities and Investments Commission. A person may not:

- (i) directly or indirectly offer for subscription or purchase, or issue an invitation to subscribe for or buy or sell any Open Offer Shares; or
- (ii) distribute any draft or definitive document in relation to any such offer, invitation or sale,

in the Commonwealth of Australia, its states, territories or possessions ("Australia") or to any resident of Australia (including corporations and other entities organised under the laws of Australia but not including a permanent establishment of such corporate or entity located outside Australia).

Application Forms will not be sent and no offer of the Open Offer Shares is being made by means of this document or the Application Form to any Shareholder with a registered address in Australia.

Envelopes containing Application Forms should not be postmarked in Australia or otherwise despatched from Australia and all subscribers for Open Offer Shares must provide addresses outside Australia for the delivery of definitive certificates for Open Offer Shares. The Company reserves the right to treat as invalid any Application Form that appears to the Company to have been executed in, or despatched from, Australia or that provides an address in Australia for delivery of a definitive share certificate for the Open Offer Shares allotted pursuant to the Open Offer, or does not make the representation and warranty set out in the Application Form to the effect that such person is not in Australia and is not acting on a non-discretionary basis for a person in Australia.

(c) South Africa

Shareholders resident in South Africa may require approval of the South African Exchange Control Authorities if they wish to take up their entitlements under the Open Offer.

(d) Republic of Ireland

No document in relation to the Open Offer Shares has been or will be lodged for registration with the Registrar of Companies in the Republic of Ireland. Accordingly, Application Forms will not be sent and no offer of Open Offer Shares is being made by means of this document or the Application Form to any Shareholder with a registered address in the Republic of Ireland. All applicants for Open Offer Shares must provide addresses outside the Republic of Ireland for the receipt of certificates for Open Offer Shares. Persons will be deemed to have made an invalid application if their Application Form appears to the Company or its agents to have been executed in or despatched from the Republic of Ireland, or if they provide an address in the Republic of Ireland for registration, or if they are unable to make the representations and warranties set out in the Application Form.

(e) Japan

No prospectus in relation to the Open Offer Shares has been or will be lodged for registration with the relevant authorities in Japan. Accordingly, the Open Offer is not being made in Japan and Application Forms are not being sent to Shareholders who have registered addresses in Japan.

Envelopes containing Application Forms should not be postmarked in Japan or otherwise despatched from Japan and all subscribers for Open Offer Shares must provide addresses outside Japan for the delivery of definitive certificates for Open Offer Shares. The Company reserves the right to treat as invalid any Application Form that appears to the Company to have been executed in, or despatched from, Japan or that provides an address in Japan for delivery of definitive share certificates for the Open Offer Shares allotted pursuant to the Open Offer, or does not make the representation and warranty set

out in the Application Form to the effect that such person is not in Japan and is not acting on a non-discretionary basis for a person in Japan.

(f) Other overseas territories

Qualifying Shareholders resident in other overseas jurisdictions should consult their professional advisers about whether they require any government or other consents or need to observe any other formalities to enable them to participate in the Open Offer.

The comments set out in this paragraph 7 are intended as a guide only and do not constitute definitive statements of the specific laws affecting Shareholders. If you are in any doubt about your eligibility to apply for Open Offer Shares, you should consult your professional adviser without delay. It is the responsibility of all persons resident outside the UK who wish to take up New Ordinary Shares to satisfy themselves as to the full observance of the laws of the relevant territory in connection therewith.

8. Taxation

General comments on the taxation implications of acquiring and holding Open Offer Shares for Shareholders resident in the UK, based on current UK legislation, are set out in paragraph 10 of Part 6 of this document. However, the precise tax treatment will depend on each Shareholder's individual circumstances. **If you are in any doubt as to your tax position or if you require more detailed information than that outlined in this document, you should consult an appropriate professional adviser immediately.**

9. Admission, Settlement and Dealings

Application has been made for the New Ordinary Shares to be admitted to trading on AIM. It is expected that Admission will become effective and that dealings will commence at 8.00 a.m. on 5 November 2003. The New Ordinary Shares will be in registered form and will be capable of being held in uncertificated form.

The Company's Existing Ordinary Shares are already admitted to CREST. Accordingly, no further application for admission to CREST is required for the New Ordinary Shares. All of such shares, when issued and fully paid, may be held and transferred by means of CREST.

Subject to the conditions of the Open Offer being satisfied or waived, Open Offer Shares are expected to be credited to the appropriate CREST stock accounts by 5 November 2003, unless the Company exercises the right to issue such Open Offer Shares in certificated form, in which case definitive certificates are expected to be despatched by post on or before 12 November 2003. Subject as aforesaid, definitive certificates of any Open Offer Shares to be issued in certificated form are expected to be despatched by post on or before 12 November 2003. No temporary documents of title will be issued. Pending despatch of definitive share certificates (if any), transfers of the Open Offer Shares will be certified against the share register. All documents or remittances sent by or to an applicant (or his agent as appropriate) will be sent through the post at the risk of the applicant. Qualifying CREST Shareholders should note that they will be sent no confirmation of the credit of the Open Offer Shares to their CREST stock account nor any other written communication by the Company in respect of the issue of the Open Offer Shares.

10. Share Option Schemes

The Open Offer is not being extended to the holders of options under the Share Option Schemes, save to the extent that any such options are or have been validly exercised and Ordinary Shares have been allotted in consequence of such exercise prior to the Record Date. The terms under which the options under the Share Option Schemes have been granted are subject to adjustment in the event of certain variations in the Company's share capital. Subject to certain limits, the adjustments concerned (if any) are those certified by the Company's auditors as fair and reasonable and agreed where appropriate with the Inland Revenue.

11. Additional information

Your attention is drawn to the additional information set out in Part 6 of this document and the terms and conditions set out in the Application Form.

Yours faithfully
for Evolution Beeson Gregory Limited

T J Worledge
Director

PART 3

UNAUDITED INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2003

The following is the full text of the interim announcement of the unaudited results for the six months ended 30 June 2003, announced on 20 August 2003.

Overview

IQE specialises in developing and producing highly advanced semiconductor materials that are to be found at the very heart of a wide range of established and emerging technologies. Materials produced by the Group operate at the forefront of technology, typically in high speed electronics and optical systems for a diverse range of devices including those used for data/audio/visual storage, optical communications, wireless and RF devices and systems, and in an increasing range of automotive, medical and industrial applications. The epitaxial growth processes employed by the Group allow very precise films of semiconductor materials to be atomically engineered to produce well-defined electrical and optical characteristics. These processes are the key step in producing established products such as amplifiers and switches used in mobile communications applications (phones, PDAs, wireless connectivity), lasers and LEDs used in a diverse range of optical technologies and are critical in emerging products such as those based on nanotechnology and MEMS.

The semiconductor industry has been an extremely high growth industry during the last 40 years despite its cyclical nature and this has been driven by continuous technological innovation. That technological progress has been achieved through increasingly complex design and continual miniaturisation. Now, however, the industry has arrived at a critical point where we believe future developments will be born out of advanced materials engineering and this is the key area of IQE's expertise.

Marketplace

The depressed state of the industry following the boom of the late 1990s has been well documented and IQE's business has suffered along with the rest of the sector. However, during the first half of 2003 there have been signs of a cautious but steady return to growth in demand for products and services in which IQE's materials are deployed, with customers returning to IQE to resume production, and engaging in many more qualification programmes, particularly in the products detailed below.

Products

One of IQE's key strengths is the fact that it is prepared to work closely with its customers from early prototype development through to "mass customisation". This integration of IQE's materials into customers' products demands close working relationships at many levels and absolute confidentiality is a key feature of such relationships. The range of products in which IQE's materials are used is diverse, but examples of newer technologies where IQE has developed a leading edge technology position include:

Strained Silicon: Rapidly raising profile on semiconductor technology roadmaps, strained silicon is the primary candidate, along with Silicon on Insulator (SOI) as the next generation materials for high speed electronic devices, particularly for Mixed Signal Processing (MSP: Digital & Analog) devices.

High Power Lasers: Semiconductor materials for high power, visible and Infrared lasers. Until recently, gas filled lasers have been used to generate the high intensities and high powers needed for industrial applications such as welding and cutting. The new generation of Aluminium-free lasers in which IQE has achieved some world-first results, allows semiconductor lasers to match the power of traditional but bulky gas lasers. IQE is currently the only epifactory currently providing these materials.

- HBTs/PHEMTs:* The key devices for wireless applications from mobile phones to base stations. IQE is the major external supplier of PHEMT wafers globally using MBE technology and has a large production capability for advanced InGaP HBTs by MOVPE. World record speeds of up to 450GHz have been achieved with transistors made from IQE's indium phosphide (InP) HBT materials.
- Metamorphics:* Emerging as an important "next generation" material for cost effective, high speed applications, enabling the enhanced properties of indium phosphide (InP) to be produced on less expensive gallium arsenide (GaAs) substrates including even more advanced technology for GaAs on Silicon.
- Lasers/VCSELs:* Edge emitting and vertical cavity semiconductor lasers operating from visible to the infrared wavelengths. For use in data storage applications (CD/DVD), data and telecommunications (optical fibre), medical (laser surgery/cosmetic devices), industrial (laser pointers/theodolites, etc) and laser printers.
- QWIPs:* Quantum Well Infrared Photodetectors used in high definition, infrared imaging applications. Examples include IR cameras for emergency services and space exploration (eg NASA).
- InSb/GaSb Substrates:* Materials on which epitaxial layers are grown for ultra high-speed and infrared detection. Market drivers include thermal imaging cameras for security, rescue and military applications, and for environmental monitoring.

Industry Position

IQE has a proven track record in developing and producing advanced semiconductor materials over the last 15 years. The industry in which it operates has been through a tumultuous two years, but it remains a sector that has seen unprecedented growth in the long term and is likely to continue to do so again. IQE's business model within that industry is based on the trend towards outsourcing and this has remained fundamentally unchanged throughout the Group's history. The Directors firmly believe that the model itself is sound and that IQE is uniquely positioned as the pre-eminent industry foundry for the outsourcing of advanced semiconductor materials.

IQE's strategy is to increase market share through penetrating in-house services by offering highly cost effective materials expertise and rapid access to new and established technologies across a range of production platforms.

As demand for end user products recovers, IQE's Directors firmly believe that the trend towards outsourcing will increase further, particularly as some of the more mature products become commoditised and access to replacement technologies becomes critical.

Since there are very significant barriers to entry both in terms of production know how and capital investment, which is also encouraging in-house producers to look externally, the Directors believe a significant shift to outsourcing is gathering momentum in the industry which will significantly benefit IQE in the future.

Results

Q2 sales were £5.097m, a 3 per cent. increase over the preceding quarter which was mainly as a result of further increases in sales of wireless materials. The gross loss for Q2 was -11 per cent., representing a further steady improvement over the previous two quarters (Q1/2003: -20 per cent., Q4/2002: -44 per cent.). As reported in the previous results, sales price pressure remains a consideration but the effect of this has largely been offset by the benefit of lower raw materials costs, which generally applied across all product ranges within the Group.

Technical capability represents a primary competitive advantage in the fast moving technology environment in which the Group operates. Research and development costs in Q2/2003 were £0.513m, representing 10.0

per cent. of sales (Q2/2002: £0.731m, 11.5 per cent. of sales). Significant progress was made in a number of key areas, positioning IQE as a respected technological leader with 12 leading research papers published during the first half of the year. H1/2003 research and development costs were £1.172m representing 11.7 per cent. of sales (H1/2002: £1.873m, 15.6 per cent. of sales). All research and development costs were expensed in the quarter. Many research and development activities include partnerships with leading, global blue-chip companies and these have resulted in a number of new products achieving advanced stages of qualification for volume production, including Al-free laser materials for high power, industrial lasers.

Q2 SG&A costs were slightly up on the previous quarter at £1.791m (Q1/2003: £1.764m) but 37.8 per cent. lower than the same period last year (Q2/2002: £2.883m) excluding non-recurring costs as shown in the Profit and Loss Analysis.

As a result of the above, the Group incurred an operating loss for Q2 before goodwill amortisation and operating exceptional items of £2.869m (Q1/2003: £3.420m). The operating loss for the quarter before tax was £2.967m (Q1/2003: £3.801m).

The Group also reduced its operating cash outflow substantially in the quarter to £1.989m, 34 per cent. less than the previous quarter (Q1/2003: outflow £3.005m). This was as a direct result of continued focus on the reduction of operating costs and careful management of working capital, in particular stock reduction. Capital expenditure in the first half of 2003 was substantially reduced to £.085m (H1/2002: £3.618m). Gross cash at the end of the quarter was £10.695m, an overall reduction of £2.802m from the end of the previous quarter.

The reduced cost base puts IQE in the powerful position of recognised technological leadership whilst being able to offer highly competitive pricing to customers.

Operations

Significant progress has been made in respect of the strategic review that was carried out in Q2/2002. Group headcount has been reduced from over 450 to 270 and considerable effort has been made to consolidate the Group's technical position and cost competitiveness. The Group itself comprises four separate and independent business units. There is a degree of synergy across all four operations but little scope for consolidation between the units as the unique technologies employed at each of the facilities is dependent both upon location and operating platform.

IQE Inc

IQE Inc in the US has continued to see improvements to trading in the wireless sector, although the strength of the recovery has been cautious with the possibility of further consolidation within the sector amongst our customers increasingly likely. Feedback from customers indicates that excess inventories that had built up during 1999/2001 have been cleared throughout customer channels and this is creating a renewed demand, particularly for materials used in amplifiers and switches used in the mobile telecoms industry. IQE Inc is a qualified supplier to several of the world's top RF component companies, and as demand increases this business unit is likely to become cash generative in the foreseeable future.

IQE Europe Ltd

Demand for optical materials remained weak during the first half of 2003, although opportunities for sampling new products increased towards the end of the second quarter as operational efficiencies and cost savings kicked in and this allowed IQE to take an aggressive stance on pricing to compete with sources in the Far East. Looking ahead, the company is now in a position where it has low operating costs, high efficiencies, significant production capacity and superior technological capabilities. Consequently, the Board believes that this business unit is poised to reap the benefits from a number of new product developments as they become qualified by major users towards the end of this year and the first half of next year.

IQE Silicon Compounds Ltd

The growing number of articles in journals and the trade press regarding strained silicon continues to raise the profile of this technology. It is a material system that offers enhanced electronic characteristics over and

above those exhibited by silicon alone and, as such, it has the potential to become the industry standard for high speed silicon applications such as microprocessors and mixed signal processors (MSP). IQE has established a leading position in this technology by both collaboration with technology partner AmberWave and in developing its own stand-alone, proprietary process. IQE's own process for producing strained silicon showcased at Semicon West in San Francisco during July and generated very significant interest amongst potential customers. Samples are now available for shipping and in qualification with a number of key potential customers. Several leading industry players are currently seeking formal, long term supply agreements as a means of securing their position in this technology. IQE believes it is the first commercial epi-source for the material worldwide and expects demand for this material to begin accelerating during the coming quarters.

Wafer Technology Ltd

The second quarter saw a steadily increasing demand for both InP and GaAs substrates, to the extent that it became necessary to recruit additional staff to open capacity that had effectively been mothballed. Demand for the range of narrow gap materials produced by the Company was also sustained resulting in a sequential increase in revenue and improvements in operating cash flow to the point of being virtually cash breakeven.

General

A further sign of the industry gaining momentum was signalled by an increase in quality-related activities – in particular, customer quality audits related to product qualification processes. All business units within the Group are separately accredited with BSi to the ISO9000 standard. IQE Silicon Compounds is accredited to the latest version of the standard at ISO9000:2000, with the remaining sites expected to complete the transition by the end of this year. Meanwhile, additional activities are underway to complete Environmental audits with the aim of achieving accreditation to the Environmental Management Standard; ISO14001. A substantial amount of work has already been completed, with the IQE Silicon Compounds division planning to complete the accreditation process during the first half of 2004.

Trading prospects

Despite the current trading environment, the first half of the year has seen the development of a number of major new opportunities for the Group, particularly in terms of wireless products and in new technologies such as high power lasers, metamorphic HEMTs and strained silicon substrates. IQE believes it is in a unique position in terms of its new product offerings, but it is unlikely that these products will have a major impact on the P&L during the third quarter simply because the qualification periods and lead-in times for new products and processes can be extremely slow and are strongly customer dependant. Nevertheless, IQE has built a very competitive position to win this new business and increase market share as the sector returns to a pattern of normal growth as a direct result of IQE's diverse product portfolio, choice of production platforms and significant 'world-class' technology leads.

During the industry recession, the Board has pursued a strategy of maintaining the Group intact, despite obvious ongoing cash requirements, in the strong belief that there exists substantial upside potential within the business as a result of past investments in capacity and technology. As confidence returns, new products are brought to market and more emphasis is placed on outsourcing, we expect this potential to come to fruition. The Group is working with many of the world's leading companies in each sector, and the Board is cautiously optimistic that there will be an increasingly positive newsflow in the coming quarters. Although cash outflows will continue this year and early next year, the Board believes that the Group is well positioned to take advantage of the opportunities that have been created to re-establish profitability and positive operating cash flows.

Dr Drew Nelson

President and Chief Executive Officer

IQE plc

ACCOUNTS FOR 6 MONTHS TO 30 JUNE 2003

PROFIT AND LOSS ACCOUNT

		3 months to 30 June 2003 unaudited £'000	3 months to 30 June 2002 unaudited £'000	6 months to 30 June 2003 unaudited £'000	6 months to 30 June 2002 unaudited £'000	12 months to 31 December 2002 audited £'000
	Note					
Turnover		5,097	6,357	10,056	12,037	22,960
Cost of Sales		(5,663)	(20,191)	(11,619)	(27,086)	(90,579)
Gross Profit/(Loss)		(565)	(13,834)	(1,562)	(15,049)	(67,619)
Gross Profit/(Loss) %		(11.1)	(217.6)	(15.5)	(125.0)	(294.5)
S G and A Costs including Distribution						
Research/Development		(513)	(731)	(1,172)	(1,873)	(3,210)
Selling/General/Administration		(1,791)	(3,348)	(3,555)	(5,968)	(10,401)
Operating Profit/(Loss) pre Goodwill/Exceptionals		(2,869)	(17,913)	(6,289)	(22,890)	(81,230)
Operating Profit/(Loss) % pre Goodwill/Exceptionals		(56.3)	(281.8)	(62.5)	(190.2)	(353.8)
Goodwill Written off	2	0	(33,866)	(0)	(34,302)	(34,302)
Exceptional Items	3	(7)	(545)	(306)	(890)	(2,686)
Operating Profit/(Loss) post Goodwill/Exceptionals		(2,876)	(52,324)	(6,595)	(58,082)	(118,218)
Operating Profit/(Loss) % post Goodwill/Exceptionals		(56.4)	(823.1)	(65.6)	(482.5)	(514.9)
Interest Received/(Paid)		(91)	24	(172)	12	(16)
Net Profit/(Loss) before Taxes		(2,967)	(52,300)	(6,768)	(58,071)	(118,234)
Net Profit/(Loss) %		(58.2)	(822.7)	(67.3)	(482.4)	(515.0)
Current Taxes		0	0	(0)	(0)	0
Deferred Taxes		0	0	(0)	(0)	1,217
Dividends		0	0	(0)	(0)	0
Net Profit/(Loss) after Taxes		(2,967)	(52,300)	(6,768)	(58,071)	(117,017)
Basic Earnings Pence/Share		(1.58)	(28.32)	(3.60)	(31.44)	(63.08)
Basic Earnings Pence/Share excl Goodwill		(1.58)	(9.98)	(3.60)	(12.87)	(44.59)
Diluted Earnings Pence/Share	4	(1.58)	(28.32)	(3.60)	(31.44)	(63.08)
Diluted Earnings Pence/Share excl Goodwill	4	(1.58)	(9.98)	(3.60)	(12.87)	(44.59)
Net Profit/(Loss) before Interest/Taxes/Depreciation and Amortisation (EBITDA)		(2,347)	(7,972)	(5,534)	(11,367)	(19,537)

PROFIT AND LOSS ACCOUNT ANALYSIS

		3 months to 30 June 2003	3 months to 30 June 2002	3 months to 30 June 2002 <i>non</i>	3 months to 30 June 2002 <i>total</i>	6 months to 30 June 2003	6 months to 30 June 2002	6 months to 30 June 2002 <i>non</i>	6 months to 30 June 2002 <i>total</i>
	Note	recurring £'000	recurring £'000	recurring £'000	total £'000	recurring £'000	recurring £'000	recurring £'000	total £'000
Turnover		5,097	6,357	0	6,357	10,056	12,127	(90)	12,037
Cost of Sales		(5,663)	(8,236)	(11,955)	(20,191)	(11,619)	(15,131)	(11,955)	(27,086)
Gross Profit/(Loss)		(565)	(1,879)	(11,955)	(13,834)	(1,562)	(3,004)	(12,045)	(15,049)
Gross Profit/(Loss) %		(11.1)	(29.6)		(217.6)		(24.8)		(125.0)
S G and A Costs including Distribution									
Research/Development		(513)	(731)	0	(731)	(1,172)	(1,873)	0	(1,873)
Selling/General/ Administration		(1,791)	(2,883)	(465)	(3,348)	(3,555)	(5,503)	(465)	(5,968)
Operating Profit/(Loss) pre Goodwill/Exceptionals		(2,869)	(5,493)	(12,420)	(17,913)	(6,289)	(10,380)	(12,510)	(22,890)
Operating Profit/(Loss) % pre Goodwill/Exceptionals		(56.3)	(86.4)		(281.8)		(85.6)		(190.2)
Goodwill Written off	2	0	(455)	(33,411)	(33,866)	(0)	(891)	(33,411)	(34,302)
Exceptional Items	3	(7)	(545)	0	(545)	(306)	(890)	0	(890)
Operating Profit/(Loss) post Goodwill/Exceptionals		(2,876)	(6,493)	(45,831)	(52,324)	(6,595)	(12,161)	(45,921)	(58,082)
Operating Profit/(Loss) % post Goodwill/Exceptionals		(56.4)	(102.1)		(823.1)		(100.3)		(482.5)
Interest Received/(Paid)		(91)	24	0	24	(172)	12	0	12
Net Profit/(Loss) before Taxes		(2,967)	(6,469)	(45,831)	(52,300)	(6,768)	(12,150)	(45,921)	(58,071)
Net Profit/(Loss) %		(58.2)	(101.8)		(822.7)		(100.2)		(482.4)
Current Taxes		0	0	0	0	0	0	(0)	(0)
Deferred Taxes		0	0	0	0	0	0	(0)	(0)
Dividends		0	0	0	0	0	0	(0)	(0)
Net Profit/(Loss) after Taxes		(2,967)	(6,469)	(45,831)	(52,300)	(6,768)	(12,150)	(45,921)	(58,071)
Basic Earnings Pence/Share		(1.58)	(3.50)		(28.32)	(3.60)	(6.58)		(31.44)
Basic Earnings Pence/Share excl Goodwill		(1.58)	(3.26)		(9.98)	(3.60)	(6.10)		(12.87)
Diluted Earnings Pence/Share⁴		(1.58)	(3.50)		(28.32)	(3.60)	(6.58)		(31.44)
Diluted Earnings Pence/Share excl Goodwill	4	(1.58)	(3.26)		(9.98)	(3.60)	(6.10)		(12.87)
Net Profit/(Loss) before Interest/Taxes/Depreciation and Amortisation (EBITDA)		(2,347)	(4,144)	(3,828)	(7,972)	(5,534)	(7,449)	(3,918)	(11,367)

BALANCE SHEET

	<i>As at 30 June 2003 unaudited £'000</i>	<i>As at 30 June 2002 unaudited £'000</i>	<i>As at 31 December 2002 audited £'000</i>
Fixed Assets			
Intangible Fixed Assets	0	0	0
Tangible Fixed Assets	12,537	65,201	13,862
Investment in Own Shares	14	2	9
Capitalised Development Costs	0	0	0
Total Fixed Assets	<u>12,551</u>	<u>65,203</u>	<u>13,871</u>
Current Assets			
Stocks	4,295	6,981	4,988
Debtors	2,955	4,813	3,721
Cash and Bank	10,695	23,817	17,715
Total Current Assets	<u>17,945</u>	<u>35,611</u>	<u>26,424</u>
Creditors: amounts falling due within one year	<u>(10,347)</u>	<u>(10,841)</u>	<u>(11,908)</u>
Net Current Assets	<u>7,598</u>	<u>24,771</u>	<u>14,516</u>
Total Assets less Current Liabilities	<u>20,149</u>	<u>89,974</u>	<u>28,387</u>
Creditors: amounts falling due after one year			
Deferred Income	(452)	(102)	(452)
Long Term Borrowings	(4,520)	(6,984)	(5,999)
Provision for Liabilities and Charges			
Deferred Taxes	(0)	(1,215)	0
Net Assets	<u>15,177</u>	<u>81,673</u>	<u>21,936</u>
Capital and Reserves			
Called Up Share Capital	1,885	1,853	1,871
Merger Reserve	(605)	(605)	(605)
Share Premium Account	140,499	140,220	140,328
Shares to be Issued	155	70	133
Retained Earnings	(126,275)	(60,561)	(119,507)
Other Reserves	(482)	696	(284)
Total Equity Shareholders' Funds	<u>15,177</u>	<u>81,673</u>	<u>21,936</u>

Approved by the Directors of IQE plc on 19 August 2003

CASH FLOW STATEMENT

	<i>3 months to 30 June 2003 unaudited £'000</i>	<i>3 months to 30 June 2002 unaudited £'000</i>	<i>6 months to 30 June 2003 unaudited £'000</i>	<i>6 months to 30 June 2002 unaudited £'000</i>	<i>12 months to 31 December 2002 audited £'000</i>
Net Inflow/(Outflow) from Operations	<u>(1,989)</u>	<u>(1,112)</u>	<u>(4,994)</u>	<u>(4,431)</u>	<u>(8,995)</u>
Returns on Investment and Servicing Finance					
Disposals of Fixed Assets	76	0	76	0	0
Interest Received/(Paid)	(91)	24	(172)	12	(16)
Capital Expenditures					
Purchases of Fixed Assets less Leases Received	(15)	(2,252)	(85)	(3,618)	(3,765)
Payments to Acquire Investments in Subsidiaries	0	0	0	0	0
Capitalised Development Costs	0	0	(0)	(0)	0
Dividends Received/(Paid)	0	0	0	0	0
Taxes Received/(Paid)	<u>0</u>	<u>(58)</u>	<u>0</u>	<u>(58)</u>	<u>(67)</u>
Net Inflow/(Outflow) before Financing	<u>(2,019)</u>	<u>(3,398)</u>	<u>(5,175)</u>	<u>(8,096)</u>	<u>(12,843)</u>
Financing					
Issues of Ordinary Share Capital	49	128	207	3,079	3,267
Loans Received/(Repaid)	(253)	(182)	(878)	(440)	(662)
Leases (Repaid)	(580)	(648)	(1,174)	(1,257)	(2,578)
Net Inflow/(Outflow) from Financing	<u>(784)</u>	<u>(702)</u>	<u>(1,845)</u>	<u>1,382</u>	<u>27</u>
Increase/(Decrease) in Total cash and Bank	<u>(2,803)</u>	<u>(4,100)</u>	<u>(7,020)</u>	<u>(6,714)</u>	<u>(12,816)</u>
Management of cash at Bank accessible between 1 and 7 days	<u>3,000</u>	<u>4,500</u>	<u>6,250</u>	<u>6,500</u>	<u>12,250</u>
Increase/(Decrease) in cash and Bank excluding cash at Bank accessible between 1 and 7 days	<u>197</u>	<u>400</u>	<u>(770)</u>	<u>(214)</u>	<u>(566)</u>

RECONCILIATION OF LOSS TO CASH INFLOW/(OUTFLOW) FROM OPERATIONS

	<i>3 months to 30 June 2003 unaudited £'000</i>	<i>3 months to 30 June 2002 unaudited £'000</i>	<i>6 months to 30 June 2003 unaudited £'000</i>	<i>6 months to 30 June 2002 unaudited £'000</i>	<i>12 months to 31 December 2002 audited £'000</i>
Operating Loss post					
Goodwill/Exceptionals	<u>(2,876)</u>	<u>(52,324)</u>	<u>(6,595)</u>	<u>(58,082)</u>	<u>(118,218)</u>
Depreciation Charged	529	10,486	1,061	12,413	64,379
Goodwill Written off	0	33,866	0	34,302	34,302
(Increase)/Decrease in Stocks	479	3,663	693	5,296	7,289
(Increase)/Decrease in Debtors	731	1,776	766	2,682	3,774
Increase/(Decrease) in Creditors	(852)	1,461	(918)	(970)	(800)
Grants Released	0	140	0	108	(141)
Grants Received	0	(180)	0	(180)	420
Net Cash Inflow/(Outflow) from Operations	<u>(1,989)</u>	<u>(1,112)</u>	<u>(4,994)</u>	<u>(4,431)</u>	<u>(8,995)</u>

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN FUNDS

	<i>3 months to 30 June 2003 unaudited £'000</i>	<i>3 months to 30 June 2002 unaudited £'000</i>	<i>6 months to 30 June 2003 unaudited £'000</i>	<i>6 months to 30 June 2002 unaudited £'000</i>	<i>12 months to 31 December 2002 audited £'000</i>
Increase/(Decrease) in cash	<u>(2,803)</u>	<u>(4,100)</u>	<u>(7,020)</u>	<u>(6,714)</u>	<u>(12,816)</u>
Loans (Received)/Repaid	253	182	878	440	662
Leases Repaid	580	648	1,174	1,257	2,578
Change in Funds Resulting from					
Cash Flows	(1,970)	(3,270)	(4,968)	(5,017)	(9,576)
New Finance Leases	0	(16)	(0)	(392)	(389)
New Loans non cash	0	0	(0)	(0)	(1,315)
Net Movement	<u>(1,970)</u>	<u>(3,286)</u>	<u>(4,968)</u>	<u>(5,409)</u>	<u>(11,280)</u>
Net Funds at Start	4,932	17,000	7,959	19,104	19,104
Exchange Differences Loans/Leases	83	(20)	54	(1)	135
Net Funds at close	<u>3,045</u>	<u>13,693</u>	<u>3,045</u>	<u>13,693</u>	<u>7,959</u>
Analysis of Net Funds					
Cash in Hand and at Bank	1,695	2,817	1,695	2,817	2,465
Cash at Bank accessible between					
1 and 7 days	9,000	21,000	9,000	21,000	15,250
Total Cash and Bank	10,695	23,817	10,695	23,817	17,715
Loans due after one year	(2,714)	(2,157)	(2,714)	(2,157)	(3,049)
Loans due within one year	(439)	(976)	(439)	(976)	(1,035)
HP/Finance Leases due after one year	(1,805)	(4,828)	(1,805)	(4,828)	(2,950)
HP/Finance Leases due within one year	(2,692)	(2,163)	(2,692)	(2,163)	(2,722)
Total	<u>3,045</u>	<u>13,693</u>	<u>3,045</u>	<u>13,693</u>	<u>7,959</u>

NOTES TO THE ACCOUNTS

1 Basis of preparation

The financial information is prepared under the historical cost convention and in accordance with applicable accounting standards, which have been applied on a consistent basis during the period under review. The particular accounting policies adopted are described below:

- Turnover represents amounts invoiced, exclusive of value added tax.
- Tangible fixed assets are stated at cost less accumulated depreciation and any provisions for impairment. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use, as defined by Financial Reporting Standard Number 15. Depreciation has been calculated so as to write down the cost of assets to their residual values over the following estimated useful economic lives. No depreciation is provided on land or assets in the course of construction, or on assets in periods of non-use where no physical or technological deterioration occurs and the remaining useful economic life is extended by the period of non-use.

Freehold buildings	25 years
Short leasehold improvements	5/27 years
Plant and machinery	5/10 years
Fixtures and fittings	4/5 years
Motor vehicles	4 years

- The financial information consolidates the financial statements of the Company and all of its subsidiaries.
- Stocks are stated at the lower of cost and net realizable value.
- Research and development expenditure is fully written off when incurred except where contracts of sufficient value exist or are likely to exist in the foreseeable future, in which case it is written off over a two year period commencing with the start of the contracts to which the costs relate.
- Transactions in foreign currencies during the period are recorded in sterling at the rates ruling at the dates of the transactions. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. All exchange differences are taken to the profit and loss account.

The balance sheets of IQE Inc are translated into sterling at the closing rates of exchange for the period, while the profit and loss accounts are translated into sterling at the average rates of exchange for the period. The resulting translation differences are taken direct to reserves.

- The Group operates defined contribution pension schemes. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the schemes.
- Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements.

Deferred tax is not provided on timing differences arising from the revaluation of fixed assets where there is no binding contract to dispose of those assets. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

- Government grants receivable in connection with expenditure on tangible fixed assets are accounted for as deferred income, which is credited to the profit and loss account by instalments over the expected useful economic life of the related assets on a basis consistent with the depreciation policy. Revenue

grants for the reimbursement of costs incurred are deducted from the costs to which they related, in the period in which the costs are incurred.

- Assets held under finance leases and hire purchase contracts are capitalised at their fair value on inception of the leases and depreciated over the shorter of the period of the lease and the estimated useful economic lives of the assets. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding and are charged to the profit and loss account. Operating lease rentals are charged to the profit and loss account in equal amounts over the lease term.
- The only derivative instruments utilised by the Group are forward exchange contracts. The Group does not enter into speculative derivative contracts. Forward exchange contracts are used for hedging purposes to alter the risk profile of an existing underlying exposure of the Group in line with the Group's risk management policies.

2 Goodwill

The goodwill arising on the acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited had been capitalised and was being amortised over its useful life, which was considered by the Directors to be 20 years. However, the Directors carried out an evaluation of the investment during 2002 and, in the light of current market conditions, considered that goodwill had lost its value. Accordingly, the remaining value of goodwill was written off in full in the 2002 accounts.

3 Exceptional items

Exceptional items comprise

	2003	2002
Restructuring costs	£306K	£0K
Legal fees	£0K	£890K

Restructuring costs relate to the cost of staff redundancies within the Group as part of the Group's cost reduction program.

Legal fees related to a complaint lodged by IQE (Europe) against Rockwell regarding a declaratory judgment that IQE Europe's processes did not infringe a Rockwell-owned MOCVD patent which expired on 11 January 2000 plus claims for damages related to this matter. Rockwell counter-claimed, alleging breaches of a licence agreement by IQE (Europe). The two parties settled their dispute during 2002. Under the terms of the settlement, IQE (Europe) paid Rockwell \$500K and provided them with 300,000 shares in IQE plc in return for their agreement that neither IQE (Europe) nor its customers had infringed the MOCVD patent. A further \$250K will be paid to Rockwell during 2003 followed by a final payment of \$250K during 2004. The cost of the settlement was charged in full in the 2002 accounts.

4 Earnings per share

FRS 14 requires the presentation of diluted EPS when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. For a loss making company with outstanding share options, net loss per share would only be increased by the exercise of the out of the money options. Since it seems inappropriate to assume that options holders would act irrationally, no adjustment has been made to diluted EPS for out of the money share options.

19 August 2003

PART 4

ILLUSTRATIVE UNAUDITED PRO FORMA STATEMENT OF NET ASSETS

The proforma financial information set out below has been prepared to illustrate the effect on the consolidated net assets of IQE plc as if the Placing and Open Offer had occurred at 30 June 2003. The pro forma financial information has been prepared for illustrative purposes only and, because of its nature, may not give a true picture of the financial position of the Company which would have been reported if the Placing and Open Offer had occurred at 30 June 2003.

The pro forma statement set out below is based on the unaudited net assets of IQE plc as at 30 June 2003 extracted from the unaudited interim results as set out in Part 3 of this document. The statement should be read in conjunction with the notes set out below.

Pro forma statement of net assets of the Company

	<i>IQE plc</i> <i>(Note 1)</i> <i>£'000</i>	<i>Adjustment:</i> <i>Placing and</i> <i>Open Offer</i> <i>(Note 2)</i> <i>£'000</i>	<i>IQE plc</i> <i>following</i> <i>Placing and</i> <i>Open Offer</i> <i>£'000</i>
Fixed assets			
Tangible fixed assets	12,537	–	12,537
Investments	14	–	14
	12,551	–	12,551
Current assets			
Stocks	4,295	–	4,295
Debtors	2,955	–	2,955
Cash at bank and in hand	10,695	17,850	28,545
	17,945	17,850	35,795
Creditors: amounts falling due within one year	(10,347)	–	(10,347)
Net current assets	7,598	17,850	25,448
Total assets less current liabilities	20,149	17,850	37,999
Creditors: amounts falling due after one year	(4,972)	–	(4,972)
Net assets	15,177	17,850	33,027

Notes:

1. The unaudited net assets of the Company have been extracted without adjustment from the unaudited financial information on IQE plc at 30 June 2003 as set out in Part 3 of this document.
2. The amount set out under "Adjustment: Placing and Open Offer" is the gross proceeds of the Placing and Open Offer of £18.75 million less expected costs of £0.9 million.
3. The proforma statement does not take account of trading results since 30 June 2003.

PART 5

RISK FACTORS

An investment in the New Ordinary Shares is subject to a number of risks. Accordingly, prospective investors in New Ordinary Shares should consider carefully all of the information set out in this document and the risks attaching to an investment in the Company, including, in particular, the risks described below prior to making any investment decision. The information below does not purport to be an exhaustive list or summary of the risks that the Company may encounter. Investors, prospective investors and Shareholders should consider carefully whether an investment in the Company is suitable for them in light of the information in this document and the financial resources available to them. References in this section to IQE include references to all Group companies.

The Company's business, financial condition or results of operations could be materially and adversely affected by any of the risks described below. In such case, the market price of the Ordinary Shares may decline due to any of these risks and investors may lose all or part of their investment. Additional risks and uncertainties not presently known to the Directors, or that the Directors currently deem immaterial, may also have an adverse effect on the Company.

IQE's business depends on the successful exploitation of existing technologies and products and development of new products

The continued success of IQE depends upon:

- the generation of increased revenues by further exploitation of its own existing technologies and products;
- the successful commercialisation by IQE of its new technologies presently at the development stage;
- the ability of IQE to identify market opportunities and invent, develop and commercialise new technologies and products appropriate for those markets; and
- continuing actively to licence the patent rights of its third party customers.

Development by the Company of its existing technologies or development of new technologies may take longer than anticipated; development delays, defects in technology or new technology proving to be unreliable may all lead to a reduction in anticipated revenue generation. IQE cannot guarantee that it will be able to commercialise technology at an early stage of development. In addition, there can be no assurance that the Group's competitors will not independently develop similar or improved technology.

Claims by others that IQE infringes their Intellectual Property rights could be costly to defend and could harm IQE's business

IQE may be subject to claims by others that its products infringe their intellectual property rights. These claims, whether or not valid, could require IQE to spend significant sums in litigation, pay damages, delay or cancel product shipments, reengineer its products or acquire licences to third-party Intellectual Property. In the event that IQE needs to acquire a third-party license, IQE may not be able to secure it on commercially reasonable terms, or at all. IQE expects that it may be more likely to face infringement claims as IQE's profile in the market grows. Any of these claims or resulting events could harm IQE's business.

IQE may require additional capital in the future

The Company's capital requirements depend on numerous factors, including the rate of market acceptance of its products and its ability to attract customers. It is difficult for the Directors to predict the timing and amount of the Company's capital requirements with accuracy. The Company may require further financing in addition to amounts raised in the Placing and Open Offer. Any additional equity financing may be dilutive to Shareholders, and debt financing, if available, may involve restrictions on financing and operating

activities. If the Company is unable to obtain additional financing as needed, it may be required to reduce the scope of its operations or anticipated expansion.

Limited protection of proprietary technology

The Group seeks to protect its technology, proprietary rights and other written materials principally under trade secret and copyright laws, which afford only limited protection. The Group does not have any patents on its proprietary technology, although it routinely enters into non-disclosure, non-compete and confidentiality agreements with employees, contractors, consultants and customers. Despite the Group's efforts to protect its proprietary rights, unauthorised parties may attempt to utilise aspects of its technology or to obtain and use information which the Group regards as proprietary.

Share price volatility

The share price of publicly traded technology companies can be highly volatile. The price at which the Company's shares will be traded and the price which investors may realise for their shares will be influenced by a large number of factors, which could include the performance of both the Company and its competitors, large purchases of the Company's shares, currency fluctuations, legislative changes in the telecommunications and information technology environment and general economic conditions.

Forward looking statements and Directors' expectations and beliefs

This document contains forward looking statements including, without limitation the words "believe", "expect", "anticipate" and other similar expressions. Such forward looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, financial condition, performance or achievements of the Group, or industry results, to be materially different from any future results, performance or achievements, expressed or otherwise by such forward looking statements. Given these uncertainties undue reliance should not be placed on such forward looking statements.

PART 6

ADDITIONAL INFORMATION

1 Responsibility

The Directors (whose names and business addresses appear on page 4 of this document) accept responsibility for the information contained in this document. To the best of the knowledge of the Directors, the information contained in this document is in accordance with the facts and makes no omission likely to affect the import of such information.

2 The Company

The Company was incorporated and registered in England and Wales on 1 April 1999 as a public company limited by shares under the Act with registered number 3745726 and with the name Filbuk 566 Plc. The liability of the members of the Company is limited.

On 26 April 1999, the name of the Company was changed to IQE plc.

The principal legislation under which the Company operates is the Act and the regulations made thereunder.

The Company's principal place of business in the United Kingdom is its registered office at Pascal Close, Cypress Drive, St Mellons, Cardiff, CF3 0EG.

3 Share Capital

3.1 The following table shows the authorised and fully paid up issued share capital of the Company as at 6 October 2003, the latest practicable date prior to the posting of this document:

<i>Authorised</i>		<i>Issued</i>	
<i>Ordinary Shares of 1p</i>		<i>Ordinary Shares of 1p</i>	
<i>No.</i>	<i>£</i>	<i>No.</i>	<i>£</i>
300,000,000	3,000,000	188,963,640	1,889,636.40

3.2 The following table shows the authorised and fully paid up issued share capital of the Company following the Placing and Open Offer:

<i>Authorised</i>		<i>Issued</i>	
<i>Ordinary Shares of 1p</i>		<i>Ordinary Shares of 1p</i>	
<i>No.</i>	<i>£</i>	<i>No.</i>	<i>£</i>
500,000,000	5,000,000	313,963,640	3,139,636.40

3.3 At the date of this document, the Company has 8,603,101 options over Ordinary Shares outstanding pursuant to the Share Option Schemes described in paragraph 9 below.

At the date of this document, the Company has share warrants outstanding which grant the warrant holders the right to subscribe for (in aggregate) up to 6,428,620 Ordinary Shares in accordance with their terms.

3.4 On 6 June 2003 by resolutions passed at an annual general meeting of the Company it was resolved that:

3.4.1 the Directors are generally and unconditionally authorised, in substitution for all existing authorities to the extent unused, to exercise all the powers of the Company to allot relevant securities of the Company in accordance with section 80 of the Act up to an aggregate number of 72,204,136 shares provided that this authority shall expire on the earlier of 15 months after the passing of that resolution and the conclusion of the annual general meeting next following the passing of that resolution save that the Company may before expiry make an offer or

agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred thereby had not expired;

3.4.2 the Directors are empowered pursuant to section 95 of the Act to allot equity securities (as defined in section 94 of the Act) of the Company pursuant to the general authority conferred by the resolution referred to in paragraph 2.4.1 above as if section 89(1) of the Act did not apply to such allotment provided that such power shall be limited to:

3.4.2.1 the allotment (otherwise than pursuant to sub-paragraph 3.4.2.2 below) of equity securities which are to be wholly paid up in cash up to an aggregate nominal number of 9,353,494 shares; and

3.4.2.2 the allotment of equity securities in connection with a rights issue or any other pre-emptive offer in favour of holders of ordinary shares and other persons entitled to participate therein in proportion (as nearly as may be) to their respective holdings of ordinary shares (or as appropriate the number of ordinary shares which they are deemed to hold for such purpose) subject only to such exclusions or other arrangements as the Directors may consider appropriate to deal with fractional entitlements or legal or practical difficulties under the laws of or the requirements of any recognised regulatory body or any stock exchange in any overseas territory

and such power shall expire on the earlier of 15 months after the passing of that resolution and the conclusion of the annual general meeting next following the passing of that resolution save that the Company may before expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if the authority conferred thereby had not expired.

3.5 Since the end of the last financial period of the Company on 31 December 2002, the following changes have occurred in the Company's share capital:

3.5.1 In aggregate, 1,097,444 Ordinary Shares have been issued to Godfrey Ainsworth and Wesley Clover Wales Limited since April 2002 in connection with the payment of the non-executive directors' fees of Godfrey Ainsworth and Simon Gibson respectively.

3.5.2 The following issues of Ordinary Shares have been made in connection with the exercise of options under the Share Option Schemes:

<i>Date</i>	<i>Issued</i>
14.01.03	41,210
06.03.03	300,000
06.03.03	300,000
09.05.03	11,880
26.08.03	112,852
02.09.03	132,562

4 Subsidiary Undertakings

The Company has the following subsidiaries, all of which are wholly owned by the Company unless stated otherwise:

<i>Name of Company and Registered Number</i>	<i>Date and Place of Incorporation</i>	<i>Registered Office</i>	<i>Issued Share Capital</i>
IQE Inc ^(a)	23 December 1998 Pennsylvania	119 Technology Drive Bethlehem Pennsylvania 18015 Pennsylvania USA	200 shares of common stock of no par value 5,000 shares of series A preferred stock of no par value
IQE USA Inc.	17 December 2001 Delaware	1201 Market Street Suite 1600 Wilmington Delaware 19801 USA	300 shares of common stock of \$0.001 5,000 shares of series A preferred stock of \$0.001
EPI Holdings Limited (3170421)	11 March 1996 England and Wales	Cypress Drive St Mellons Cardiff CF3 0EG	3,000,000 ordinary shares of 1p each
IQE (Europe) Limited ^(b) (2107558)	9 March 1987 England and Wales	Cypress Drive St Mellons Cardiff CF3 0EG	1,595,400 ordinary shares of £1.00 each
Epitaxial Products Inc. ^(c)	5 February 1992 Delaware	119 Technology Drive Bethlehem Pennsylvania 18015 USA	1,000 shares of common stock of no par value
Wafer Technology Limited ^(d) (1829722)	3 July 1984 England and Wales	Pascal Close Cypress Drive St Mellons Cardiff CF3 0EG	2,058,334 ordinary shares of £1.00 each
Wafer Technology International Limited (2928144)	12 May 1994 England and Wales	Pascal Close Cypress Drive St Mellons Cardiff CF3 0EG	20,000 ordinary shares of £1.00 each
IQE Silicon Compounds Limited (3986643)	5 May 2000 England and Wales	Beech House Cypress Drive St Mellons Cardiff CF3 0LW	2 ordinary shares of £1.00 each

(a) Shares owned by IQE USA Inc.

(b) Shares owned by EPI Holdings Limited

(c) Shares owned by IQE USA Inc.

(d) Shares owned as to 81 per cent. by Wafer Technology International Limited and as to 19 per cent. by the Company

5 Material provisions of the Memorandum of Association

The principal purpose of the Company (as set out in clause 3.1(a) of its Memorandum of Association) is to act as a holding company and to invest in other companies and businesses. The objects of the Company are set out in full in Clause 3.1(a) of the Memorandum of Association which is available for inspection as specified in paragraph 17 of this Part 6 "Documents Available for Inspection".

6 Material provisions of the Articles of Association

This paragraph 6 describes the rights of Ordinary Shareholders as set out in the Articles. It is a description of significant rights and does not purport to be complete or exhaustive.

6.1 *Voting Rights*

Subject to any rights of disenfranchisement which the Company may exercise following: (i) failure of a shareholder to comply with a notice under section 212 of the Act; (ii) failure of a shareholder to comply with a notice requiring him to state he is the beneficial owner of a share; or (iii) failure of a shareholder to disclose a significant shareholding in the capital of the Company, and subject to any special rights or restrictions as to voting attached to any share, every shareholder personally present at a general meeting or, being a corporation, present by representative, shall, on a show of hands, have one vote and on a poll every shareholder who is present in person, or by proxy, shall have one vote for every share of which he is the holder.

6.2 *Dividends, Other Distributions and Rights*

There is no entitlement for shareholders to receive dividends. The Company may, by ordinary resolution, declare dividends and these shall be payable only out of the profits of the Company available for distribution in accordance with the provisions of the Act and every other statute for the time being in force concerning companies and affecting the Company ("the Statutes"). The amount of the dividend must not exceed the amount recommended by the Board. The Company may, with the sanction of an ordinary resolution, satisfy the payment of any dividend, in whole or in part, by the distribution of specific assets or offer shareholders the right to elect to receive additional Ordinary Shares in the Company credited as fully paid in respect of all or part of such dividend.

6.3 *Time Limits for Lapsing of Dividend Rights*

Dividends that are unclaimed for 12 years after they become due for repayment shall be deemed liable to be forfeited and revert to the Company. If dividend warrants are left uncashed for a period of at least six months on two consecutive occasions or have been returned undelivered or left uncashed for a period of at least six months and thereafter reasonable enquiries have failed to establish a new address for delivery, no further dividend warrants shall be despatched until the shareholder notifies the Company of the correct address.

6.4 *Distribution of assets on a winding-up*

Subject to any special rights for the time being attached to any class of shares, on a return of assets on liquidation or otherwise the surplus assets remaining after payment of the Company's liabilities shall be distributed in proportion to the amounts paid up or deemed to be paid up on the shares of the Company then in issue.

6.5 *Changes in Capital*

6.5.1 Subject to the Statutes and without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any shares in the capital of the Company for the time being may be allotted with such special rights, privileges or restrictions as the Company may by resolution (before the allotment of such shares) from time to time determine. Subject to the Statutes and any other rights conferred on the holders of any other shares, the Company may issue redeemable shares. Subject to the Statutes and the Articles, the power of

the Company to allot and issue shares shall be exercised by the Board at such time, for such consideration and upon such other terms as the Board may determine.

6.5.2 The Company may from time to time by resolution increase its share capital, consolidate all or any of its share capital into shares of larger amount and, subject to the Statutes, sub-divide all or any of its share capital into shares of a smaller nominal amount, cancel any shares which, at the date of the passing of the relevant resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the nominal amount of the shares so cancelled. Whenever, as a result of a consolidation of shares, any members would become entitled to a fraction of a share, the Board may deal with the fractions as it thinks fit.

6.5.3 Subject to the Statutes and the rights attaching to any shares, the Company may from time to time by Special Resolution reduce its share capital, any capital redemption reserve and any share premium account or other distributable reserve in any manner.

6.5.4 Subject to the provisions of the Statutes, the Company may from time to time purchase its own shares (including any redeemable shares) but no contract for such a purchase shall be entered into unless the purchase has previously been sanctioned by an extraordinary resolution passed at a separate meeting of the holders of any class of securities issued by the Company which are listed and convertible into shares which are of the same class as those proposed to be purchased.

6.6 *Variation of rights and class meetings*

Whenever the share capital is divided into different classes of shares, all or any of the rights attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may be modified, varied, extended, abrogated or surrendered either in such manner (if any) as may be provided by such rights or (in the absence of any such provision) with the written consent of the holders of at least three fourths in nominal value of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of such shares. To every separate general meeting of the holders of a particular class of shares the provisions of the Articles relating to general meetings shall (*mutatis mutandis*) apply except that:

6.6.1 no member shall be entitled to receive notice of such meeting or to attend it unless he is a holder of shares of the class in question and no vote shall be given except in respect of a share of that class;

6.6.2 the necessary quorum shall be two persons at least present in person and holding or representing by proxy at least one third in nominal amount of the issued shares of the class in question (and at an adjourned meeting shall be one person holding shares of that class or his proxy); and

6.6.3 any holder of shares of the class in question who is present in person or by proxy and entitled to vote may demand a poll and on a poll every holder of shares of the class in question who is present in person or by proxy shall have one vote for every share of that class held by him.

The rights or privileges attaching to any class of securities shall not, subject to the terms on which such securities may be issued, be deemed to be varied or abrogated by the creation or issue of new shares ranking *pari passu* with or subsequent to shares already issued.

6.7 *Transferability*

6.7.1 All transfers of shares may be effected by transfer in writing in any usual or common form or in any other form acceptable to the Directors or by any other method which is authorised by statute and approved or adopted by the Directors. Any such instrument of transfer shall be signed by or on behalf of the transferor and (except in the case of fully paid shares) by or on behalf of the transferee. The transferor shall remain the holder of the shares concerned until the name of the transferee is entered in the register of members in respect thereof.

6.7.2 The Directors may in their absolute discretion, and without assigning any reason therefor, refuse to register any transfer of a share:

6.7.2.1 if the share is not fully paid and the Company has a lien on it; or

6.7.2.2 (except in the circumstances specified in the Articles) if:

6.7.2.2.1 a notice has been duly served in respect of that share pursuant to section 212(1) of the Act or any other statutory provision concerning the disclosure of interests in voting shares; and

6.7.2.2.2 the share or shares which were the subject of that notice represent in aggregate at least 0.25 per cent. of that class of share; and

6.7.2.2.3 the notice has not been complied with within the period stipulated in the notice (which must not be less than 14 days); or

6.7.2.3 which is in favour of more than four persons jointly; or

6.7.2.4 which is not listed or otherwise dealt in on a recognised investment exchange and is not fully paid up.

6.7.3 The Directors may also decline to recognise a transfer of shares unless it is in respect of only one class of share and is deposited at the place where the register of members of the Company is kept for the time being (or at such other place as the directors may from time to time determine) accompanied (save in the case of a transfer by a recognised clearing house or a nominee of a recognised clearing house or of a recognised investment exchange, unless and to the extent that certificates must by law have been issued in respect of the shares in question) by the relevant share certificate(s) and in any case such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer.

6.7.4 Instruments of transfer shall include, in relation to uncertificated shares, instructions and/or notifications made in accordance with the relevant system concerned relating to the transfer of such shares.

6.8 *Directors*

6.8.1 Subject to the provisions of the Articles, the Directors shall not be less than four nor more than fifteen in number. At least two Directors shall be independent directors.

6.8.2 Save as provided in the Articles, a Director shall not vote as a Director in respect of any contract, transaction or arrangement or proposed contract, transaction or arrangement or any other proposal whatsoever in which he has any interest which (together with any interest of any person connected with him) is to his knowledge a material interest (otherwise than by virtue of an interest in shares or debentures or other securities of or otherwise in or through the Company), and if he shall do so his vote shall not be counted, nor in relation thereto shall he be counted in the quorum present at the meeting.

6.8.3 A Director shall (in the absence of some other material interest than is indicated below) be entitled to vote (and be counted in the quorum) in respect of any resolution relating to any of the following matters namely:

6.8.3.1 the giving of any security, guarantee or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of or for the benefit of the Company or any of its subsidiary undertakings or its parent company (if any) or any other subsidiary undertaking of any such parent company; or

6.8.3.2 the giving of any security, guarantee or indemnity in respect of a debt or obligation of the Company or any of its subsidiary undertakings for which the Director himself has assumed responsibility in whole or in part under a guarantee or indemnity or by the giving of security; or

- 6.8.3.3 an offer of shares or debentures or other securities of or by the Company or any of its subsidiary undertakings or its parent company (if any) or any other subsidiary undertaking of any such parent company for subscription or purchase in which offer he is or is to be or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate; or
- 6.8.3.4 any other company in which he or any person connected with him is interested, directly or indirectly, and whether as an officer or shareholder or otherwise howsoever, provided that he and any persons connected with him are not to his knowledge the holder (otherwise than as a nominee for the Company or any of its subsidiary undertakings or its parent company (if any) or any other subsidiary undertaking of any such parent company) of or beneficially interested in 1 per cent. or more of any class of the equity share capital of such company (or of any third company through which his interest is derived) or of the voting rights available to members of the relevant company (any such interest being deemed for this purpose to be a material interest in all circumstances); or
- 6.8.3.5 an arrangement for the benefit of the employees of the Company or any of its subsidiary undertakings which does not award him any privilege or benefit not generally awarded to the employees to whom such arrangement relates; or
- 6.8.3.6 the purchase and/or maintenance of any insurance policy for the benefit of Directors or for the benefit of persons including Directors.
- 6.8.4 Fees may be paid out of the funds of the Company to Directors who are not managing or executive Directors at such rates as the Directors may from time to time determine provided that such fees do not in the aggregate exceed the sum of £150,000 per annum (exclusive of value added tax if applicable) or such other figure as the Company may by resolution from time to time determine. Any such fee shall be distinct from any salary, remuneration or other amounts payable to a Director pursuant to any other provision of the Articles or any contract or arrangement between the Company and the relevant individual.
- 6.8.5 Any Director who devotes special attention to the business of the Company, or otherwise performs services which in the opinion of the Directors are outside the scope of the ordinary duties of a Director, may be paid such additional remuneration as the Directors or any committee authorised by the Directors may determine.
- 6.8.6 A Director may hold any other office or place of profit under the Company (other than the office of auditor) or any undertaking in which the Company is interested, may be a party to or be in any way interested whether directly or indirectly in any contract, arrangement, transaction or proposal to which the Company is a party or in which the Company is in any way interested, subject to the nature and extent of his interest being disclosed by him in accordance with the Statutes.
- 6.8.7 There is no age limit for Directors and sub-sections (1) to (6) of section 293 of the Act do not apply to the Company.
- 6.8.8 At each annual general meeting one third of the Directors, or if their number is not a multiple of three, then the number nearest to but not exceeding one third, shall retire from office and shall be eligible for re-election. The Directors to retire by rotation shall be those who became or were re-elected Directors on the same day and shall, unless they agree otherwise, be determined by lot provided that each Director shall be required to retire from office (and if he so desires offer himself for re-election) at least once in every three year period. Any Director appointed by the Board shall hold office only until the next annual general meeting, shall be eligible for election, but shall not be taken into account in determining the Directors to retire by rotation at that meeting. Any Director holding any executive office or employment under the Company shall not be exempt from retirement by rotation.

6.8.9 The Directors may appoint one or more of their number to be the holder of any executive office on such terms, and for such period, as they may (subject to the provisions of the Statutes) determine and, without prejudice to the terms of any service contract entered into any particular case, may at any time revoke such appointment.

6.8.10 A Director shall not be required to hold qualification shares.

6.8.11 The quorum necessary for the transaction of business of the Directors may be fixed by the Directors and unless so fixed at any other number shall be two.

6.8.12 The Board may provide benefits, whether by payment of gratuities or pensions or by insurance or otherwise to or for employees and ex-employees of the Company or its subsidiary undertakings (which term includes any director who may hold or have held office with the Company or with its subsidiary undertakings) and any dependant (including spouse or ex-spouse) of any employee or ex-employee.

6.9 *Borrowing Powers*

Subject to the provisions of the Articles, the Directors may exercise all the powers of the Company to borrow or raise money and to mortgage or charge its undertaking, property, assets and uncalled capital or any part thereof, and to issue debentures and other securities, whether outright or as collateral security for any debt, liability or obligation of the Company or its holding company (if any) or any subsidiary of the Company or its holding company or of any third party. The Board shall restrict the borrowings of the Company and exercise all voting and other rights or powers of control exercisable by the Company in relation to its subsidiaries (if any) so as to secure (as regards subsidiaries so far as by such exercise they can secure) that the aggregate amount for the time being remaining undischarged of all moneys borrowed by the Group (which expression in the relevant Articles means and includes the Company and all its subsidiaries for the time being) and for the time being owing to persons outside the Group shall not without the previous sanction of a resolution of the Company exceed an amount equal to three times the Adjusted Capital and Reserves (as defined in the Articles).

6.10 *Untraced Shareholders*

The Company shall be entitled to sell in such manner and for such price as the Directors think fit, any share held by a member or any share to which a person is entitled by transmission on death or bankruptcy, or other operation of law, if and provided that for a period of 12 years no cheque or warrant for amounts payable in respect of the shares sent and payable in a manner authorised by the Articles has been cashed and no communication in respect of the shares has been received by the Company from the member or person concerned and during that period at least three cash dividends in respect of the shares have become payable and no dividend in respect of the shares has been claimed and the Company has, after the expiration of that period, by advertisement in both a daily national newspaper and a newspaper circulated in the area in which the last known address of the member is located and by notice to a recognised investment exchange if shares of the class concerned are listed or dealt in on such exchange, giving notice of its intention to sell such shares, and the Company has not, during the further period of three months after the date of advertisement (or the last date if published on different dates) and prior to the sale of the shares, received any communication from the member or person concerned. The Company shall be indebted to the former member or other person entitled to the share for an amount equal to the net proceeds of the sale, but no trust shall be created and no interest shall be payable in respect of the proceeds of sale. The Company may employ the net proceeds of sale in the business of the Company.

6.11 *Indemnity*

Every Director or other officer of the Company shall be entitled to be indemnified out of the assets of the Company against all losses or liabilities which he may sustain or incur in or about the execution or discharge of his duties as an officer or otherwise in relation thereto, including any liability incurred by him in defending any proceedings whether civil or criminal in which judgment is given in his favour or in which he is acquitted or on which the charge is found not proven or in connection with any application

under section 77 of the Act in which relief is granted to him by the Court from liability for negligence, default, breach of duty or breach of trust in relation to the affairs of the Company and no Director or other officer shall be liable for any loss, damage or misfortune which may happen to be incurred by the Company in the execution or discharge of the duties of his office in relation thereto. But this provision shall only have effect insofar as it is not avoided by section 310 of the Act. The Directors shall have power to purchase and maintain insurance for the benefit of any persons who are or were Directors, officers, employees or auditors of the Company or of any other company which is its holding company or in which the Company or such holding company or any of the predecessors of the Company or of such holding company has any interest whether direct or indirect or which is in any way allied to or associated with the Company or of any subsidiary undertaking of the Company or of any such other company, or who are or were at any time trustees of any pension fund in which employees of the Company or of any of such other company or subsidiary undertaking are interested, including (without prejudice to the generality of the foregoing) insurance against any liability incurred by such persons in respect of any act or omission in the actual or purported execution and/ or discharge of their duties and/ or the exercise of their powers and/ or otherwise in relation to their duties, powers or offices in relation to the Company or any such other company, subsidiary undertakings or pension funds.

7 Directors' and other interests in the Company

7.1 *Interests in the Company's Ordinary Share Capital*

7.1.1 At the date of this document and immediately following the Placing and Open Offer, the interests of the Directors (including persons connected with them within the meaning of section 346 of the Act) in the issued share capital of the Company which have been notified by each Director to the Company pursuant to sections 324 and 328 of the Act and which are shown in the register of Directors' interests maintained pursuant to section 325 of the Act are as follows:

	<i>At the date of this document</i>		<i>Immediately following the Placing and Open Offer</i>	
	<i>Number of Ordinary Shares held</i>	<i>Percentage of issued share capital</i>	<i>Number of Ordinary Shares held</i>	<i>Percentage of issued share capital</i>
Dr Andrew Nelson (shares held on trust by Bankhill Trustees Limited for the Andrew Nelson Interest in Possession Settlement)	26,057,970	13.79	26,724,637	8.51
Dr Michael Scott (shares held on trust by Bankhill Trustees Limited for the Dr Scott interest in Possession Settlement)	26,057,970	13.79	26,157,970	8.33
Martin Lamb	3,675,584	1.95	3,775,584	1.20
Dr Godfrey Ainsworth	1,152,149	0.61	1,305,768	0.42
Simon Gibson ⁽¹⁾	nil	nil	nil	nil

Note

¹ Since the beginning of 2002, 306,052 Ordinary Shares have been issued to Wesley Clover Wales Limited ("Wesley Clover") in settlement of Simon Gibson's fees as non-executive director of the Company. Simon Gibson is a director of Wesley Clover.

7.1.2 None of the Directors are interested in any options over Ordinary Shares.

7.1.3 All the above interests of the Directors are or will be beneficial unless otherwise stated.

7.1.4 At the date of this document and immediately following the Placing and Open Offer, so far as the Directors are aware, the only persons who are directly or indirectly interested in 3 per cent. or more of the issued share capital of the Company are as follows:

	<i>At the date of this document</i>		<i>Immediately following the Placing and Open Offer</i>	
	<i>Number of Ordinary Shares held</i>	<i>Percentage of issued share capital</i>	<i>Number of Ordinary Shares held</i>	<i>Percentage of issued share capital</i>
Dr Andrew Nelson (shares held on trust by Bankhill Trustees Limited for the Andrew Nelson Interest in Possession Settlement)	26,057,970	13.79	26,724,637	8.51
Dr Michael Scott (shares held on trust by Bankhill Trustees Limited for the Dr Scott interest in Possession Settlement)	26,057,970	13.79	26,157,970	8.33
Mr T Hierl	16,489,230	8.73	16,489,230*	5.25*

* assuming that Mr Hierl does not take up any of his entitlement under the Open Offer

7.1.5 Save as disclosed in this paragraph 7, none of the Directors are aware of any person or persons who is, or, immediately following the Placing and Open Offer will, directly or indirectly, jointly or severally, exercise or could exercise control over the Company.

7.2 *Interests in transactions*

No Director has or has had any interest in any transaction which is of an unusual nature, contains unusual terms or is significant in relation to the business of the Group and was effected by the Group during the current or immediately preceding financial year, during any earlier financial year and remains in any respect outstanding or unperformed.

7.3 *Loans and guarantees*

No loans or guarantees have been granted or provided to or for the benefit of the Directors by any member of the Group.

8 **Directors and Service Agreements**

8.1 *Executive Directors*

Each of the executive Directors has entered into a service agreement with the Company the terms of which are set out below.

8.1.1 *Dr Andrew Nelson*

Dr Andrew Nelson entered into a service agreement with the Company on 26 May 1999. This agreement is terminable by either party on 12 months notice. The Company may, at its sole discretion, terminate Dr Nelson's employment immediately by making payment in lieu of notice.

In addition to his basic salary, Dr Nelson is provided with the benefits of a company car, pension contributions at the rate of 10 per cent. of his annual salary, private medical insurance, critical illness cover, life assurance at a rate of four times salary and permanent health insurance cover. The Company may, at its discretion, pay to Dr Nelson a bonus, the amount of which is to be determined by the Company's Remuneration Committee. The remuneration of Dr Nelson (including benefits and pension contributions) for the current financial year is estimated to be £138,000.

The agreement contains post termination restrictive covenants which place limitations on solicitation of customers and employees of the Group and on acting in competition with the business of the Group.

8.1.2 *Dr Michael Scott*

Dr Michael Scott entered into a service agreement with the Company on 26 May 1999. This agreement is terminable by either party on 12 months notice. The Company may, at its sole discretion, terminate Dr Scott's employment immediately by making payment in lieu of notice.

In addition to his basic salary, Dr Scott is provided with the benefits of a company car, pension contributions at the rate of 10 per cent. of his annual salary, private medical insurance, critical illness cover, life assurance at a rate of four times salary and permanent health insurance cover. The Company may, at its discretion, pay to Dr Scott a bonus, the amount of which is to be determined by the Company's Remuneration Committee. The remuneration of Dr Scott (including benefits and pension contributions) for the current financial year is estimated to be £96,000.

The agreement contains post termination restrictive covenants which place limitations on solicitation of customers and employees of the Group and on acting in competition with the business of the Group.

8.1.3 *Martin Lamb*

Martin Lamb entered into a service agreement with the Company on 22 November 2000. This agreement is terminable by either party on 12 months notice. The Company may, at its sole discretion, terminate Mr Lamb's employment immediately by making payment in lieu of notice.

In addition to his basic salary, Mr Lamb is provided with the benefits of a company car, pension contributions at the rate of 10 per cent. of his annual salary, private medical insurance, critical illness cover, life assurance at a rate of four times salary and permanent health insurance cover. The Company may, at its discretion, pay to Mr Lamb a bonus, the amount of which is to be determined by the Company's Remuneration Committee. The remuneration of Mr Lamb (including benefits and pension contributions) for the current financial year is estimated to be £79,000.

The agreement contains post termination restrictive covenants which place limitations on solicitation of customers and employees of the Group and on acting in competition with the business of the Group.

8.2 *Non-Executive Directors*

Each of the non-executive Directors entered into agreements for the provision of their services on the terms set out below.

8.2.1 *Dr Godfrey Ainsworth*

Dr Godfrey Ainsworth was appointed as a non-executive director of the Company with effect from 22 April 1999. Dr Ainsworth was appointed as the non-executive Chairman of the Company pursuant to a letter of appointment dated 4 February 2002.

Dr Ainsworth's appointment may be terminated upon either party giving 3 months notice. However, the Board (acting unanimously) may require Dr Ainsworth's resignation forthwith. His appointment may be terminated automatically if he is convicted of an indictable offence or on grounds relating to his mental health or financial status.

Dr Ainsworth is required to spend approximately 3 days per month performing his duties for a fee of £35,000 per annum to be paid quarterly as to 50 per cent. in cash and 50 per cent. in Ordinary Shares. A fee of £1,000 per day is payable in respect of each additional day Dr Ainsworth is engaged performing his duties, also payable as to 50 per cent. in cash and 50 per cent. in Ordinary Shares. At Dr Ainsworth's request, he may take up to 100 per cent. of any payments due to him (including out of pocket expenses) in Ordinary Shares. Dr Ainsworth is required to be a member of the Remuneration and Audit Committees of the Board.

8.2.2 *Simon Gibson*

Simon Gibson was appointed as a non-executive director of the Company with effect from 1 January 2002.

Simon Gibson's appointment may be terminated by either party giving 3 months notice. However, the Board (acting unanimously) may require his resignation forthwith. His appointment may be terminated automatically if he is convicted of an indictable offence or on grounds relating to his mental health or financial status.

Pursuant to his letter of appointment, Mr Gibson is required to spend approximately 1.5 days per month performing his duties for a fee of £16,500 per annum to be paid as to 50 per cent. in cash and 50 per cent. in Ordinary Shares. A fee of £750 per day is payable in respect of any additional day Simon Gibson is engaged performing his duties, also payable as to 50 per cent. in cash and 50 per cent. in Ordinary Shares. Mr Gibson is required to be a member of the Remuneration and Audit Committee of the Board.

8.3 *Remuneration*

The aggregate remuneration including salaries, fees, pension contributions, bonus payments and benefits in kind of the Directors during the year ended 31 December 2002 amounted to £935,000. It is estimated that the aggregate amount of the remuneration to be paid including salaries, fees, pension contributions and benefits in kind to be granted to the Directors for the current financial year under the arrangements in force at the date of this document will not exceed £414,000. During the year ended 31 December 2002, the Executive Directors volunteered to forego up to 25 per cent. of their salary entitlement for that year in order to assist the Company through the difficult period. In addition, from 1 January 2003, Dr Nelson, Dr Scott and Mr Lamb have foregone up to 25 per cent. of their salary entitlement for the current financial year to support the Group's cost cutting process.

8.4 *Other directorships*

Set out below are the details of the directorships (other than those relating to the Company and its subsidiaries) held over the previous 5 years by each of the Directors.

<i>Director</i>	<i>Current Directorships</i>	<i>Past Directorships</i>
Dr Andrew Nelson	Cardiff Partnership Fund Limited	None
Dr Michael Scott	None	None
Martin Lamb	None	None
Dr Godfrey Ainsworth	Butetown Artists Cardiff Partnership Fund Ltd Gambit Corporate Finance Ltd Gambit Venture Capital Ltd Omniport Plc Peter's Food Service Ltd Peter's Savoury Products Ltd	Archway Supplies Plc Clode Plc Go Foods Limited New College (Cardiff) Ltd Riley Leisure Limited Sandco Limited Sidney Clode Finance Limited
Simon Gibson	Artaurus Software Limited Celtic House Investment Partners Limited Cynhyrchiadau Boomerang Cyfyngedig Enfis Limited Newport Networks Limited Ubiquity Software Corporation Ubiquity Software Corporation Limited Wesley Clover Corporation Wesley Clover Wales Limited	LANergy Limited

8.5 *Convictions and insolvency*

8.5.1 Save as disclosed in this document, none of the Directors has:

8.5.1.1 any unspent convictions in relation to indictable offences;

8.5.1.2 had a bankruptcy order made against him or entered into any individual voluntary arrangements;

8.5.1.3 been a director of a company which has been placed in receivership, compulsory liquidation, creditors' voluntary liquidation, administration or been subject to a company voluntary arrangement or any composition or arrangement with its creditors generally or any class of its creditors whilst he was a director of that company or within the twelve months after he had ceased to be a director of that company;

8.5.1.4 been a partner in any partnership which has been placed in compulsory liquidation, administration or been the subject of any partnership voluntary arrangement whilst he was a partner of that partnership or within the twelve months after he ceased to be a partner in that partnership;

8.5.1.5 been the owner of, or a partner in, any partnership which is the owner of any assets which have been placed in receivership whilst he was a partner in that partnership or within the twelve months after he ceased to be a partner in that partnership; or

8.5.1.6 been publicly criticised by any statutory or regulatory authority (including recognised professional bodies);

8.5.1.7 been disqualified by a court from acting as a director of any company or from acting in the management or conduct of the affairs of any company.

8.5.2 Dr Ainsworth was appointed as a non-executive director of Sandco Limited, a company in which 3i Plc invested. Dr Ainsworth was appointed to the board by 3i Plc as part of an attempt to turn around the company's fortunes. This company went into administrative receivership in February 1997.

Dr Ainsworth was appointed as a non-executive director of Archway Supplies Plc ("Archway"), a company in which 3i Plc invested. Dr Ainsworth was appointed to the board of Archway by 3i Plc as part of an attempt to turn around Archway's fortunes. Dr Ainsworth resigned as a director of Archway on 19 May 2000. Archway went into administrative receivership on 28 June 2000. Archway is no longer in administrative receivership, the administrative receiver having ceased to act in November 2002.

8.5.3 Simon Gibson was a non-executive director of LANergy Limited. This company went into voluntary liquidation pursuant to an extraordinary resolution passed on 15 April 2003. Simon Gibson resigned as a director of LANergy Limited on 21 January 2003.

9 **Share Option Schemes**

9.1 *The IQE plc Share Option Scheme ("The Scheme")*

The Scheme was adopted on 26 May 1999. The main features of the Scheme (which is not approved by the UK Inland Revenue) are summarised below.

9.1.1 *Eligibility*

All full time employees (including executive directors) of the Company or any of its subsidiaries, required to devote substantially the whole of their working time to their duties, are eligible to be nominated for participation in the Scheme. To be eligible an executive director must work at least 25 hours per week and an employee must work at least 20 hours per week. An option may not be granted to a qualifying employee within 3 years preceding his normal retirement date. The benefits under the Scheme are not pensionable. There is a limit on the

aggregate value of options which may be granted to an individual of 200 per cent. of remuneration in each year. This limit was adopted pursuant to a special resolution of the Company dated 8 May 2001.

9.1.2 *Grant of options*

Options may be granted during the 42 day period following the day on which the Company announces its results for the immediately preceding financial year or half year. Options may be granted outside these periods in exceptional circumstances.

On the grant of an option, the Board may impose objective conditions of exercise. Such conditions may relate to the achievement of targets by the Company or any member of the Group and/or may relate to the performance of a personal task by individuals.

9.1.3 *Exercise price*

The exercise price of an option shall be not less than the greater of the nominal value of a share and the market value of an Ordinary Share. Market value will be as determined in accordance with section 272 to 274 of the Taxation of Chargeable Gains Act 1992.

9.1.4 *Exercise of options*

Subject to satisfaction of the performance conditions, options will normally be exercisable only after the third anniversary and before the tenth anniversary of their date of grant.

Options will, however, be exercisable early (without regard to performance conditions) in certain specified circumstances including (1) the option holder's death; (2) if the option holder ceases to be employed by reason of injury, disability, redundancy or retirement; (3) the sale of the business or the subsidiary company by which he is employed; (4) for any other reason at the discretion of the Board. Options will also be exercisable within limited periods on a take-over, winding-up or the sanctioning by the court of a scheme of arrangement of the Company. Alternatively, following a take-over, options may, with the agreement of the acquiring company, be rolled over to become equivalent options over the acquiring company's shares.

If an option holder ceases employment other than in the specified circumstances, his options will lapse.

9.1.5 *Variation of share capital*

On a variation of the Company's share capital, the exercise price and/or the number of Ordinary Shares the subject of an option may be adjusted.

9.1.6 *Amendments*

Certain amendments to the Scheme which are to the advantage of eligible employees or optionholders are subject to the prior approval of the Company in general meeting. The Board may amend the Scheme to take account of a change in legislation or to obtain favourable tax, exchange control or regulatory treatment or to benefit the administration of the Scheme.

No amendments can be made which would abrogate or adversely affect the subsisting rights of a participant unless it is made with the written consent of participants who have the right to acquire 75 per cent. of the shares under subsisting options granted under the Scheme or by a resolution passed by 75 per cent. of participants present at a meeting.

9.1.7 *Scheme Limits*

By a special resolution of the Company passed on 8 May 2001, a single corporate limit was introduced allowing the Company to issue 10 per cent. of its shares within a 10 year period to satisfy awards to employees under the Scheme or any other Company share arrangement under which shares may be issued. Where awards are granted to executives which will be satisfied by the issue of shares, no more than 5 per cent. of the Company's shares will be issued under the Scheme or any other Company share arrangements under which share may be issued provided

that this limit may be exceeded if the executives are required to satisfy more stretching performance requirements.

9.1.8 *Expiry of Scheme*

The Scheme will expire on the tenth anniversary of its approval by the Company or such earlier time as determined by a resolution of the board or an Ordinary Resolution of the Company in general meeting.

9.1.9 *National Insurance*

Following changes in legislation which were effective from 6 April 1999, a secondary class one national insurance charge became payable by the Company following exercise of options granted under the Scheme. On the basis of current legislation, the liability of the Company will be calculated at a rate of 12.2 per cent. of the difference between the option exercise price and the market value of the Ordinary Shares issued to the relevant option holders following exercise. The Company has decided to normally transfer the employer's national insurance contributions on the gain on the exercise of unapproved options to the option holder.

9.2 *IQE plc All Employee Share Ownership Plan ("the AESOP")*

The AESOP was adopted by special resolution passed on 8 May 2001 and was introduced following a change in legislation in the Finance Act 2000. The main features of the AESOP are summarised below:

9.2.1 *Operation*

A specially constituted committee of the Board, set up to oversee the operation and administration of the AESOP, will supervise the AESOP.

9.2.2 *Qualifying Employees*

All employees of the Group who shall be determined by the Board as being qualifying employees, including trustees acting on behalf of such employees.

9.2.3 *Type of Awards*

From time to time, the Board may invite applications from qualifying employees in accordance with the rules of the AESOP. Employees may enter into a savings contract to acquire shares in accordance with such terms as the Board may determine from time to time ("Partnership Shares"). Partnership Shares may be acquired monthly, or savings may be accumulated for a period as determined by the Board, which may be no more than one year. If savings are accumulated, the number of shares awarded to each employee may be determined as the lower of the market value of the shares at the beginning of the accumulation period and the market value of the shares on the date the shares are acquired.

Alternatively, or in addition to the above, the Board may, in its discretion, and in accordance with the rules of the AESOP, award a number of shares to each employee being:

- (a) an outright award of shares ("Free Shares"), on such basis as determined by the Board; and/or
- (b) if an employee agrees to buy a certain number of Partnership Shares, an award of shares ("Matching Shares"), on such basis as determined by the Board.

All shares acquired in accordance with the AESOP shall be held in a trust and may be subject to a retention period to be determined by the Board. Directors of the Company may be appointed as trustees of such trust.

9.2.4 *Individual Limits*

The number of Free Shares over which awards may be granted to a qualifying employee under the AESOP in any year shall be determined from time to time by the Board and may be dependent on performance. The performance may be based on either Group, subsidiary, divisional or personal targets.

The aggregate market value per employee of those Free Shares subject to such awards shall not exceed the statutory maximum for Inland Revenue approved employee share ownership plans (currently £3,000 per annum).

The number of Partnership Shares that a qualifying employee may acquire from his or her pre-tax salary under the AESOP in any year shall be determined from time to time by the Board. The aggregate market value of those Partnership Shares shall not exceed the statutory maximum for Inland Revenue approved employee share ownership plans, (currently the lesser of £1,500 per annum or 10 per cent. of salary).

The number of Matching Shares that the Board may award if a qualifying employee has acquired Partnership Shares under the AESOP in any year shall be determined from time to time by the Board but shall not exceed the statutory maximum for Inland Revenue approved employee share ownership plans (currently two Matching Shares for every one Partnership Share acquired).

9.2.5 *Corporate Limits*

The aggregate number of unissued shares in respect of which awards may be made under the AESOP and any other share scheme adopted by the Company in any rolling ten year period shall not exceed 10 per cent. of the ordinary share capital of the Company.

9.2.6 *Timing of Awards*

Except as otherwise provided, the grant of awards under the AESOP will only be made at times permitted by the Model Code which is annexed to the Listing Rules issued by the UK Listing Authority (as amended from time to time) and any code adopted by the Company or order or regulation governing dealing in shares by which the Company is bound that may be issued from time to time.

9.2.7 *Non-Transferability of Awards*

Awards are not transferable except in the case of a participant for whom a trustee is acting, in which case the trustee will be able to transfer the benefit to the participant.

9.2.8 *Restrictions on Shares and Release of Shares*

Partnership Shares may be withdrawn from the AESOP at any time.

Awards of Free Shares and Matching Shares shall be subject to a period of retention. This period shall be such period as determined by the Board from time to time, which shall not be less than three years or greater than five years. If an employee leaves the Group prior to the release of Free Shares or Matching Shares then those shares shall normally be subject to forfeiture unless the Board determines otherwise. The maximum forfeiture period is three years.

Shares held under the AESOP may be subject to other restrictions as determined by the Board. This includes the imposition of restrictions on voting rights.

Dividends received by the trust may be reinvested.

In the event of a change of control of the Company, in certain circumstances, shares must either be withdrawn from the AESOP or exchanged for shares in the new holding. These new shares will have the same rights and be subject to the same restrictions as the original shares.

9.2.9 *Allotment and Transfer of Shares*

Shares subscribed will not rank for dividends payable by reference to a record date falling before the date on which the shares are acquired but will otherwise rank *pari passu* with existing shares.

Application will be made to the relevant exchange on which the shares are listed for admission to trading on the relevant exchange for new shares that are to be issued pursuant to the AESOP.

9.2.10 *Adjustment of Awards*

On a variation of the capital of the Company, the number of shares subject to an Award may be adjusted in such manner as the Board determines and the auditors of the Company confirm to be fair and reasonable.

9.2.11 *Duration*

The Board may not grant awards under the AESOP more than ten years after its adoption.

9.2.12 *Amendments*

Amendments to the rules may be made at the discretion of the Board. However, the provisions governing eligibility requirements, equity dilution, share utilisation and individual participation limits and the adjustments that may be made following a rights issue or any other variation of capital and the limitations on the number of shares that may be issued cannot be altered to the advantage of participants without prior shareholder approval, except for minor amendments to benefit the administration of the AESOP, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants of the Group.

The Board may add to, vary or amend the rules of the unapproved part of the AESOP by way of a separate schedule in order that the AESOP may operate to take account of local legislative and regulatory treatment for participants or the relevant Group Company, provided that the parameters of these arrangements will provide no greater benefits than the rules of the AESOP as summarised above.

Any amendments to key features are subject to the approval of the UK Inland Revenue.

9.2.13 *General*

Any benefits granted or shares awarded under the AESOP will not be pensionable.

10 Taxation

The comments below are intended only as a general guide to the current tax position under United Kingdom law and Inland Revenue practice of Shareholders who are resident or ordinarily resident in the United Kingdom for tax purposes and who hold their Ordinary Shares as investments. A Shareholder who is in any doubt as to his tax position or who is subject to tax in a jurisdiction other than the United Kingdom should consult his professional adviser without delay.

10.1 *Taxation of Chargeable Gains*

(a) *Tax consequences of acquiring Ordinary Shares under the Open Offer up to entitlement*

For the purposes of United Kingdom tax on chargeable gains, the issue of Ordinary Shares to Shareholders pursuant to the Open Offer up to and including their *pro rata* entitlement should be treated as a reorganisation of the share capital of the Company.

On the above basis, to the extent that a Shareholder takes up Ordinary Shares pursuant to the Open Offer up to and including his/her entitlement, the Ordinary Shares so acquired and the existing holding in respect of which they are issued will, for the purposes of tax on chargeable gains, be treated as the same asset and as having been acquired when the existing holding was acquired (other than for computing indexation allowance where relevant). The amount paid for the Ordinary Shares will be added to allowable expenditure constituting an addition to the base cost of the enlarged holding when computing the gain on any disposal of the increased holding.

(b) *Tax consequences of acquiring Ordinary Shares under the Placing*

The issue of Ordinary Shares to Shareholders pursuant to the firm placing element of the Placing will not constitute a reorganisation of the share capital of the Company for the purposes of tax on chargeable gains, such that any Ordinary Shares so acquired by a Shareholder within the charge to capital gains tax will constitute a new holding separate from any existing holding of that Shareholder. Any Ordinary Shares so acquired by a Shareholder within the charge to corporation tax will be treated as an addition to such Shareholder's existing shareholding subject to the applicable capital gains pooling provisions.

(c) *Indexation Allowance*

Shareholders within the charge to corporation tax will, for the purposes of computing gains but not losses, be allowed to claim an indexation allowance in respect of the amounts they have paid for the Ordinary Shares.

Although Ordinary Shares acquired by such Shareholders pursuant to the Open Offer up to the Shareholder's entitlement will be treated as acquired at the same time as the Shareholder's existing holding of Ordinary Shares as described above, for the purposes of computing indexation allowance, amounts paid for all the Ordinary Shares, whether up to or in excess of the Shareholder's entitlement under the Open Offer or whether under the firm placing element of the Placing, will be regarded as incurred on the date when such amounts are paid or fall due for payment.

(d) *Taper Relief*

For Shareholders within the charge to capital gains tax, indexation allowance has been frozen as at April 1998 and so such Shareholders will not be able to claim an indexation allowance in respect of the amounts they have paid for Ordinary Shares.

Taper relief now applies to such Shareholders and reduces the percentage of any gain that is chargeable to capital gains tax, depending on how long the relevant Ordinary Shares have been held before disposal. Ordinary Shares acquired under the Open Offer up to the Shareholder's entitlement will be treated for these purposes as having been acquired at the same time as the original holding of Ordinary Shares to which they relate. However, Ordinary Shares acquired under the firm Placing will be treated as having been acquired on the date of their actual acquisition.

10.2 *Stamp Duty and Stamp Duty Reserve Tax*

Except in relation to depository receipt arrangements or clearance services, where special rules apply, under current UK legislation relating to stamp duty and stamp duty reserve tax ("SDRT"):

- (a) the subscription for the Ordinary Shares under the Open Offer or the firm placing element of the Placing will be free of stamp duty and SDRT where the Ordinary Shares are registered in the names of the Shareholders taking up their rights under the Open Offer or in the names of the Shareholders to whom the Ordinary Shares are being issued under the firm placing element of the Placing, as the case may be;
- (b) a subsequent transfer or sale of Ordinary Shares will generally be subject to stamp duty on the instrument of transfer, normally at the rate of 0.5 per cent. of the amount or value of the consideration (with duty rounded up to the nearest £5). A charge to SDRT (generally at the same rate and generally collected through CREST for shares within that system) may arise on any unconditional agreement to transfer such shares although any liability will be cancelled and any SDRT already paid will be repaid, provided that an instrument of transfer is executed and stamp duty is paid on that instrument within six years after the date on which the liability to SDRT arises. SDRT is generally payable by the purchaser except where the purchase is effected through a stockbroker or other financial intermediary, in which case such person will normally account for SDRT and should indicate that this has been done in any contract note issued to the purchaser. Stamp duty is generally payable by the purchaser or transferee; and
- (c) special rules apply to market makers, broker dealers and certain other persons.

10.3 *Taxation of dividends*

There is no United Kingdom withholding tax on dividends. An individual Shareholder resident in the UK for tax purposes will be taxable on the total of any dividend received and the related tax credit (the "gross dividend"), which will be regarded as the top slice of the individual's income. The related tax credit will be equal to one ninth of the cash dividend received (or 10 per cent. of the gross dividend) and may be set against the individual Shareholder's liability to income tax on the dividend.

An individual Shareholder who is not liable to tax at the higher rate will be subject to tax at the rate of 10 per cent. on the gross dividend. The tax credit will therefore satisfy in full such a Shareholder's liability to income tax on the dividend received.

An individual Shareholder who is liable to tax at the higher rate will be subject to tax at the rate of 32.5 per cent. on the gross dividend. The tax credit will therefore not fully satisfy such a Shareholder's liability to income tax and he will have to account for additional tax equal to 22.5 per cent. of the gross dividend (or 25 per cent. of the cash dividend received). The same procedure applies for UK resident trustees, save that the rate applicable to trusts is 25 per cent. (not 32.5 per cent.).

Generally, Shareholders will not be entitled to reclaim the tax credit attaching to any dividends paid by the Company save where their Ordinary Shares are held in a Personal Equity Plan or Individual Savings Account, when the tax credit can be reclaimed for dividends paid on or before 5 April 2004. Certain transitional relief applies to dividends received by charities. UK pension funds are not entitled to reclaim any part of the tax credit associated with dividends paid by the Company.

Subject to certain exceptions for traders in securities, a Shareholder which is a company resident for tax purposes in the United Kingdom will not be chargeable to tax on dividends received from the Company.

Generally, Shareholders not resident in the UK for tax purposes have either ceased to be able to claim repayment of any part of the tax credit or the amounts repayable under the applicable Double Tax Treaty are very limited. Such Shareholders should consult their own tax advisers concerning their tax liability on dividends received, whether they are entitled to claim repayment of any part of the tax credit and, if so, the procedure for so doing.

11 Material Contracts

There are no contracts, not being contracts entered into in the ordinary course of business, which have been entered into by members of the Group within the two years immediately preceding the date of this document and are, or may be, material or which have been entered into at any time, which contain provisions under which a member of the Group has an obligation or entitlement which is outstanding and which is or may be material to the Group as at the date of this document other than the Placing and Open Offer Agreement, the principal terms of which are summarised below.

Pursuant to the Placing and Open Offer Agreement, Evolution Beeson Gregory has agreed, as agent for the Company, to use all reasonable endeavours to procure subscribers for the New Ordinary Shares at the Issue Price or, failing which, to subscribe itself. Under the Placing and Open Offer Agreement:

- (a) the Company has agreed to pay Evolution Beeson Gregory:
 - (i) a commission of 4 per cent. of a sum equal to the Issue Price multiplied by the aggregate number of New Ordinary Shares;
 - (ii) together with value added tax on all such costs;
- (b) the Company has given certain warranties and indemnities to Evolution Beeson Gregory as to the accuracy of information in this document and other matters in relation to the Company and its business; and
- (c) Evolution Beeson Gregory may terminate the agreement before completion of the Placing and Open Offer in certain circumstances, including for material breach of the warranties referred to above.

12 Working Capital

The Directors are of the opinion, having made due and careful enquiry, that taking into account the net proceeds of the Placing and Open Offer receivable by the Company and the bank and other facilities available to it, the Group will have sufficient working capital for its present requirements, that is for at least 12 months from the date of this document.

13 Litigation

There are no legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Group is aware) being brought against or by any member of the Group which may have or have had in the 12 months preceding the date of this document a significant effect on the financial position of the Group.

14 Intellectual Property Rights

The Group's business is reliant on its collective corporate knowledge of materials processes. Patents do not provide the Group with fundamental protection of its intellectual property because of the data being process rather than product related and therefore difficult if not impossible to determine infringements. Consequently, the Group relies on its systems and procedures to protect its intellectual property.

15 Significant Change

Except as stated in this document, there has been no significant change in the financial or trading position of the Group since 30 June 2003 being the date to which the Group's last interim accounts were prepared.

16 General

- 16.1 There are no investments in progress which are significant.
- 16.2 There have been no interruptions in the business of the Group which may have or have had in the 12 months preceding publication of this document, a significant effect on the financial position of the Group.
- 16.3 The total costs and expenses of, and incidental to, the Placing and Open Offer and which are payable by the Company are estimated to be £900,000 (exclusive of VAT). These include the cost of the application for Admission in respect of the New Ordinary Shares, underwriting costs, accountancy fees, the Company's and Evolution Beeson Gregory's legal fees, the costs of printing this document and the fees and expenses of the Registrar and Receiving Agent.
- 16.4 For the purpose of paragraph 45(1)(a)(iv) of Schedule 1 to the Public Offers of Securities Regulations 1995 (as amended), Deloitte & Touche LLP consents to the inclusion in this document of the Group's annual accounts for the three financial years ended 31 December 2002 and their reports on those accounts as auditors within the meaning of section 235 of the Act and accepts responsibility for its reports. Deloitte & Touche have not become aware since the date of any such report, of any matter affecting the validity of that report at that date.
- 16.5 The Directors are responsible for the preparation of the Group's unaudited interim results for the six months ended 30 June 2003, set out in Part 3, in accordance with the Listing Rules of the Financial Services Authority. These interim results have been reviewed by Deloitte & Touche LLP in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom.
- 16.6 The statutory accounts of the Company and its group for the period ended 31 December 2002 which form part of this document have been delivered to the Registrar of Companies in accordance with section 242 of the Act. These accounts have been prepared in accordance with the law and the Directors accept responsibility for them.

16.7 Evolution Beeson Gregory of 100 Wood Street, London has given and has not withdrawn its written consent to the issue of this document with the inclusion of its name in the form and context in which it appears.

16.8 The Ordinary Shares were admitted to trading on Nasdaq Europe on 27 May 1999 and to the Official List on 19 May 2000. The Ordinary Shares ceased to be listed on Nasdaq Europe on 29 November 2002 and ceased to be listed on the Official List on 30 September 2003.

16.9 In the Directors' opinion the minimum amount to be raised pursuant to the Placing and Open Offer for the purposes set out in paragraph 21(a) of Schedule 1 to the Public Offers of Securities Regulations 1995 (as amended) is £18,750,000 which will be applied as follows:

purchase price of property	£NIL
commissions and expenses payable under the Placing and Open Offer	£0.9 million
repayment of monies borrowed in respect of the above	£NIL
working capital	£17.85 million

16.10 Save as disclosed in this document no person (other than professional advisers named in this document and trade suppliers) has received, directly or indirectly from the Group within the 12 months preceding the date of this document or entered into contractual arrangements (not otherwise disclosed in this document) to receive, directly or indirectly, from the Group on or after Admission any of the following:

16.10.1 fees totalling £10,000 or more;

16.10.2 securities of the Company where these have a value of £10,000 or more calculated by reference to the Issue Price; or

16.10.3 any other benefit with the value of £10,000 or more at the date of this document.

17 Documents available for inspection

Copies of the following documents may be inspected at the offices of Evolution Beeson Gregory at 100 Wood Street, London, EC2V 7AN during usual business hours on any weekday (Saturdays and public holidays excepted) for a period from the date of this document until the date falling 14 days from the date of this document:

17.1 the Memorandum and Articles of Association of the Company;

17.2 the Directors' service agreements and letters of appointment referred to in paragraph 8 of this Part 6;

17.3 the Placing and Open Offer Agreement referred to in paragraph 11 of this Part 6;

17.4 the rules of the IQE plc Share Option Scheme and the AESOP;

17.5 the written consents referred to in paragraph 16 above;

17.6 a copy of this document.

18 Availability of Prospectus

Copies of this document will be available free of charge to the public at the registered office of the Company and at the offices of Evolution Beeson Gregory at 100 Wood Street, London, EC2V 7AN during normal business hours on any weekday (Saturdays and public holidays excepted) from the date of this document until the date following one month after the date of Admission.

7 October 2003

APPENDIX I

IQE PLC ANNUAL REPORT AND FINANCIAL STATEMENTS 2002

Directors' report

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

Activities

The principal activity of the Group during the year was the manufacture of advanced semiconductor materials.

Review of developments and future prospects

The Group's activities and future prospects are detailed in the Chairman's & CEO's Review and the Operations Review, which should be read as part of this report.

Dividends

The Directors do not recommend the payment of a dividend (2001 – £nil).

Directors

The Directors in office at 31 December 2002 and their beneficial interests in the Company's issued ordinary share capital were as follows:

	<i>Ordinary shares of 1p each 2002 No.</i>	<i>Ordinary shares of 1p each 2001 No.</i>
Dr A W Nelson	26,057,970	26,057,970
Dr M D Scott	26,057,970	26,057,970
T L Hierl	16,489,230	16,489,230
M S M Lamb	3,675,583	3,341,250
Dr G H H Ainsworth	462,943	5,842
S Byars	5,000	5,000
S J Gibson	–	–

S J Gibson was appointed a Non-Executive Director on 1 January 2002. Dr G H H Ainsworth was appointed Non-Executive Chairman on 5 February 2002.

G Bressner resigned as Non-Executive Director on 17 May 2002.

R J G Clarke and S T Massie resigned as Directors on 31 August 2002. S Byars and T L Hierl resigned on 7 March 2003.

As at 31 December 2002, Dr G H H Ainsworth held options for nil unissued 1p ordinary shares (2001 – 75,000 options) and S Byars held options for 250,000 unissued 1p ordinary shares (2001 – 250,000 options). No other Director held share options at 31 December 2002. Further details are given in Note 5 to the accounts.

The Company is not aware of any substantial interests in the shares of the Company as defined by the Listing Rules other than those disclosed for the Directors.

Research & development

The Group incurred costs in respect of research and development during the year of £3,210,000 (2001 – £3,792,000). All research and development expenditure is charged to the profit and loss account in the period

in which it is incurred, with the exception of the carry forward of costs in respect of new products. No research and development expenditure was carried forward at 31 December 2002.

Payment terms

It was the Group's policy during the year ended 31 December 2002 to follow the "Better Payment Practice Code". The Group agrees payment terms in advance with individual suppliers and abides by the terms. The Group's average number of days purchases outstanding in respect of trade creditors at 31 December 2002 was 55 days (2001 – 41 days).

Employment policies

It is the Group's policy that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

The Group remains committed to its policy of keeping employees fully informed about all matters which concern them. Formal communications are used to achieve this objective, including notice board announcements, e-mail and intranet. Employee involvement takes different forms in each subsidiary, ranging from formal committee meetings to less formal discussion groups.

Schemes have been implemented to ensure that employees are properly rewarded for performance and loyalty.

Going concern

The Directors, after making enquiries, have deliberated on the future prospects of the Group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these accounts.

Auditors

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Statement of Directors' responsibilities

United Kingdom 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 the Group as at the end of the financial year and of the profit or loss of the Group 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.

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

Approved by the Board of Directors and signed on behalf of the Board

Leslie Coventry
Company Secretary

24 April 2003

Report of the remuneration committee

Introduction

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 which introduced new statutory requirements for the disclosure of directors' remuneration. As required by the Regulations, a resolution to approve the report will be proposed at the forthcoming Annual General Meeting of the Company.

The Regulations require the auditors to report to the Company's members on the "auditable part" of the Directors' Remuneration report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The report has therefore been divided into separate sections for audited and unaudited information.

Unaudited information

Remuneration committee

The Remuneration Committee consists of the Non-Executive Directors, namely Dr G H H Ainsworth and S J Gibson, OBE who was appointed Chairman of the Committee on 17 May 2002 following the resignation of G Bressner as Non-Executive Director and Chairman of the Remuneration Committee. The Committee complies with Schedule A of the Best Practice Provisions annexed to the Listing Rules of the London Stock Exchange, and is responsible for determining the Company's policy on compensation of Executive Directors and the basis of their service agreements with due regard to the interests of shareholders. It also approves the allocation of share options to employees. The Committee has access to and takes independent professional advice as appropriate. The Committee met four times during 2002 to review the performance of the Executive Directors and, within agreed terms of reference, set the scale and structure of their remuneration.

Remuneration policy

In establishing its remuneration policy, the Committee has given full consideration to Schedule B of the Best Practices Provisions annexed to the Listing Rules of the Financial Services Authority. The objective of the Company's remuneration policy is that Executive Directors should receive remuneration which is appropriate to their position of responsibility, and which will attract, motivate and retain Executives of the necessary calibre. The remuneration of the Executive Directors consists of annual salary, performance bonus, taxable benefits in kind and pension contributions.

There is an annual review at which the Committee approves the basic salary and profit sharing bonus scheme for each Executive Director. The Committee receives input from the Chief Executive regarding recommended packages for the Executive Directors. No changes were made in 2002 to the packages recommended to the Committee by the Chief Executive

Basic salary

Basic salaries of Executive Directors were unchanged throughout 2002. M S M Lamb, Dr A W Nelson and Dr M D Scott agreed to sacrifice a proportion of their salaries during the year as part of the Group's cost saving initiatives. As at 31 December 2002, M S M Lamb had sacrificed £15,000, Dr A W Nelson had sacrificed £16,250 and Dr M D Scott had sacrificed £11,250.

Performance bonus

Bonus payments are linked to Executive Directors achieving internal annual plan targets in respect of Group profit before tax and amortisation. No bonuses were paid in respect of 2002 as plan targets were not achieved.

Taxable benefits in kind

Taxable benefits comprise fully expensed company cars, medical health insurance and allowances for domestic and foreign business travel. Dr A W Nelson receives a car allowance of £18,375/annum in lieu of

a company car. The Company reimburses fuel and maintenance costs in respect of his private car, and these are treated as taxable benefits in kind.

Share incentive schemes

The Company operates a number of share incentive schemes. The IQE plc Share Option Scheme, as adopted on 26 May 2000 and amended by shareholders at the Company's Annual General Meeting on 17 May 2002, allows the Company to grant options over up to 10% of the issued share capital and those options are subject to performance conditions. On 20 August 2002, the Remuneration Committee approved the cancellation of 2,129,840 share options where the market price was less than the option price at the date of cancellation and the options had no performance criteria for exercise. An equal number of new share options with performance criteria were issued as replacements with a price of £0.2450/option, the number of new options being determined by the Black Scholes valuation method.

As at 31 December 2002, 9,529,831 share options have been granted under the IQE plc Share Option Scheme with exercise prices ranging from £0.0100/option to £5.8700/option.

The numbers and prices of share options at 31 December 2002 were as follows:

<i>Option price</i>	<i>Number of options</i>
Share options of £0.0100/option	2,458,761
Share options of £0.0566/option	2,194,215
Share options of £0.0812/option (\$0.1300/option)	1,290,354
Share options in excess of £0.0812/option	3,586,501
Total	<u>9,529,831</u>

The Company also operates UK and US All Employee Share Ownership Plans whereby employees agree to contribute fixed amounts per month which are used to purchase shares in the Company. The UK Plan commenced in November 2001 and the US Plan commenced in August 2002. The Company issued 250,000 shares to an Employee Trust ("the UK Trust") at the commencement of the UK Plan, and a further 750,000 shares in 2002 to the UK Trust and a General Benefit Trust ("the Offshore Trust") from which it allocated matching shares to employees equivalent in number to the shares purchased on their behalf.

The Company also awarded free shares to employees at the commencement of each Plan – 137,166 free shares were awarded to UK employees and 66,737 free shares were awarded to US employees. Ownership in the free shares passes to employees three years after date of award. Included in the awards were the following free shares to Directors – S Byars 1,610 shares, T L Hierl 1,610 shares, M S M Lamb 1,440 shares, Dr A W Nelson 1,610 shares, Dr M D Scott 1,610 shares.

As at 31 December 2002, the UK and Offshore Trusts comprised 715,864 allocated shares and 222,318 unencumbered shares. The Company has the ability to make option and share awards from the Offshore Trust.

Pension arrangements

The Executive Directors are members of the Group pension schemes and their pension contributions are based on a percentage of basic annual salary. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. Except as noted below, there have been no changes in the terms of Directors' pension entitlements during 2002, and there were no unfunded pension promises or similar arrangements for Directors at 31 December 2002.

On 16 December 2002, the Remuneration Committee approved an arrangement whereby part of the remuneration of Dr A W Nelson and Dr M D Scott, including salary of £24,921 and car allowance of £18,375 which were accrued but not paid to Dr A W Nelson in 2001, be converted into special pension contributions which were paid to the pension scheme on 20 December 2002. The special contributions in respect of Dr A W Nelson and Dr M D Scott were £116,056 and £7,871 respectively.

Executive Directors' contracts

The Executive Directors have entered into service agreements with the Company, which are terminable by either party on twelve month's notice. Each of the agreements contains post-termination restrictive covenants, which place limitations on solicitation of customers and employees of the Group and on acting in competition with the business of the Group.

During 2002, R J G Clarke resigned as Executive Director and the Remuneration Committee approved a payment to him of six month's salary in lieu of notice which has been charged to exceptional items in the accounts as part of the Group's restructuring exercise. S T Massie also resigned as Executive Director during 2002 after giving the Group twelve month's notice. The Remuneration Committee permitted him to take an executive appointment with a partial competitor and approved a variation to his share options whereby these became exercisable in full between 31 December 2002 and 31 December 2003, after which date all unexercised options would be cancelled. As at 31 December 2002, S T Massie held 1,258,300 options at prices ranging from to \$0.1300/option to \$1.4100/option.

S Byars and T L Hierl both resigned as Executive Directors on 7 March 2003 and the Remuneration Committee approved a contractual arrangement whereby each will work as a consultant to the Group for a period of up to twelve months. No compensation was payable to either Director for termination of their contracts of employment. The Remuneration Committee approved a variation to the share options granted to S Byars whereby these became exercisable in full between 7 March 2003 and 7 March 2004, after which date all unexercised options would be cancelled. As at 7 March 2003, S Byars held 250,000 options at a price of £2.1500/option.

Non-Executive Directors' contracts

The Non-Executive Directors have entered into service agreements with the Company, and these are terminable by either party on three month's notice.

Non-Executive Directors have specific terms of engagement, and their fees are determined by the Board within the limits set by the Company's Articles of Association. Dr G H H Ainsworth, a Non-Executive Director since 22 April 1999, was appointed Non-Executive Chairman on 5 February 2002 and was paid £42,437 plus out of pocket expenses of £3,275 for his services in 2002. S J Gibson was paid £17,500. Each was paid in the form of shares in the Company based on the weighted average share price throughout the year. Dr G H H Ainsworth and S J Gibson were awarded 300,131 shares and 88,566 shares respectively, of which 197,945 shares and 88,566 shares respectively were awarded on 14 January 2003. The shares paid for the services of S J Gibson are held in the name of Wesley Clover Wales Limited, a company of which S J Gibson is a director. Included in the payment in shares to Dr Ainsworth was VAT on the invoices for his fees and expenses totalling £8,000. This VAT was recovered by the Company. No fees were paid in 2002 to G Bressner, who resigned on 17 May 2002.

Under the terms of their engagement, the Non-Executive Directors were entitled to receive share options in addition to their fees. In accordance with Best Practice Guidelines included in the Higgs Report, Dr G H H Ainsworth and S J Gibson both agreed to forego that entitlement, and Dr G H H Ainsworth agreed to the cancellation of 75,000 share options which had previously been granted to him. Therefore, as at 31 December 2002, neither of the Non-Executive Directors had any share options in the Company and it is not intended that share options will be issued to the Non-Executive Directors in the future under the terms of their appointment, which have been changed accordingly.

Audited information

Aggregate Directors' remuneration

The total amounts for Directors' remuneration were as follows:

	2002 £'000	2001 £'000
Basic salaries	608	685
Bonuses	–	–
Compensation for loss of office	60	–
Non-executives fees and reimbursed expenses	63	9
Sub total salaries and fees	<u>731</u>	<u>694</u>
Car allowance	5	18
Benefits in kind	69	53
Money purchase pension contributions	130	46
Total	<u>935</u>	<u>811</u>

Directors' emoluments

The aggregate emoluments paid to each Director during 2002 were as follows:

	<i>Basic salary</i>	<i>Fees</i>	<i>Bonus</i>	<i>Car allowance</i>	<i>Benefits</i>	<i>Total remuneration</i>		<i>Pension contributions</i>	
	2002 £'000			2002 £'000		2002 £'000	2002 £'000	2002 £'000	2003 est. £'000
Executive Directors									
Dr A W Nelson	76	–	–	5	10	91	125	82	13
Dr M D Scott	72	–	–	–	20	92	87	15	9
T L Hierl	116	–	–	–	5	121	20	2	–
S T Massie	61	–	–	–	3	64	–	1	–
M S M Lamb	60	–	–	–	9	69	71	6	8
S Byars	141	–	–	–	15	156	25	10	3
R J G Clarke	142	–	–	–	7	149	–	14	–
Non-Executive Directors									
Dr G H H Ainsworth	–	46	–	–	–	46	35	–	–
G Bressner	–	–	–	–	–	–	–	–	–
S J Gibson	–	17	–	–	–	17	18	–	–
	<u>668</u>	<u>63</u>	<u>–</u>	<u>5</u>	<u>69</u>	<u>805</u>	<u>381</u>	<u>130</u>	<u>33</u>

Dr A W Nelson, Dr M D Scott and M S M Lamb decided to forego salary payments of £16,250, £11,250 and £15,000 respectively during 2002. Dr A W Nelson and Dr M D Scott have agreed to forego 25% of their salary and M S M Lamb has agreed to forego 20% of his salary from 1 January 2003 in support of the Group's cost cutting.

S T Massie and R J G Clarke resigned on 31 August 2002. Their emoluments are from 1 January 2002 to date of resignation.

Dr G H H Ainsworth and S J Gibson took all their remuneration during 2002 in the form of Company shares calculated on a weighted average share price basis.

S J Gibson was appointed on 1 January 2002. His emoluments are from date of appointment to 31 December 2002.

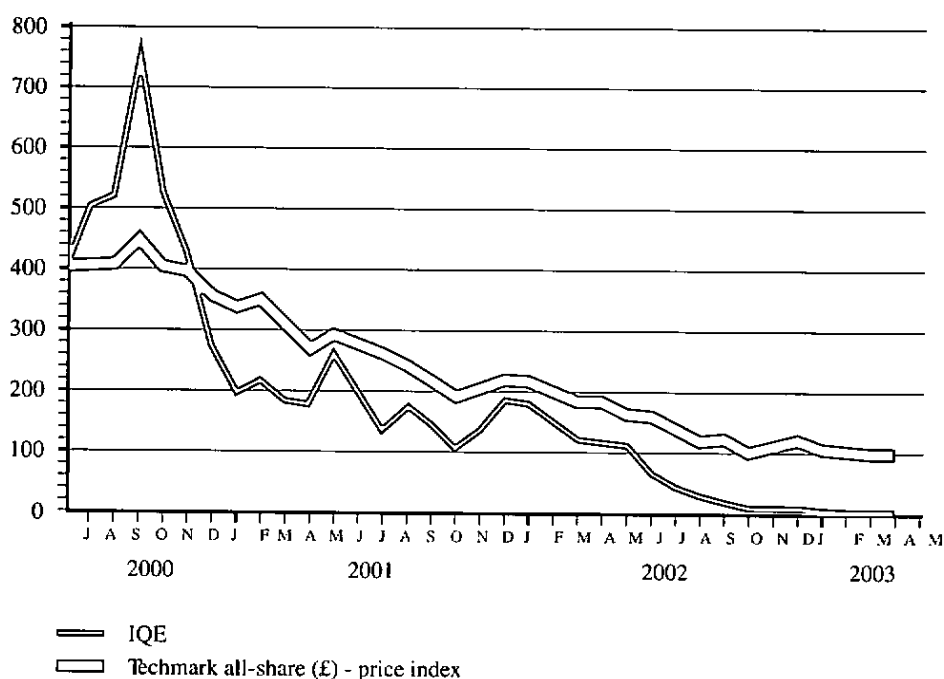
The estimated remuneration and pensions for 2003 are unaudited.

The aggregate emoluments paid to each Director during 2001 were as follows:

	<i>Basic</i>	<i>Fees</i>	<i>Bonus</i>	<i>Car</i>	<i>Benefits</i>	<i>Total</i>		<i>Pension</i>	
	<i>salary</i>			<i>allowance</i>		<i>remuneration</i>	<i>contributions</i>		
	<i>2001</i>	<i>2001</i>	<i>2001</i>	<i>2001</i>	<i>2001</i>	<i>2001</i>	<i>2000</i>	<i>2001</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Executive Directors									
Dr A W Nelson	104	-	-	18	7	129	170	7	7
Dr M D Scott	73	-	-	-	12	85	113	7	7
T L Hierl	122	-	-	-	6	128	117	1	-
S T Massie	87	-	-	-	5	92	102	1	-
M S M Lamb	60	-	-	-	6	66	5	9	1
S Byars	141	-	-	-	10	151	-	12	-
R J G Clarke	98	-	-	-	7	105	-	9	-
Non-Executive Directors									
Dr G H H Ainsworth	-	9	-	-	-	9	10	-	-
G Bressner	-	-	-	-	-	-	-	-	-
S J Gibson	-	-	-	-	-	-	-	-	-
	<u>685</u>	<u>9</u>	<u>-</u>	<u>18</u>	<u>53</u>	<u>765</u>	<u>517</u>	<u>46</u>	<u>15</u>

R J G Clarke was appointed on 8 March 2001. His emoluments are from date of appointment to 31 December 2001.

IQE plc share prices 2002 (UK pence)



The IQE share price has been compared with the Techmark all-share index as this was considered to be the most representative market group.

Directors' interests in ordinary shares of IQE plc

The Directors' interests in ordinary shares of IQE plc at 31 December 2002 were as follows:

<i>Name of Director</i>	<i>As at 1 January 2002</i>	<i>As at 31 December 2002</i>
Executive		
Dr A W Nelson	26,057,970	26,057,970
Dr M D Scott	26,057,970	26,057,970
T L Hierl	16,489,230	16,489,230
M S M Lamb	3,341,250	3,675,583
S Byars	5,000	5,000
Non-Executive		
Dr G H H Ainsworth	5,842	462,943
S J Gibson	—	—
Total	<u>71,957,262</u>	<u>72,748,696</u>

The Directors' interests in share options at 31 December 2002 were as follows:

<i>Name of Director</i>	<i>Date of grant</i>	<i>Exercise price</i>	<i>Term of option</i>	<i>No. of options</i>
Executive				
S Byars	2 Jan 2001	£2.15	(a)	250,000

(a) Options exercisable one third after one year, one third after two years and one third after three years with expiry dates of 2 January 2009, 2 January 2010 and 2 January 2011 respectively. Following S Byars' resignation on 7 March 2003, the Remuneration Committee approved a variation to the terms of these options whereby they became exercisable in full between 7 March 2003 and 7 March 2004.

The highest and lowest mid-market share prices in respect of the shares of IQE plc during 2002 were £1.9500/share and £0.0475/share respectively.

As at 31 December 2002, the mid-market price closed at £0.06250/share.

Approval

This report was approved by the Board of Directors on 24 April 2003 and signed on its behalf by:

S J Gibson, OBE
Remuneration Committee Chairman

Corporate governance

IQE plc is committed to ensuring high standards of corporate governance. This statement describes how the principles of corporate governance are applied to the Group and the Group's compliance with the provisions set out in Section 1 of the Combined Code.

The Group complied with the provisions of this Code during the year ended 31 December 2002 with the following exceptions:

Provision A.1.6, Training: The Company does not have a formal training programme for Directors either on appointment or subsequently, although all Directors are encouraged to obtain such training as they consider necessary at the expense of the Company. This is considered to be appropriate given the size of the organisation.

Provision A.2.1, Chairman and CEO: The positions of Chairman and CEO were combined until 5 February 2002 as the Board considered this to be appropriate at that stage of its development. However on 5 February 2002, the roles were split, with Dr G H H Ainsworth being appointed to the position of Non-Executive Chairman and Dr A W Nelson becoming President and CEO. Dr G H H Ainsworth is recognised as the senior Non-Executive Director. The Board considers this to be appropriate in view of his length of service with the Company.

Provision A.3.1, Board composition: The Non-Executive Directors consisted of less than one third of the Board following the resignation of G Bressner on 17 May 2002. The Board has been looking to appoint a third Non-Executive Director.

Provision D.3.1, Audit Committee composition. The Audit Committee consisted of less than three Non-Executive Directors following the resignation of G Bressner on 17 May 2002. The Board has been looking to appoint a third Non-Executive Director.

The Board of Directors

The management of IQE plc is directed by the Board which is responsible for ensuring the development and implementation of the Group's overall strategy.

Following the resignations of S Byars, R J G Clarke, T L Hierl and S T Massie, the Board now comprises the Non-Executive Chairman, the President and CEO, two Executive Directors and one Non-Executive Director. In the opinion of the Board, the two Non-Executive Directors, Dr G H H Ainsworth and S J Gibson, are independent of management and, notwithstanding Note 5 to the accounts, free from any business or other relationship which could materially interfere with the exercise of their independent judgement. The Non-Executive Chairman, Dr G H H Ainsworth, is recognised as the senior independent Non-Executive Director to whom concerns can be conveyed as required by the Code of Best Practice. Under the Company's Articles of Association each of the Directors is required ordinarily to retire by rotation once every three years.

The Board held five regular meetings and several special meetings during the year. The Board has a formal schedule of matters referred to it for decision; these include the approval of annual, interim and quarterly results, the annual budget, acquisitions and disposals, major items of capital expenditure, share capital issues, governance issues and executive appointments. The Board is provided with appropriate strategic and financial information prior to each meeting together with monthly reports to enable it to monitor the performance of the Group.

All the Directors have direct access to the advice and the services of the Group Company Secretary who is responsible for ensuring that Board procedures are followed.

Board committees

The Board has delegated specific responsibilities to the following committees:

Group Executive Committee

The Group Executive Committee consists of the Executive Directors under the chairmanship of Dr A W Nelson and is responsible for the development of strategy, annual budgets and operating plans linked to the management and control of the day-to-day operations of the Group. The Executive Committee is also responsible for monitoring key research and development programmes and for ensuring that Board policies are carried out on a Group-wide basis.

Audit Committee

The Audit Committee consists of the Non-Executive Directors under the chairmanship of Dr G H H Ainsworth and meets at least three times a year, and more frequently if required. The Audit Committee has specific written terms of reference which deal with its authority and duties. The Committee receives and considers reports relating to the monitoring of the adequacy of the Group's internal controls, the suitability of its accounting policies and financial reporting systems and the nature and scope of the audit. Although there is currently no internal audit function, the Audit Committee regularly reviews the need to implement one. The Acting CFO and the external auditors attend, as necessary. The Audit Committee also holds separate meetings with the external auditors, as appropriate.

Remuneration Committee

The Remuneration Committee consists of the Non-Executive Directors under the chairmanship of S J Gibson and meets periodically as required. The Remuneration Committee has specific terms of reference which deal with its authority and duties. It is responsible for providing advice and recommendations to the Board on the remuneration and terms and conditions of service of the Executive Directors, including annual bonus entitlements.

The Group's policy on Directors' remuneration has been in line with the Code provisions throughout the year. Full details are given in the Report of the Remuneration Committee and in Note 5 to the accounts.

The Board has not established a separate Nomination Committee as the Board considers itself to be small. The responsibility for nominations rests with the Remuneration Committee.

Internal control

The Board has overall responsibility for the Group's system of internal control, the effectiveness of which has been reviewed during the year and reported on to the Board. The review has taken account of any material developments up to the date of signing of the Financial Statements.

The processes to identify and manage the key risks to the success of the Group are an integral part of the internal control environment. Such processes, which are ongoing and regularly reviewed and improved as necessary, include strategic planning, the appointment of senior managers, the regular monitoring of performance, control of capital expenditure and significant revenue investment and the setting of high standards for health, safety and environmental performance. These processes have been in place for the full financial year and up to the date of approval of the financial statements and are in accordance with Internal Control: Guidance for Directors on the Combined Code Published in September 1999.

The effectiveness of the control systems and procedures is monitored regularly through a combination of management self-assessment and external audit. The results are reported to, and considered by, the Audit Committee.

The system of internal control comprises those controls established in order to provide assurance that the assets of the Group are safeguarded against unauthorised use or disposal and to ensure the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. Any system of internal control can only provide reasonable, but not absolute assurance against material misstatement or loss, as it is designed to manage rather than to eliminate the risk of failing to achieve the business objectives of the Group.

The key procedures that the Directors have established with a view to providing effective internal control are as follows:

- (a) a clearly defined organisational structure and limits of authority
- (b) corporate policies and procedures for financial reporting and control, project appraisal, human resources, quality control, health and safety, information security and corporate governance
- (c) the preparation of annual budgets and regular re-forecasts which require approval from both the Group Executive Committee and the Board
- (d) the monitoring of performance against budget and forecasts and the reporting of any variances in a timely manner to the Board
- (e) regular review and self-assessment of the risks to which the Group is exposed, taking steps to monitor and mitigate these wherever possible including, where appropriate, taking out insurance cover
- (f) the Audit Committee approves audit plans and, on behalf of the Board, receives reports on the Group's accounting and financial reporting practices and its internal controls. It also receives reports from the external auditors as part of their normal audit work.

Going concern basis

After making enquiries, the Directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements.

Shareholder relations

The President and CEO and the Acting CFO regularly meet with representatives of institutional shareholders to discuss their views and to ensure that the strategies and objectives of the Group are well understood. Issues discussed with institutional shareholders include the Group's performance and the impact of any major transactions. The Chairman has also met with shareholders during the year.

The Annual General Meeting allows individual shareholders to raise questions with the Board, although shareholder enquiries and questions are also addressed throughout the year. In accordance with the recommendation of the Combined Code, the Company will advise shareholders attending the Annual General Meeting of the number of proxy votes lodged for each resolution, in the categories 'For' and 'Against', together with the numbers 'at the Chairman's discretion' and abstentions. These will be advised after each resolution has been dealt with on a show of hands.

All shareholders receive a copy of the annual report and financial statements and an interim report is issued at the half year. The Company has a web site, which provides details of the Group's facilities and products. The site includes a separate investor relations section on which quarterly financial data and other significant announcements are published. The web site address is shown on the back cover of the annual report.

Audit and other professional fees

The Group has employed the services of a number of professional advisers during the year. The nature of the services provided by those advisers and the amounts paid to them are as detailed below :

	<i>SGA costs</i>	<i>Exceptional costs</i>	<i>Share premium</i>	<i>Total 2002</i>	<i>Total 2001</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Audit and related services					
Deloitte & Touche UK	194	–	–	194	241
Deloitte & Touche USA	47	–	–	47	–
Arthur Andersen USA	–	–	–	–	47
Total	<u>241</u>	<u>–</u>	<u>–</u>	<u>241</u>	<u>288</u>

	<i>SGA costs £'000</i>	<i>Exceptional costs £'000</i>	<i>Share premium £'000</i>	<i>Total 2002 £'000</i>	<i>Total 2001 £'000</i>
Analysed as follows:					
Payable to Deloitte & Touche UK					
Group audit services	110	–	–	110	75
Group audit services prior year	30	–	–	30	–
Company audit services	4	–	–	4	3
Reporting accountants and other regulatory services	–	–	–	–	4
Tax services	40	–	–	40	88
Other services	10	–	–	10	71
Payable to overseas auditors	47	–	–	47	47
Total	241	–	–	241	288

Deloitte & Touche UK were appointed as the Group's auditors and tax advisers in 1999. They provided UK and US audit and taxation services to the Group in 2002 of £170,000 (2001: £170,000). The Board is aware of the importance of maintaining the independence of its auditors and will not contract for additional services from them which would compromise their audit independence. Where additional services may be required, they will be subject to appropriate market testing. During 2001, Deloitte & Touche UK also charged fees of £71,000 in respect of services provided in relation to a placing and open offer as referred to below.

Deloitte & Touche USA were appointed as the Group's US auditors and tax advisers in 2002 following the resignation of Arthur Andersen USA. They provided US audit and taxation services to the Group in 2002 of £47,000 (2001: £nil).

Arthur Andersen USA served as auditors and tax advisers to IQE Inc from the incorporation of that company in 1989 until 2001, when they were replaced by Deloitte & Touche. They provided audit and tax services to IQE Inc in 2001 of £47,000.

	<i>SGA costs £'000</i>	<i>Exceptional costs £'000</i>	<i>Share premium £'000</i>	<i>Total 2002 £'000</i>	<i>Total 2001 £'000</i>
Other professional services					
Buchanan Ingersoll USA	–	1,024	–	1,024	–
Capita IRG plc UK	34	–	–	34	64
Evolution Beeson Gregory Limited UK	–	–	122	122	841
Gambit Corporate Finance UK	–	–	–	–	17
Inbucon MEIS UK	105	–	–	105	131
M and A Solicitors UK	43	–	–	43	791
Pepper Hamilton USA	86	58	–	144	908
Price Waterhouse Coopers UK	–	–	–	–	50
Price Waterhouse Coopers USA	–	74	–	74	17
Total	268	1,156	122	1,546	2,819

Buchanan Ingersoll USA provided legal services to the Group in 2002 of £1,024,000 (2001: £nil) in respect of the legal dispute between IQE (Europe) Limited and Rockwell.

Capita IRG plc UK were appointed in 1999 to act as the Group's registrars. They provided services to the Group in 2002 of £34,000 (2001: £40,000) in respect of the management of the shareholder register of IQE plc. During 2001, they also charged fees of £24,000 in respect of a placing and open offer of shares on behalf of IQE plc.

Evolution Beeson Gregory Limited UK were appointed in 1999 to act as the Group's sponsors, financial advisers and brokers. They provided sponsor services, financial advice and broking services to the Group in 2002 of £122,000 (2001: £841,000) in respect of a placing and open offer of shares on behalf of IQE plc.

The fees and expenses of the Chairman, Dr G H H Ainsworth are paid to Gambit Corporate Finance of which Dr G H H Ainsworth is the Managing Partner. These fees and expenses are dealt with in the Directors' Remuneration report. Gambit Corporate Finance provided no other services to the Group in 2002 (2001: £17,000).

Inbucon MEIS UK were appointed in 2001 to set up and administer the Group's UK and US employee share schemes. They provided share scheme management services to the Group in 2002 of £105,000 (2001: £131,000).

M and A Solicitors were appointed in 2001 to act as the Group's solicitors on matters relating to English law. They provided legal services to the Group in 2002 of £43,000 (2001: £250,000) in respect of acquisitions, contract advice and joint ventures. During 2001, they also charged fees of £541,000 in respect of a placing and open offer of shares on behalf of IQE plc. A Whiteley, who is a partner in M and A Solicitors, is also a partner in Gambit Corporate Finance. Dr Ainsworth takes no part in instructing the services of M and A Solicitors or negotiation of their fees. Gambit Corporate Finance and M and A Solicitors are not related parties for the purposes of FRS 8.

Pepper Hamilton USA have served as legal advisers to IQE Inc since the incorporation of that company in 1989 and were appointed in 1999 to act as the Group's counsel on matters relating to US law. They provided legal services to the Group in 2002 of £86,000 (2001: £95,000) in respect of acquisitions, contract advice and joint ventures. They also provided legal services to the Group in 2002 of £58,000 (2001: £759,000) in respect of the legal dispute between IQE (Europe) Limited and Rockwell. During 2001, they charged fees of £54,000 in respect of a placing and open offer of shares on behalf of IQE plc.

Price Waterhouse Coopers UK provided financial services to the Group in 2001 of £50,000 in respect of a successful application to the Welsh Assembly for grant assistance towards the cost of setting up IQE Silicon Compounds Limited.

Price Waterhouse Coopers USA provided financial services to the Group in 2002 of £74,000 (2001: £17,000) in respect of the legal dispute between IQE (Europe) Limited and Rockwell.

Independent auditors' report to the members of IQE

We have audited the financial statements of IQE plc for the year ended 31 December 2002 which comprised the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses, the combined statement of movements in shareholders' funds and statement of movements on reserves and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration report that is described as having been audited.

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

Respective responsibilities of Directors and auditors

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the Directors' Remuneration report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration report described as having been audited have been 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 or the Listing Rules regarding Directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' report and other information contained in the Annual Report for the above year as described in the contents section, including the unaudited part of the Directors' Remuneration report, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration report described as having been audited. 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 circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit of the Company and the Group 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 and the part of the Directors' Remuneration report described as having been audited are free from material misstatement, whether caused by fraud or other

irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration report described as having been audited.

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;

The financial statements and the part of the Directors' Remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Chartered Accountants and Registered Auditors

Cardiff

24 April 2003

Consolidated profit and loss account

Year ended 31 December 2002

	Note	2002 £'000	2001 £'000
Turnover: continuing operations	3	22,960	42,047
Cost of sales	3	(90,579)	(32,381)
Gross (loss)/profit	3	<u>(67,619)</u>	<u>9,666</u>
Operating expenses			
Distribution expenses	3	(1,591)	(2,708)
Administrative expenses:			
Research and development	3	(3,210)	(3,792)
Other administrative expenses (including goodwill and exceptional items)	3	<u>(45,798)</u>	<u>(9,227)</u>
		<u>(50,599)</u>	<u>(15,727)</u>
Operating loss before goodwill and exceptional administrative expenses		(81,230)	(3,467)
Other operating expenses			
Goodwill amortisation	3	(34,302)	(1,835)
Exceptional items	3, 11	(2,686)	(759)
Operating loss	4	(118,218)	(6,061)
Other interest receivable and similar income		869	1,009
Interest payable and similar charges	6	(885)	(798)
Loss on ordinary activities before taxation		(118,234)	(5,850)
Tax on loss on ordinary activities	7	<u>1,217</u>	<u>270</u>
Loss for the financial year		<u>(117,017)</u>	<u>(5,580)</u>
Dividends	8	—	—
Retained loss for the financial year		<u>(117,017)</u>	<u>(5,580)</u>
Earnings per ordinary share	10	<u>(63.08p)</u>	<u>(3.38p)</u>
Diluted earnings per ordinary share	10	<u>(63.08p)</u>	<u>(3.38p)</u>

Consolidated statement of total recognised gains and losses

Year ended 31 December 2002

	2002 £'000	2001 £'000
Loss for the financial year	(117,017)	(5,580)
Currency translation differences on foreign currency net investments	<u>(1,567)</u>	<u>595</u>
Total recognised gains and losses relating to the year	<u>(118,584)</u>	<u>(4,985)</u>

Combined statement of movements in shareholders' funds and statement of movements on reserves

Year ended 31 December 2002

	<i>Issued share capital</i>	<i>Share premium</i>	<i>Shares to be issued</i>	<i>Merger reserve</i>	<i>Profit and loss account</i>	<i>Exchange rate reserve</i>	<i>Total 2002</i>	<i>Total 2001</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
The Group								
Balance at 1 January 2002	1,824	136,662	938	(605)	(2,490)	1,283	137,612	117,597
Shares issued	47	3,666	(582)	-	-	-	3,131	27,374
Cost of shares issued	-	-	133	-	-	-	133	(2,324)
Deferred consideration on acquisition of subsidiary	-	-	(356)	-	-	-	(356)	(50)
Foreign exchange translation differences	-	-	-	-	-	(1,567)	(1,567)	595
Loss attributable to members of the Group	-	-	-	-	(117,017)	-	(117,017)	(5,580)
Balance at 31 December 2002	<u>1,871</u>	<u>140,328</u>	<u>133</u>	<u>(605)</u>	<u>(119,507)</u>	<u>(284)</u>	<u>21,936</u>	<u>137,612</u>
The Company								
Balance at 1 January 2002	1,824	136,662	938	-	5,139	-	144,563	118,624
Shares issued	47	3,666	(582)	-	-	-	3,131	27,374
Cost of shares issued	-	-	133	-	-	-	133	(2,324)
Deferred consideration on acquisition of subsidiary	-	-	(356)	-	-	-	(356)	(50)
(Loss)/profit attributable to members of the Company	-	-	-	-	(120,328)	-	(120,328)	939
Balance at 31 December 2002	<u>1,871</u>	<u>140,328</u>	<u>133</u>	<u>-</u>	<u>(115,189)</u>	<u>-</u>	<u>27,143</u>	<u>144,563</u>

Consolidated balance sheet

31 December 2002

	Note	2002 £'000	2001 £'000
Fixed assets			
Intangible assets	12	–	34,658
Tangible assets	13	13,862	74,193
Investment in own shares	14	9	2
		<u>13,871</u>	<u>108,853</u>
Current assets			
Stocks	15	4,988	12,277
Debtors	16	3,721	7,495
Cash at bank and in hand	24	17,715	30,533
		<u>26,424</u>	<u>50,305</u>
Creditors: amounts falling due within one year	17	<u>(11,907)</u>	<u>(11,944)</u>
Net current assets		<u>14,517</u>	<u>38,361</u>
Total assets less current liabilities		<u>28,388</u>	<u>147,214</u>
Creditors: amounts falling due after more than one year	18	<u>(6,452)</u>	<u>(8,385)</u>
Provision for liabilities and charges	20	<u>–</u>	<u>(1,217)</u>
		<u>21,936</u>	<u>137,612</u>
Capital and reserves			
Called-up share capital	21	1,871	1,824
Merger reserve		(605)	(605)
Share premium		140,328	136,662
Shares to be issued		133	938
Profit and loss account		(119,507)	(2,490)
Exchange rate reserve		(284)	1,283
Total equity shareholders' funds		<u>21,936</u>	<u>137,612</u>

These financial statements were approved by the Board of Directors on 24 April 2003

Signed on behalf of the Board of Directors

Dr G H H Ainsworth**Dr A W Nelson**

Parent company balance sheet

31 December 2002

	<i>Note</i>	<i>2002</i> <i>£'000</i>	<i>2001</i> <i>£'000</i>
Fixed assets			
Tangible fixed assets		–	124
Investments	14	<u>7,560</u>	<u>75,112</u>
		<u>7,560</u>	<u>75,236</u>
Current assets			
Debtors	16	4,325	42,049
Cash at bank and in hand		<u>15,614</u>	<u>27,841</u>
		<u>19,939</u>	<u>69,890</u>
Creditors: amounts falling due within one year	17	<u>(356)</u>	<u>(563)</u>
Net current assets		<u>19,583</u>	<u>69,327</u>
Total assets less current liabilities		<u>27,143</u>	<u>144,563</u>
Capital and reserves			
Called-up share capital	21	1,871	1,824
Share premium account		140,328	136,662
Shares to be issued		133	938
Profit and loss account		<u>(115,189)</u>	<u>5,139</u>
Total equity shareholders' funds		<u>27,143</u>	<u>144,563</u>

These financial statements were approved by the Board of Directors on 24 April 2003

Signed on behalf of the Board of Directors

Dr G H H Ainsworth

Dr A W Nelson

Consolidated cash flow statement

Year ended 31 December 2002

	Note	2002 £'000	2001 £'000
Net cash outflow from operating activities	22	(8,995)	(7,066)
Returns on investments and servicing of finance			
Interest received		869	1,009
Interest paid		(885)	(798)
Net cash (outflow)/inflow from returns on investments and servicing of finance		<u>(16)</u>	<u>211</u>
Taxation			
UK and US corporation taxes		<u>(67)</u>	<u>322</u>
Capital expenditure			
Payments to acquire tangible fixed assets		<u>(3,765)</u>	<u>(25,169)</u>
Net cash outflow from capital expenditure		<u>(3,765)</u>	<u>(25,169)</u>
Net cash outflow before use of liquid resources and financing		<u>(12,843)</u>	<u>(31,702)</u>
Management of liquid resources		<u>12,250</u>	<u>6,000</u>
		593	(25,702)
Financing			
Issue of ordinary share capital		3,265	25,049
Repayment of loans		(662)	(463)
Repayment of finance leases		<u>(2,578)</u>	<u>(1,863)</u>
Net cash inflow from financing		<u>25</u>	<u>22,723</u>
Decrease in cash	23	<u>(568)</u>	<u>(2,979)</u>

NOTES TO THE ACCOUNTS

1. Accounting policies

The financial statements are prepared in accordance with applicable accounting standards under UK GAAP. The particular accounting policies adopted are described below.

Accounting convention

The financial information is prepared under the historical cost convention and in accordance with applicable accounting standards, which have been applied on a consistent basis during the year under review.

Basis of consolidation

The financial information consolidates the financial statements of the Company and all of its subsidiaries.

The acquisition of EPI Holdings Limited and IQE Inc (formerly Quantum Epitaxial Designs Inc.) by IQE plc, a new holding Company established for that purpose, on 16 May 1999 has been accounted for under merger accounting, whereby the financial information is disclosed as if the companies had always been part of the Group.

The acquisition of IQE (Europe) Limited (formerly Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc by EPI Holdings Limited, a new company established for that purpose, on 27 March 1996 and the acquisition of Wafer Technology International and its subsidiary Wafer Technology Limited on 22 November 2000 have been accounted for under acquisition accounting, whereby these companies became part of the Group on the date of acquisition.

Turnover

Turnover represents amounts invoiced, exclusive of value added taxation.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use, as defined by Financial Reporting Standard Number 15.

Depreciation has been calculated so as to write down the cost of assets to their residual values over the following estimated useful economic lives:

Freehold buildings	25 years
Short leasehold improvements	5 – 27 years
Plant and machinery	5 – 10 years
Fixtures and fittings	4 – 5 years

No depreciation is provided on land or assets in the course of construction. Depreciation is also not provided on assets in periods of non-use where no physical or technological deterioration occurs and the remaining useful economic life of the asset is extended by the period of non-use.

Goodwill

On the acquisition of a business, fair values are attributed to the Group's share of the net tangible assets acquired. Where the cost of acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill. The goodwill arising on the acquisition of Epitaxial Products International Limited and its subsidiary Epitaxial Products Inc, by EPI Holdings Limited was written off directly to reserves in the year of acquisition. Goodwill of £284,000 remains eliminated in the profit and loss reserve and will be charged to the profit and loss account on the subsequent disposal of IQE (Europe) Limited (formerly Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc. Following the issue of Financial Reporting Standard 10, goodwill arising in accounting periods ending on or after 23 December 1998 must be classified as an asset on the balance sheet and amortised over its useful life. The

goodwill arising on the acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited has been capitalised and is being amortised over its useful life of 20 years subject to impairment reviews.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Research and development

Research and development expenditure is fully written off when incurred except where contracts of sufficient value exist or are likely to exist in the foreseeable future in which case it is written off over a two year period commencing with the start of the contracts to which the costs relate. During 2002, all research and development expenditure was fully written off.

Foreign currencies

Transactions in foreign currencies during the year are recorded in sterling at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. All exchange differences are taken to the profit and loss account.

The balance sheets of IQE Inc (formerly Quantum Epitaxial Design Inc) are translated into sterling at the closing rates of exchange for each year whilst the profit and loss accounts are translated into sterling at the average rates of exchange for the year. The resulting translation differences are taken direct to reserves.

Pension costs

The Group operates defined contribution pension schemes. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the schemes.

Deferred taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements.

Deferred tax is not provided on timing differences arising from the revaluation of fixed assets where there is no binding contract to dispose of those assets. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Government grants

Government grants receivable in connection with expenditure on tangible fixed assets are accounted for as deferred income, which is credited to the profit and loss account by instalments over the expected useful economic life of the related assets on a basis consistent with the depreciation policy.

Revenue grants for the reimbursement of costs charged to the profit and loss account are credited to the profit and loss account in the year in which the costs are incurred.

Leases

Assets held under finance leases and hire purchase contracts are capitalised at their fair value on the inception of the leases and depreciated over the shorter of the period of the lease and the estimated useful economic lives of the assets. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding and are charged to the profit and loss account. Operating lease rentals are charged to profit and loss in equal annual amounts over the lease term.

Financial instruments

The only derivative instruments utilised by the Group are forward exchange contracts. The Group does not enter into speculative derivative contracts. Forward exchange contracts are used for hedging purposes to alter the risk profile of an existing underlying exposure of the Group in line with the Group's risk management policies.

2. Segmental analysis

Turnover and operating loss are analysed by activity and geographical location as follows:

	<i>Turnover</i>	<i>Turnover</i>	<i>Operating</i>	<i>Operating</i>	<i>Net assets</i>	<i>Net assets</i>
	<i>2002</i>	<i>2001</i>	<i>loss</i>	<i>loss</i>	<i>2002</i>	<i>2001</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
III-V epitaxy	17,482	33,962	(65,824)	(3,053)	21,500	84,168
Silicon epitaxy	797	524	(15,331)	(766)	(2,993)	7,736
III-V materials/substrates	4,681	7,561	(2,761)	(407)	3,429	11,048
Goodwill	–	–	(34,302)	(1,835)	–	34,660
Total by activity	22,960	42,047	(118,218)	(6,061)	21,936	137,612
United Kingdom	11,707	28,623	(80,918)	(4,136)	6,588	90,888
United States	11,253	13,424	(37,300)	(1,925)	15,348	46,724
Total by geographical location	22,960	42,047	(118,218)	(6,061)	21,936	137,612

3. Analyses of operations

Recurring and non-recurring operations

	<i>Recurring</i>	<i>Non-</i>	<i>2002</i>	<i>Recurring</i>	<i>Non-</i>	<i>2001</i>
	<i>£'000</i>	<i>recurring</i>	<i>Total</i>	<i>£'000</i>	<i>recurring</i>	<i>Total</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Turnover	23,050	(90)	22,960	42,047	–	42,047
Cost of sales	(31,283)	(59,296)	(90,579)	(32,381)	–	(32,381)
Gross (loss)/profit	(8,233)	(59,386)	(67,619)	9,666	–	9,666
Operating expenses:						
Distribution expenses	(1,591)	–	(1,591)	(2,708)	–	(2,708)
Research and development	(3,210)	–	(3,210)	(3,792)	–	(3,792)
Other administrative expenses	(8,100)	(710)	(8,810)	(6,633)	–	(6,633)
Goodwill amortisation	(891)	(33,411)	(34,302)	(1,835)	–	(1,835)
Exceptional items	(2,686)	–	(2,686)	(759)	–	(759)
	(16,478)	(34,121)	(50,599)	(15,727)	–	(15,727)
Operating loss	(24,711)	(93,507)	(118,218)	(6,061)	–	(6,061)

Non-recurring costs comprise fixed asset impairment, the write down of the valuation of stocks, onerous lease provisions, and the write off of the goodwill arising on the acquisition of Wafer Technology Limited.

4. Operating loss

	2002 £'000	2001 £'000
Operating loss is after charging/(crediting):		
Depreciation and impairment of tangible fixed assets:		
Owned assets	49,819	5,733
Leased assets	14,560	690
Amortisation and impairment of goodwill	34,302	1,835
Auditors' remuneration	241	288
Operating lease rentals:		
Plant and machinery	588	597
Other	536	474
Exchange (gains)/losses	(155)	(188)

5. Information regarding directors and employees

Directors' emoluments:

	Basic salary 2002 £'000	Fees 2002 £'000	Bonus 2002 £'000	Car allowance 2002 £'000	Benefits 2002 £'000	Total remuneration 2002 2003 est. £'000 £'000		Pension contributions 2002 2003 est. £'000 £'000		
Executive Directors										
Dr A W Nelson	76	-	-	5	10	91	129	82	7	
Dr M D Scott	72	-	-	-	20	92	85	15	7	
T L Hierl <i>(resigned 7 March 2003)</i>	116	-	-	-	5	121	128	2	1	
S T Massie <i>(resigned 31 August 2002)</i>	61	-	-	-	3	64	92	1	1	
M S M Lamb	60	-	-	-	9	69	66	6	9	
S Byars <i>(resigned 7 March 2003)</i>	141	-	-	-	15	156	151	10	12	
R J G Clarke <i>(resigned 31 August 2002)</i>	142	-	-	-	7	149	105	14	9	
Non-Executive Directors										
Dr G H H Ainsworth	-	46	-	-	-	46	9	-	-	
G Bressner <i>(resigned 17 May 2002)</i>	-	-	-	-	-	-	-	-	-	
S Gibson <i>(appointed 1 January 2002)</i>	-	17	-	-	-	17	-	-	-	
	<u>668</u>	<u>63</u>	<u>-</u>	<u>5</u>	<u>69</u>	<u>805</u>	<u>765</u>	<u>130</u>	<u>46</u>	

Directors' share options:

The following Directors' share options were in existence at 31 December 2002:

	At 1 Jan 2002	Granted/ (waived)	At 31 Dec 2002	Exercise price	Date from which exercisable	Expiry date
S Byars	250,000	-	250,000	£2.15	02.01.02 to 02.01.04	02.01.11
R J G Clarke	250,000	(250,000)	-	£2.04	08.03.04	08.03.11
S T Massie	336,100	-	336,100	\$0.13	24.10.98 to 24.10.01	31.12.03
S T Massie	672,200	-	672,200	\$0.13	14.12.99 to 14.12.02	31.12.03
S T Massie	250,000	-	250,000	\$1.41	05.11.02	31.12.03
Dr G H H Ainsworth	75,000	(75,000)	-	£4.13	16.05.03 to 16.05.10	16.05.10

The above options are granted under a share option scheme adopted on 26 May 2000.

No other Director held share options at any point during the year.

No Directors exercised any options during the year.

5. Information regarding directors and employees (continued)

	2002 £'000	2001 £'000
Employee costs		
Wages and salaries	11,128	13,225
Social security costs	1,048	1,153
Other pension costs	755	654
	<u>12,931</u>	<u>15,032</u>

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

	2002 No.	2001 No.
IQE plc	7	6
IQE (Europe) Limited	150	203
IQE Inc	142	147
IQE Silicon Compounds Limited	33	25
Wafer Technology Limited	52	67
	<u>384</u>	<u>448</u>

6. Interest payable and similar charges

	2002 £'000	2001 £'000
Bank loans	4	2
Other loans	318	364
Finance lease interest	563	432
	<u>885</u>	<u>798</u>

7. Taxation

	2002 £'000	2001 £'000
United Kingdom corporation tax at 30% (2001 – 30%)	—	—
Current charge for the period	—	—
United Kingdom deferred tax	(1,217)	(373)
Overseas corporation tax	—	85
Adjustments in respect of prior year's provision:		
Overseas corporation tax	—	18
United Kingdom deferred tax	—	—
	<u>(1,217)</u>	<u>(270)</u>

7. Taxation (continued)

Factors affecting current tax charge

The tax assessed for the period is lower than that resulting from applying the standard rate of corporation tax in the UK: 30% (2001: 30%). The differences are explained below:

	2002 £'000	2001 £'000
Loss on ordinary activities before tax	(118,234)	(5,850)
Tax at 30% thereon	35,470	1,755
Effects of:		
Capital allowances in excess of depreciation	(8,961)	394
Expenses not deductible for tax purposes	(286)	(66)
Movement in short term timing differences	19	(19)
Increase in tax losses	(4,565)	(835)
Other deferred tax movements	(148)	25
Group relief	-	17
Non taxable income	-	3
Late accounts adjustments	-	(98)
Goodwill amortisation	(10,291)	(550)
Overseas losses	(10,822)	(438)
Revaluation adjustment	(416)	(68)
Exchange gain on capitalised intra group loan	-	(120)
Current charge for the period	<u>-</u>	<u>-</u>

The Group has UK tax losses of approximately £25,000,000 which are available for carry forward.

8. Dividends

No dividend has been paid or proposed in 2002 (2001: £nil).

9. Profit of parent company

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent Company is not presented as part of these accounts.

The parent Company's loss for the financial year amounted to 120,328,000 (2001: profit £939,000).

10. Earnings per ordinary share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares during the year. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares in issue on the assumption of conversion of all dilutive potential ordinary shares.

	2002 £'000	2001 £'000
Basic and diluted earnings attributable to ordinary shareholders	<u>(117,017)</u>	<u>(5,580)</u>
	<i>No.</i>	<i>No.</i>
Weighted average number of ordinary shares	185,513,850	164,951,834
Diluted share options	<u>6,768,478</u>	<u>4,366,065</u>
Adjusted weighted average number of ordinary shares	<u>192,282,328</u>	<u>169,317,899</u>
Loss per share	<u>(63.08p)</u>	<u>(3.38p)</u>
Diluted loss per share	<u>(63.08p)</u>	<u>(3.38p)</u>

The Group has incurred losses in the year and as such the only options that would be considered to be dilutive under FRS 14 would be out of the money options. Option holders are unlikely to exercise out of the money options and as such these are not considered dilutive. Therefore, no adjustment has been made to diluted earnings per share for out of the money share options.

11. Exceptional items

Exceptional items comprise legal fees of £1,984,000 (2001: £759,000) and restructuring costs of £702,000 (2001: £nil).

Legal fees relate to a complaint by IQE (Europe) Limited against Rockwell regarding a declaratory judgement that IQE (Europe) Limited's processes did not infringe a Rockwell-owned MOCVD patent which expired on 11 January 2000 plus claims for damages related to this matter. Rockwell counter-claimed, alleging breaches of a licence agreement by IQE (Europe) Limited. The two parties have now settled their dispute. Under the terms of the settlement, IQE plc has provided Rockwell with 300,000 shares in the Company and IQE (Europe) Limited has paid Rockwell \$500,000 in return for their agreement that neither IQE (Europe) Limited nor its customers had infringed the MOCVD patent. IQE (Europe) Limited will pay Rockwell a further \$500,000 after 31 December 2002. The full cost of the settlement has been charged in these accounts.

Restructuring costs relate to the cost of staff redundancies at IQE (Europe) Limited, IQE Inc and Wafer Technology Limited as part of the Group's cost reduction programme.

The Group also incurred an exceptional cost of £93,507,000 (2001: £nil) in respect of non-recurring costs. These comprise fixed asset impairment of £55,931,000, stock provisions of £2,866,000, onerous lease provisions of £743,000, miscellaneous provisions of £556,000, and goodwill impairment of £33,411,000.

12. Intangible fixed assets

The Group	<i>Goodwill £'000</i>
Cost	
At 1 January 2002	36,702
Adjustment due to deferred consideration (note 14)	(356)
At 31 December 2002	<u>36,346</u>
Accumulated amortisation and impairment	
At 1 January 2002	2,044
Charge for the year	891
Impairment provision	33,411
At 31 December 2002	<u>36,346</u>
Net book value	
At 31 December 2002	-
At 31 December 2001	<u>34,658</u>

The above goodwill relates to the acquisition of 100% of the issued share capital of Wafer Technology International Limited and Wafer Technology Limited that was acquired on 22 November 2000.

13. Tangible fixed assets

The Group	<i>Freehold land & buildings</i>	<i>Short leashold improvements</i>	<i>Fixtures & fittings</i>	<i>Plant & machinery</i>	<i>Assets in the course of construction</i>	<i>Total</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Cost						
At 1 January 2002	6,663	5,216	2,901	58,860	22,239	95,879
Additions	-	125	248	1,379	3,717	5,469
Transfers	(2,660)	5,073	1,321	22,222	(25,956)	-
Exchange difference	-	(309)	(107)	(3,841)	-	(4,257)
At 31 December 2002	<u>4,003</u>	<u>10,105</u>	<u>4,363</u>	<u>78,620</u>	<u>-</u>	<u>97,091</u>
Depreciation and impairment						
At 1 January 2002	498	714	1,344	19,130	-	21,686
Charge for the year	248	2,467	926	4,807	-	8,448
Impairment provisions	1,089	7,110	1,309	46,423	-	55,931
Transfers	(78)	78	-	-	-	-
Exchange difference	-	(264)	(68)	(2,504)	-	(2,836)
At 31 December 2002	<u>1,757</u>	<u>10,105</u>	<u>3,511</u>	<u>67,856</u>	<u>-</u>	<u>83,229</u>
Net book value						
At 31 December 2002	<u>2,246</u>	<u>-</u>	<u>852</u>	<u>10,764</u>	<u>-</u>	<u>13,862</u>
At 31 December 2001	<u>6,165</u>	<u>4,502</u>	<u>1,557</u>	<u>39,730</u>	<u>22,239</u>	<u>74,193</u>

The fixed assets of IQE plc, IQE (Europe) Limited, IQE Inc and IQE Silicon Compounds Limited have been written down to their market values as at 31 December 2002.

The fixed assets of Wafer Technology Limited have been written down to their value in use based on a discount rate of 12%. The net book value of fixtures and fittings includes £nil (2001: £45,000) and the net book value of plant and machinery includes £2,577,000 (2001: £12,2289,000) in respect of assets held under finance leases.

13. Tangible fixed assets (continued)

	<i>Fixtures & fittings</i> £'000
The Company	
Cost	
At 1 January 2002	138
Additions	2
At 31 December 2002	<u>140</u>
Depreciation and impairment	
At 1 January 2002	14
Charge for the year	28
Impairment provision	98
At 31 December 2002	<u>140</u>
Net book value	
At 31 December 2002	-
At 31 December 2001	<u>124</u>

14. Investments held as fixed assets

	2002
The Company	£'000
Cost	
At 1 January 2002	75,112
Additions	7
At 31 December 2002	<u>75,119</u>
Impairment	
At 1 January 2002	-
Impairment provision	67,559
At 31 December 2002	<u>67,559</u>
Net book value	
At 31 December 2002	<u>7,560</u>
At 31 December 2001	<u>75,112</u>

The above is represented by investments in the following 100% owned subsidiaries:

	£'000
IQE Inc (formerly Quantum Epitaxial Designs Inc.)	4,770
EPI Holdings Limited	-
Wafer Technology International Limited and Wafer Technology Limited	2,781
Shares in IQE plc held on behalf of Employee Benefit Trusts	9
	<u>7,560</u>

14. Investments held as fixed assets (continued)

Investments in own shares

The IQE plc Employee Benefit Trust and the IQE plc General Benefit Trust were established to manage the IQE plc All Employee Share Ownership Plans (the Plans) for UK and US employees respectively. The Trustees of the Plans purchase the Company's ordinary shares in the open market with financing provided by the employees. The Trusts contribute matching shares at no cost to the employees which are generated from new issues made by the Company to the Trusts. As at 31 December 2002, the Company had issued 1,000,000 ordinary shares of 1p each to the Trusts to establish the Plans and allocated 715,864 matching shares.

The cost of shares awarded under the Plans is amortised evenly over the period from the original grant of the particular award to the time of vesting, which is normally a period of three years. Other administrative costs are charged to the profit and loss account as incurred.

The Company has not paid a dividend in the year. The market value of IQE plc ordinary shares at 31 December 2002 was 6.25p per share.

Group and Company	<i>Shares held</i>		<i>Cost</i> £'000	<i>Amortisation</i> £'000	<i>Net book value</i> £'000
	<i>in trust</i> <i>No.</i>	<i>Nominal value</i> £'000			
At 1 January 2002	250,000	2	2	–	2
Issued to the Trust	750,000	8	8	(1)	7
At 31 December 2002	<u>1,000,000</u>	<u>10</u>	<u>10</u>	<u>(1)</u>	<u>9</u>

The IQE plc General Benefit Trust was also established to manage a Deferred Share Bonus Plan for UK and US employees by granting shares to employees in lieu of salary and bonus sacrifices. As at 31 December 2002, no shares had been awarded to employees under the Deferred Share Bonus Plan.

15. Stocks

	2002		2001	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Raw materials and consumables	3,513	–	10,239	–
Work in progress and finished goods	1,475	–	2,038	–
	<u>4,988</u>	<u>–</u>	<u>12,277</u>	<u>–</u>

16. Debtors

	2002		2001	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Trade debtors	2,736	–	6,138	–
Amounts owed by Group undertakings	–	4,237	–	42,049
Other debtors and prepayments	985	88	1,357	–
Corporation tax	–	–	–	–
	<u>3,721</u>	<u>4,325</u>	<u>7,495</u>	<u>42,049</u>

Amounts owed by Group undertakings are due after more than one year.

17. Creditors: amounts falling due within one year

	2002		2001	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Other loans	1,035	–	674	–
Trade creditors	4,912	–	6,674	–
Amounts due under hire purchase and finance leases	2,722	–	2,543	–
Other taxation and social security	118	–	316	–
Corporation tax	–	–	65	–
Accruals and deferred income	3,120	356	1,672	563
	<u>11,907</u>	<u>356</u>	<u>11,944</u>	<u>563</u>

18. Creditors: Amounts falling due after more than one year

	2002		2001	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Amounts due under hire purchase and finance leases	2,950	–	5,313	–
Other loans	3,050	–	2,898	–
Deferred income	452	–	174	–
	<u>6,452</u>	<u>–</u>	<u>8,385</u>	<u>–</u>

19. Borrowings

	<i>The Group</i>	
	2002 £'000	2001 £'000
Other loans		
Other loans are payable as follows:		
Within one year	1,035	674
Between one and two years	1,186	774
Between two and five years	874	827
Over five years	989	1,297
	<u>4,084</u>	<u>3,572</u>

Hire purchase and finance lease repayments

Hire purchase and finance lease repayments are payable as follows:

	<i>The Group</i>	
	2002 £'000	2001 £'000
Within one year	2,722	2,543
Between one and two years	2,374	2,617
Between two and five years	576	2,696
	<u>5,672</u>	<u>7,856</u>

19. Borrowings (continued)

Other loans comprise a loan from 3i of £1,045,000 (2001: £1,140,000), a loan from the WDA of £1,326,753 (2001: £1,466,792), a loan from Copelco of £479,150 (2001: £965,698) and a loan from GCS of £1,233,653 (2001: £nil).

Interest is charged on the 3i loan at a rate equal to the base rate and a margin of 2.5% per annum. The loan is secured by a fixed and floating charge over the assets of IQE (Europe) Limited and is repayable by 15 annual instalments of £95,000, which commenced on 13 August 2000. Subsequent to the year end, a loan repayment of £160,000 was made ahead of schedule in return for the release of charges over fixed and floating assets at the Cardiff facility, resulting in the loan being secured solely on IQE (Europe) Limited's property.

Interest is charged on the WDA loan at a maximum rate of 8.5% per annum. The loan is secured on IQE (Europe) Limited's property and is repayable by 32 instalments, quarterly in arrears, commencing on 1 October 2001.

Interest is charged on the Copelco loan at 10.86% per annum. The loan was secured on equipment and was repayable by monthly instalments of \$63,924 per month.

The final instalment of \$767,070 was repaid in January 2003.

There are no fixed repayment terms for the GCS loan.

Amounts due under hire purchase and finance leases are secured on the related assets.

20. Deferred taxation

	<i>At 1 January 2002 £'000</i>	<i>Credited to profit & loss account £'000</i>	<i>At 31 December 2002 £'000</i>
UK deferred tax	<u>1,217</u>	<u>(1,217)</u>	<u>–</u>

The amounts of deferred taxation provided and unprovided in the accounts are:

	<i>2002 £'000</i>	<i>Provided 2001 £'000</i>	<i>2002 £'000</i>	<i>Unprovided 2001 £'000</i>
The Group				
Capital allowances in excess of depreciation	–	2,238	(4,875)	190
Other timing differences	–	(1,021)	(264)	(627)
Losses	–	–	(7,721)	–
	<u>–</u>	<u>1,217</u>	<u>(12,860)</u>	<u>(437)</u>

21. Share capital

	<i>2002</i>		<i>2001</i>	
	<i>No. of shares</i>	<i>£'000</i>	<i>No. of shares</i>	<i>£'000</i>
Authorised				
Ordinary shares of 1p each	<u>300,000,000</u>	<u>3,000</u>	<u>300,000,000</u>	<u>3,000</u>
Allotted, called up and fully paid				
Ordinary shares of 1p each	<u>187,069,878</u>	<u>1,871</u>	<u>182,383,507</u>	<u>1,824</u>

21. Share capital (continued)

The movement in the number of ordinary shares during the year was:

	<i>At</i> <i>1 January</i> <i>2002</i> <i>£'000</i>	<i>Shares</i> <i>issued</i> <i>No.</i>	<i>At</i> <i>31 December</i> <i>2002</i> <i>£'000</i>
Brought forward	182,383,507	–	182,383,507
Open offer and placing	–	1,972,837	1,972,837
Options exercised	–	1,561,348	1,561,348
Other	–	1,152,186	1,152,186
	<u>182,383,507</u>	<u>4,686,371</u>	<u>187,069,878</u>

4,686,371 shares were issued during the year for the following considerations:

	<i>No of shares</i>	<i>Consideration</i>
Open offer and placing	1,972,837	155p
Employee share options	1,061,348	1p to 42p
Employee Benefit Trusts	750,000	1p
Wafer Technology acquisition	500,000	116p
Rockwell settlement	300,000	10p
Non-Executive Directors in lieu of fees	102,186	20p to 116p
Total	<u>4,686,371</u>	

Under the Company's share option scheme adopted on 26 May 2000, employees held options at 31 December 2002 for 9,529,831 unissued 1p ordinary shares as follows:

<i>No. of shares</i>	<i>Option price per shares</i> <i>£</i>	<i>Option period ending</i>
698,924	0.01 – 0.09	31 December 2007
867,080	0.01 – 0.09	31 December 2008
1,383,451	0.01 – 0.94	31 December 2009
45,500	2.53 – 5.87	31 December 2010
297,000	0.93 – 2.33	31 December 2011
6,237,876	0.06 – 0.25	31 December 2012

The movements on share options during the year were as follows:

	<i>Options</i> <i>No.</i>
At 1 January 2002	8,387,295
Granted	6,373,440
Exercised	(1,061,348)
Cancelled	(4,169,556)
At 31 December 2002	<u>9,529,831</u>

During the previous year the Company issued a share warrant. The warrant is capable of being exercised at any time during the period of five years from 10 December 2001. The warrant is for up to 4,428,620 new ordinary shares, ranking *pari passu* with existing ordinary shares, and may be exercised in whole or in part, although if exercised in part, it must be exercised in minimum tranches of 442,862 shares.

21. Share capital (continued)

Upon the occurrence of certain adjustment events including any allotment or issue of equity shares or any sub-division, consolidation or redesignation of equity shares, the nominal value and subscription price of the warrant shares shall be adjusted in such manner as the auditors of the Company certify to be necessary in order that the subscription rights after such adjustment will carry the same entitlement to participate in the profits and assets of the Company as they did prior to such adjustments and the aggregate subscription price payable by the share warrant holder shall be as nearly as possible the same as it was prior to such adjustment. The initial subscription price of the warrant shares is £1.55 per share. The applicable subscription price is capable of increase over the term of the warrant. Any adjustment to the prevailing subscription price will occur with effect from each anniversary of 10 December ("an anniversary date") and will depend upon the average mid market price for an ordinary share on the twenty trading days immediately preceding the relevant anniversary date ("the actual share price"). There will also be a maximum "cap" for the subscription price (the "maximum share price") equal to £1.55 increased on each anniversary date by a sum equal to five per cent of £1.55. If on any anniversary date the actual share price is below the prevailing subscription price there will be no increase to the prevailing subscription price. If the actual share price is higher than the prevailing subscription price, the subscription price will automatically increase to the lower of the actual share price and the maximum share price.

22. Reconciliation of operating loss to net cash outflow from operating activities

	2002	2001
	£'000	£'000
Operating loss	(118,218)	(6,061)
Depreciation and impairment charges	64,379	6,423
Amortisation and impairment of goodwill	34,302	1,835
Movement in stocks	7,289	(4,392)
Movement in debtors	3,774	2,882
Movement in creditors	(512)	(7,842)
Government grant release	(141)	(504)
Government grant received	420	608
Exchange differences	(288)	(15)
Net cash outflow from operating activities	<u>(8,995)</u>	<u>(7,066)</u>

Included in the net cash outflow from operating activities is £2,374,000 (2001: £759,000) in respect of exceptional items and non-recurring costs.

23. Reconciliation of net cash flow to movement in net funds

	2002	2001
	£'000	£'000
Movement in cash in the year	(568)	(2,979)
Loan repayments	662	463
Loans received	2,578	1,863
Cash outflow from decrease in liquid resources	<u>(12,250)</u>	<u>(6,000)</u>
Change in net funds resulting from cash flows	(9,578)	(6,653)
Inception of new finance leases/loans	<u>(1,704)</u>	<u>(7,055)</u>
Net movement for year	(11,282)	(13,708)
Net funds at 1 January 2002	19,105	32,813
Exchange differences	<u>135</u>	<u>-</u>
Net funds at 31 December 2002	<u>7,958</u>	<u>19,105</u>

24. Analysis of net funds

	<i>At 1 Jan</i> 2002 £'000	<i>Cash</i> <i>flow</i> £'000	<i>Other</i> <i>non-cash</i> <i>movements</i> £'000	<i>At 31 Dec</i> 2002 £'000
Cash in hand and at bank	3,033	(568)	–	2,465
Cash at bank accesible between one and seven days	27,500	(12,250)	–	15,250
Debt due after one year	(2,898)	–	(152)	(3,050)
Debt due within one year	(674)	662	(1,023)	(1,035)
Finance leases	(7,856)	2,578	(390)	(5,672)
	<u>19,105</u>	<u>(9,578)</u>	<u>(1,565)</u>	<u>7,958</u>

25. Additional information on subsidiary undertakings

<i>Name</i>	<i>Class of</i> <i>capital</i>	<i>Portion of</i> <i>shares held</i>	<i>Activity</i>	<i>Country of</i> <i>incorporation</i>
IQE Inc USA	Preferred stock of \$0.001 Common stock of \$0.001	100% 100%	Holding Company	USA
IQE Inc	Common stock of \$0.001	100%	Manufacture of advanced semi-conductor materials	USA
EPI Holdings Limited	Ordinary shares of £1	100%	Holding Company	UK
IQE (Europe) Limited	Ordinary shares of £1	100%*	Manufacture of advanced semi-conductor materials	UK
Epitaxial Products, Inc	Common stock of \$10	100%	Dormant	USA
Wafer Technology International Limited	Ordinary shares of £1	100%	Holding Company	UK
Wafer Technology Limited	Ordinary shares of £1	100%*	Manufacture of semi-conductor compounds and ultra high purity materials	UK
IQE Silicon Compounds Limited	Ordinary shares of £1	100%	Manufacture of silicon epitaxy	UK

The proportion of voting rights of subsidiaries held by the Group is the same as the proportion of shares held.

*Indirect holdings

26. Financial instruments

The Group's policies with regard to derivatives and financial instruments are set out in the Financial Review and the accounting policies.

The Group does not trade in financial instruments.

The Group enters into forward currency contracts with its bankers in order to fix exchange rate risks associated with currency shortfalls over a rolling twelve month period in respect of Dollar and Yen inflows (and to a lesser extent other currencies). The Group had not entered into any forward contracts at 31 December 2002.

There were no material gains or losses brought forward or carried forward at the year end. Gains and losses are recognised in the year and are disclosed in Note 4.

26. Financial instruments (continued)

The currency profile of the Group's trade debtors and trade creditors is as follows:

	31 December 2002		31 December 2001	
	Trade debtors £'000	Trade creditors £'000	Trade debtors £'000	Trade creditors £'000
Sterling	358	1,181	54	1,691
US\$	1,441	3,284	5,720	4,791
Yen	367	126	236	64
Other	570	321	128	128
Total	2,736	4,912	6,138	6,674

The interest rate profile of the Group's financial assets and liabilities is as follows:

	Assets floating rate £'000	Assets fixed rate £'000	Liabilities floating rate £'000	Liabilities fixed rate £'000	Total £'000
At 31 December 2002					
Sterling	311	15,500	1,573	6,470	7,768
US\$	1,364	-	-	1,713	(349)
Yen	105	-	-	-	105
Other	435	-	-	-	435
	<u>2,215</u>	<u>15,500</u>	<u>1,573</u>	<u>8,183</u>	<u>7,959</u>
Comprising:					
Cash at bank	2,215	15,500	-	-	17,715
Other loans	-	-	1,573	8,183	9,756
Total	<u>2,215</u>	<u>15,500</u>	<u>1,573</u>	<u>8,183</u>	<u>7,959</u>
At 31 December 2001					
Sterling	2,212	27,500	1,970	8,493	19,249
US\$	716	-	-	966	(250)
Yen	100	-	-	-	100
Other	5	-	-	-	5
	<u>3,033</u>	<u>27,500</u>	<u>1,970</u>	<u>9,459</u>	<u>19,104</u>
Comprising:					
Cash at bank	3,033	27,500	-	-	30,533
Other loans	-	-	1,970	9,459	11,429
Total	<u>3,033</u>	<u>27,500</u>	<u>1,970</u>	<u>9,459</u>	<u>19,104</u>

The weighted average interest rate for the fixed rate liabilities is 7.25% (2001: 9.61%) and the weighted average period for which interest rates are fixed is 2.7 years (2001: 3.5 years). Further details of the financial liabilities at 31 December 2002 are shown in notes 18 and 19.

There is no significant difference between the book value and the fair value of the Group's financial assets and liabilities.

27. Related party transactions

The Group incurred professional fees and expenses during the year of £45,713 (2001: £16,957) payable to Gambit Corporate Finance and £17,500 (2001: £ nil) payable to Wesley Clover Wales Limited. Dr Godfrey Ainsworth, who is a Director of IQE plc, is a partner in Gambit Corporate Finance. Mr Simon Gibson, who is a Director of IQE plc, is also a director of Wesley Clover Wales Limited. The payments in 2002 relate entirely to services provided by Dr Ainsworth and Mr Gibson in their capacity as Non-Executive Directors.

28. Operating lease commitments

The Group was committed at 31 December 2002 to making the following payments during the next year in respect of operating leases:

	<i>Land and buildings</i>		<i>Plant and machinery</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Annual commitments which expire:				
Within one year	–	4	440	2
In the second to fifth year	539	539	132	628
	<u>539</u>	<u>543</u>	<u>572</u>	<u>630</u>

29. Capital commitments

The Group had the following capital commitments as at 31 December 2002:

	<i>2002</i>	<i>2001</i>
	<i>£'000</i>	<i>£'000</i>
Authorised and contracted for	<u>101</u>	<u>1,119</u>

APPENDIX II

IQE PLC ANNUAL REPORT AND FINANCIAL STATEMENTS 2001

Directors' report

The Directors present their annual report and the audited financial statements for the year ended 31 December 2001.

Activities

The principal activity of the Group during the year was the manufacture of advanced semiconductor materials.

Review of developments and future prospects

The Group's activities and future prospects are detailed in the Chairman's Statement, the Operations Review and the Financial Review and should be read as part of this report.

Dividends

The Directors do not recommend the payment of a dividend.

Directors

The Directors in office during the year and their beneficial interests in the Company's issued ordinary share capital were as follows:

	<i>Ordinary shares of 1p each 2001 No.</i>	<i>Ordinary shares of 1p each 2000 No.</i>
Dr A W Nelson	26,057,970	26,057,970
Dr M D Scott	26,057,970	26,057,970
T L Hierl	16,489,230	16,489,230
S T Massie	108,620	108,620
M S M Lamb	3,341,250	3,341,250
Dr G H H Ainsworth	5,842	5,410
G Bressner	–	–
S Byars (appointed 1 January 2001)	5,000	–
R J G Clarke (appointed 8 March 2001)	–	–

Dr. G H H Ainsworth was appointed Non-Executive Chairman on 05 February 2002.

S Gibson was appointed a Non-Executive Director on 1 January 2002.

S T Massie held options for 1,258,300 unissued 1p ordinary shares at 31 December 2001 (2000: 1,258,300 options for unissued 1p ordinary shares); S Byars and R J G Clarke each held options for 250,000 unissued 1p ordinary shares (2000: nil); and Dr G H H Ainsworth held options for 75,000 unissued 1p ordinary shares (2000: 75,000 options for unissued 1p ordinary shares). No other Director held share options at 31 December 2001. Further details are given in Note 5 to the accounts.

Research & development

The Group incurred costs in respect of research and development during the year of £3,792,000 (2000 – £1,870,000). All research and development expenditure is charged to the profit and loss account in the period it is incurred, with the exception of the carry forward of costs in respect of new products. No research and development expenditure was carried forward at 31 December 2001.

Payment terms

It was the Group's policy during the year ended 31 December 2001 to follow the "Better Payment Practice Code". The Group agrees payment terms in advance with individual suppliers and abides by the terms. The Group's average number of days purchases outstanding in respect of trade creditors at 31 December 2001 was 41 days (2000 – 45 days).

Employment policies

It is the policy of the Group that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

The Group remains committed to its policy of keeping employees fully informed about all matters which concern them. Formal communications are used to achieve this objective, including notice board announcements, e-mail and intranet. Employee involvement takes different forms in each subsidiary, ranging from formal committee meetings to less formal discussion groups.

Schemes have been implemented to ensure that employees are properly rewarded for performance and loyalty.

Going concern

The Directors, after making enquiries, have deliberated on the future prospects of the Group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these accounts.

Auditors

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board

Leslie Coventry
Company Secretary

19 March 2002

Statement of directors' responsibilities

United Kingdom 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 the Group as at the end of the financial year and of the profit or loss of the Group 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;

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

Approved by the Board of Directors
and signed on behalf of the Board

Leslie Coventry
Company Secretary

19 March 2002

Report of the remuneration committee

The Committee

The Remuneration Committee consists of the Non-Executive Directors and is chaired by G Bressner. The Committee complies with Schedule A of the Best Practice Provisions annexed to the Listing Rules of the London Stock Exchange.

The Committee is responsible for the determination of remuneration policy for the Executive Directors. It has access to and takes professional advice.

The fees of the Non-Executive Directors are determined by the Board.

Policy

In establishing its policy, the Committee has given full consideration to Schedule B of the Best Practice Provisions annexed to the Listing Rules of the Financial Services Authority. The basic objective of the policy is that Executive Directors should receive remuneration which is appropriate to their position of responsibility, and which will attract, motivate and retain Executives of the necessary calibre. Remuneration of the Executive Directors consists of annual salary, bonus, taxable benefits in kind and pension contributions.

Basic salary & performance bonus

There is an annual review at which the Committee approves the basic salary for each Executive Director. Details of Directors' salaries, benefits, bonuses and share options are reported by the Remuneration Committee and are shown in Note 5 to the accounts.

Benefits

Benefits for Executive Directors comprise fully expensed company cars, medical health insurance and daily allowances for domestic and foreign business travel.

Share options

Executive Directors hold share options under The IQE plc Share Option Scheme. The Committee grants options to Executive Directors and other employees to encourage long-term commitment to the Company.

Service contracts

The Executive Directors have entered into service agreements with the Company, which are terminable by either party on twelve months' notice. Each of the agreements contains post-termination restrictive covenants, which place limitations on solicitation of customers and employees of the Group and on acting in competition with the business of the Group. On his appointment to the role of Non-Executive Chairman, Dr G Ainsworth entered into a service agreement terminable by either party on three months' notice. The Non Executive Directors have entered into letter agreements with the Company which are renewable annually and are terminable on one month's notice by the Non-Executive Directors or without notice by the Company.

Pensions

The Executive Directors are members of the Group pension schemes and their pension contributions are based on a percentage of annual salary. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service.

There have been no changes in the terms of Directors' pension entitlements during the year. There are no unfunded pension promises or similar arrangements for Directors.

Remuneration

Full details of Directors' remuneration are shown in Note 5 to the accounts.

Share options

Full details of Directors' share options are shown in Note 5 to the accounts.

Corporate governance report

Corporate governance

IQE is committed to ensuring high standards of corporate governance. This statement describes how the principles of corporate governance are applied to the Group and the Group's compliance with the provisions set out in Section 1 of the Combined Code.

The Group complied with the provisions of this Code during the year ended 31 December 2001 with the following exceptions:

Provision A.1.6, Training: The company does not have a formal training programme for Directors either on appointment or subsequently, although all Directors are encouraged to obtain such training as they consider necessary at the expense of the Company.

Provision A.2.1, Chairman and CEO: During the year, the positions of Chairman and CEO were combined as the Board considered this to be appropriate at that stage of its development. However, subsequent to the year end, the roles were split, with Dr Godfrey Ainsworth being appointed to the position of Non-Executive Chairman and Dr Drew Nelson becoming President and CEO.

Provision A.3.1, Board composition: Throughout the year, Non-Executive Directors consisted of less than one third of the Board. However, once again after the year end, a further Non-Executive Director, Mr Simon Gibson, was appointed, thereby increasing the proportion of Non-Executive Directors on the Board.

Provision D.3.1, Audit Committee: During the year, the Audit Committee comprised the two Non-Executive Directors, which is less than the three prescribed by the Combined Code. However, following the appointment of the additional Non-Executive Director, membership of the Committee will be increased to three.

The Board of Directors

The management of IQE plc is directed by the Board which is responsible for ensuring the development and implementation of the Group's overall strategy.

The Board comprises the Non-Executive Chairman, the President and CEO, six Executive Directors and two Non-Executive Directors. In the opinion of the Board, the three Non-Executive Directors, Dr Godfrey Ainsworth, Mr Glen Bressner and Mr Simon Gibson, are independent of management and, notwithstanding Note 5 to the Accounts, free from any business or other relationship which could materially interfere with the exercise of their independent judgement. The Non-Executive Chairman, Dr Godfrey Ainsworth, is recognised as the senior independent Non-Executive Director to whom concerns can be conveyed as required by the Code of Best Practice. Under the Company's Articles of Association each of the Directors is required ordinarily to retire by rotation once every three years.

During the year the Board held five regular meetings and several special meetings. The Board has a formal schedule of matters referred to it for decision; these include the approval of annual, interim and quarterly results, the annual budget, acquisitions and disposals, major items of capital expenditure, share capital issues, governance issues and executive appointments. Prior to each meeting the Board is provided with appropriate strategic and financial information together with monthly reports to enable it to monitor the performance of the Group.

All the Directors have direct access to the advice and the services of the Group Company Secretary who is responsible for ensuring that Board procedures are followed.

Board committees

The Board has delegated specific responsibilities to the following committees:

Group Executive Committee

The Committee consists of the Executive Directors under the chairmanship of Dr Drew Nelson and is responsible for the development of strategy, annual budgets and operating plans linked to the management and control of the day-to-day operations of the Group. The Committee is also responsible for monitoring key research and development programmes and for ensuring that the Board policies are carried out on a Group-wide basis.

Audit Committee

The Committee consists of the Non-Executive Directors, under the chairmanship of Dr Godfrey Ainsworth and meets at least three times a year, and more frequently if required. The Audit Committee has specific written terms of reference which deal with its authority and duties. The Committee receives and considers reports relating to the monitoring of the adequacy of the Group's internal controls, the suitability of its accounting policies and financial reporting systems and the nature and scope of the audit. Although there is currently no internal audit function, the Audit Committee regularly reviews the need to implement one. The Group Finance Director and the external auditors attend, as necessary. The Committee also holds separate meetings with the external auditors, as appropriate.

Remuneration Committee

The Committee consists of the Non-Executive Directors, under the chairmanship of Mr Glen Bressner, and meets periodically as required. The Remuneration Committee has specific terms of reference which deal with its authority and duties. It is responsible for providing advice and recommendations to the Board on the remuneration and terms and conditions of service of the Executive Directors, including annual bonus entitlements.

The Group's policy on Directors' remuneration has been in line with the Code provisions throughout the year. Full details are given in the Report of the Remuneration Committee and in Note 5 to the accounts.

The Board has not established a separate Nomination Committee as the Board considers itself to be small. The responsibility for nominations rests with the Remuneration Committee.

Internal control

The Board has overall responsibility for the Group's system of internal control, the effectiveness of which has been reviewed during the year and reported on to the Board. The review has taken account of any material developments up to the date of signing of the Financial Statements.

The processes to identify and manage the key risks to the success of the Group are an integral part of the internal control environment. Such processes, which are ongoing and are regularly reviewed and improved as necessary, include strategic planning, the appointment of senior managers, the regular monitoring of performance, control of capital expenditure and significant revenue investment and the setting of high standards for health, safety and environmental performance.

These processes have been in place for the full financial year and up to the date of approval of the Financial Statements.

The effectiveness of the control systems and procedures is monitored regularly through a combination of management self-assessment and external audit. The results are reported to, and considered by, the Audit Committee.

The system of internal control comprises those controls established in order to provide assurance that the assets of the Group are safeguarded against unauthorised use or disposal and to ensure the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. Any system of internal control can only provide reasonable but not absolute assurance against

material misstatement or loss, as it is designed to manage rather than to eliminate the risk of failing to achieve the business objectives of the Group.

The key procedures that the Directors have established with a view to providing effective internal control are as follows:

- (a) a clearly defined organisational structure and limits of authority.
- (b) corporate policies and procedures for financial reporting and control, project appraisal, human resources, quality control, health and safety, information security and corporate governance.
- (c) the preparation of annual budgets and regular re-forecasts which require approval from both the Group Executive Committee and the Board.
- (d) the monitoring of performance against budget and forecasts and the reporting of any variances in a timely manner to the Board.
- (e) regular review and self-assessment of the risks to which the Group is exposed, taking steps to monitor and mitigate these wherever possible including, where appropriate, taking out insurance cover.
- (f) The Audit Committee approves audit plans and, on behalf of the Board, receives reports on the Group's accounting and financial reporting practices and its internal controls. It also receives reports from the external auditors as part of their normal audit work.

Shareholder relations

The President and CEO and the Group Finance Director regularly meet with representatives of institutional shareholders to discuss their views and to ensure that the strategies and objectives of the Group are well understood. Issues discussed with institutional shareholders include the Group's performance and the impact of any major transactions.

The Annual General Meeting allows individual shareholders to raise questions with the Board, although shareholder enquiries and questions are also addressed throughout the year. In accordance with the recommendation of the Combined Code, the Company will advise shareholders attending the Annual General Meeting of the number of proxy votes lodged for each resolution, in the categories 'For' and 'Against', together with the numbers 'at the Chairman's discretion' and abstentions.

These will be advised after each resolution has been dealt with on a show of hands.

All shareholders receive a copy of the annual report and financial statements and an interim report is issued at the half year. The Company has a web site, which provides details of the Group's facilities and products. The site includes a separate investor relations section on which quarterly financial data and other significant announcements are published. The web site address is shown on the back cover of the annual report.

Independent auditors' report to the members of IQE

We have audited the financial statements of IQE plc for the year ended 31 December 2001 which comprise the profit and loss account, the balance sheets, the consolidated cash flow statement, the statement of total recognised gains and losses, the combined statements of movements in shareholders' funds and statement of movements on reserves and the related notes 1-31. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the statement of Directors' responsibilities, the company's Directors are responsible for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards and the Listing Rules of the Financial Services Authority.

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 Group 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 or the Listing Rules regarding Directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Group's compliance with the seven provisions of the Combined Code specified for our review by the UK Listing Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' report and other information contained in the Annual Report, for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of the affairs of the Company and the Group as at 31 December 2001 and of the loss of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Chartered Accountants and Registered Auditors

19 March 2002

Consolidated profit and loss account

Year ended 31 December 2001

	Note	2001 £'000	2000 £'000
Turnover:	3	42,047	30,117
Cost of sales	3	<u>(32,381)</u>	<u>(19,785)</u>
Gross profit	3	<u>9,666</u>	<u>10,332</u>
Operating expenses			
Distribution expenses	3	(2,708)	(2,052)
Administrative expenses:			
Research and development	3	(3,792)	(1,870)
Other administrative expenses (including goodwill and exceptional items)	3	<u>(9,227)</u>	<u>(4,624)</u>
		<u>(15,727)</u>	<u>(8,546)</u>
Operating (loss)/profit before goodwill and exceptional items		(3,467)	1,995
Other operating expenses:			
Goodwill amortisation	3	(1,835)	(209)
Exceptional items	3, 11	(759)	-
Operating (loss)/profit	4	(6,061)	1,786
Other interest receivable and similar income		1,009	1,630
Interest payable and similar charges	6	<u>(798)</u>	<u>(422)</u>
(Loss)/profit on ordinary activities before taxation		(5,850)	2,994
Tax on profit on ordinary activities	7	<u>270</u>	<u>(1,184)</u>
(Loss)/profit for the financial year		<u>(5,580)</u>	<u>1,810</u>
Dividends	8	-	-
Retained (loss)/profit for the financial year		<u>(5,580)</u>	<u>1,810</u>
Earnings per ordinary share	10	<u>(3.38p)</u>	<u>1.24p</u>
Diluted earnings per ordinary share	10	<u>(3.38p)</u>	<u>1.18p</u>

Consolidated statement of total recognised gains and losses

Year ended 31 December 2001

	2001 £'000	2000 £'000
(Loss)/profit for the financial year	(5,580)	1,810
Currency translation differences on foreign currency net investments	<u>595</u>	<u>680</u>
Total recognised gains and losses relating to the year	<u>(4,985)</u>	<u>2,490</u>

Combined statement of movements in shareholders' funds and statement of movements on reserves

Year ended 31 December 2001

	<i>Issued share capital £'000</i>	<i>Share premium £'000</i>	<i>Shares to be issued £'000</i>	<i>Merger reserve £'000</i>	<i>Profit & loss account £'000</i>	<i>Exchange rate reserve £'000</i>	<i>Total 2001 £'000</i>	<i>Total 2000 £'000</i>
The Group								
Balance at 1 January 2001	1,633	111,802	988	(605)	3,091	688	117,597	20,950
Shares issued	191	27,183	-	-	-	-	27,374	94,358
Cost of shares issued	-	(2,324)	-	-	-	-	(2,324)	(1,189)
Deferred consideration on acquisition of subsidiary	-	-	(50)	-	-	-	(50)	988
Foreign exchange translation differences	-	-	-	-	-	595	595	680
(Loss)/profit attributable to members of the Group	-	-	-	-	(5,580)	-	(5,580)	1,810
Balance at 31 December 2001	<u>1,824</u>	<u>136,661</u>	<u>938</u>	<u>(605)</u>	<u>(2,489)</u>	<u>1,283</u>	<u>137,612</u>	<u>117,597</u>
The Company								
Balance at 1 January 2001	1,633	111,802	988	-	4,201	-	118,624	20,958
Shares issued	191	27,183	-	-	-	-	27,374	94,358
Cost of shares issued	-	(2,324)	-	-	-	-	(2,324)	(1,189)
Deferred consideration on acquisition of subsidiary	-	-	(50)	-	-	-	(50)	988
Profit attributable to members of the Company	-	-	-	-	939	-	939	3,509
Balance at 31 December 2001	<u>1,824</u>	<u>136,661</u>	<u>938</u>	<u>-</u>	<u>5,140</u>	<u>-</u>	<u>144,563</u>	<u>118,624</u>

Consolidated balance sheet

31 December 2001

	Note	2001 £'000	2000 £'000
Fixed assets			
Intangible assets	12	34,658	36,543
Tangible assets	13	74,193	47,848
Investment in own shares	14	2	-
		<u>108,853</u>	<u>84,391</u>
Current assets			
Stocks	15	12,277	7,885
Debtors	16	7,495	10,311
Cash at bank and in hand		30,533	39,512
		<u>50,305</u>	<u>57,708</u>
Creditors: Amounts falling due within one year	17	<u>(11,944)</u>	<u>(17,405)</u>
Net current assets		<u>38,361</u>	<u>40,303</u>
Total assets less current liabilities		<u>147,214</u>	<u>124,694</u>
Creditors: Amounts falling due after more than one year	18	<u>(8,385)</u>	<u>(5,507)</u>
Provision for liabilities and charges	20	<u>(1,217)</u>	<u>(1,590)</u>
		<u>137,612</u>	<u>117,597</u>
Capital and reserves			
Called-up share capital	21	1,824	1,633
Merger reserve		(605)	(605)
Share premium		136,661	111,802
Shares to be issued		938	988
Profit and loss account		(2,489)	3,091
Exchange rate reserve		1,283	688
Total equity shareholders' funds		<u>137,612</u>	<u>117,597</u>

These financial statements were approved by the Board of Directors on 19 March 2002

Signed on behalf of the Board of Directors

Dr A W Nelson

R J G Clarke

Parent company balance sheet

31 December 2001

	<i>Note</i>	<i>2001</i> £'000	<i>2000</i> £'000
Fixed assets			
Tangible fixed assets	13	124	–
Investments	14	75,112	42,340
		<u>75,236</u>	<u>42,340</u>
Current assets			
Debtors	16	42,049	41,648
Cash at bank and in hand		27,841	35,138
		<u>69,890</u>	<u>76,786</u>
Creditors: Amounts falling due within one year	17	(563)	(502)
Net current assets		<u>69,327</u>	<u>76,284</u>
Total assets less current liabilities		<u>144,563</u>	<u>118,624</u>
Capital and reserves			
Called-up share capital	21	1,824	1,633
Share premium account		136,661	111,802
Shares to be issued		938	988
Profit and loss account		5,140	4,201
Total equity shareholders' funds		<u>144,563</u>	<u>118,624</u>

These financial statements were approved by the Board of Directors on 19 March 2002

Signed on behalf of the Board of Directors

Dr A W Nelson

R J G Clarke

Consolidated cash flow statement*Year ended 31 December 2001*

	<i>Note</i>	<i>2001</i> <i>£'000</i>	<i>2000</i> <i>£'000</i>
Net cash (outflow)/inflow from operating activities	22	<u>(7,066)</u>	<u>10,949</u>
Returns on investments and servicing of finance			
Interest received		1,009	1,630
Interest paid		<u>(798)</u>	<u>(422)</u>
Net cash inflow from returns on investments and servicing of finance		<u>211</u>	<u>1,208</u>
Taxation			
United Kingdom corporation tax		<u>322</u>	<u>(144)</u>
Capital expenditure			
Payments to acquire tangible fixed assets		<u>(25,169)</u>	<u>(33,566)</u>
Net cash outflow from capital expenditure		<u>(25,169)</u>	<u>(33,566)</u>
Acquisitions and disposals			
Payments to acquire investments in subsidiaries		-	(14,501)
Net cash acquired with subsidiary		<u>-</u>	<u>533</u>
Net cash outflow from acquisitions and disposals		<u>-</u>	<u>(13,968)</u>
Financing			
Issue of ordinary share capital		25,049	67,357
Repayment of loans		(463)	(417)
Repayment of finance leases		<u>(1,863)</u>	<u>(24)</u>
Net cash inflow from financing		<u>22,723</u>	<u>66,916</u>
(Decrease)/increase in cash	23	<u>(8,979)</u>	<u>31,395</u>

Notes to the accounts

Year ended 31 December 2001

1. Accounting policies

The financial statements are prepared in accordance with applicable accounting standards under UK GAAP. The particular accounting policies adopted are described below.

Accounting convention

The financial information is prepared under the historical cost convention and in accordance with applicable accounting standards, which have been applied on a consistent basis during the year under review.

Basis of consolidation

The financial information consolidates the financial statements of the Company and all of its subsidiaries.

The acquisition of EPI Holdings Limited and IQE Inc (formerly Quantum Epitaxial Designs, Inc) by IQE plc, a new holding Company established for that purpose, on 16 May 1999 has been accounted for under merger accounting, whereby the financial information is disclosed as if the companies had always been part of the Group.

The acquisition of IQE (Europe) Limited (formerly Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc by EPI Holdings Limited, a new company established for that purpose, on 27 March 1996 and the acquisition of Wafer Technology International and its subsidiary Wafer Technology Limited on 22 November 2000 have been accounted for under acquisition accounting, whereby these companies became part of the Group on the date of acquisition.

Turnover

Turnover represents amounts invoiced, exclusive of value added taxation.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use, as defined by Financial Reporting Standard Number 15.

Depreciation has been calculated so as to write down the cost of assets to their residual values over the following estimated useful economic lives:

Freehold buildings	25 years
Short leasehold improvements	5 – 27 years
Plant and machinery	5 – 7 years
Fixtures and fittings	4 – 5 years
Motor vehicles	4 years

No depreciation is provided on land or assets in the course of construction. Depreciation is also not provided on assets in periods of non-use, where no physical or technological deterioration occurs and the remaining useful economic life of the asset is extended by the period of non-use.

Goodwill

On the acquisition of a business, fair values are attributed to the Group's share of the net tangible assets acquired. Where the cost of acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill. The goodwill arising on the acquisition of Epitaxial Products International Limited and its subsidiary Epitaxial Products, Inc., by EPI Holdings Limited was written off directly to reserves in the year of acquisition. Goodwill of £284,000 remains eliminated in the profit and loss reserve and will be charged to the profit and loss account on the subsequent disposal of IQE (Europe) Limited (formerly Epitaxial Products International Limited) and its subsidiary Epitaxial Products, Inc. Following the

issue of Financial Reporting Standard 10, goodwill arising in accounting periods ending on or after 23 December 1998 must be classified as an asset on the balance sheet and amortised over its useful life. The goodwill arising on the acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited has been capitalised and is being amortised over its useful life, which is considered by the Directors to be 20 years.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Research and development

Research and development expenditure is fully written off when incurred except where contracts of sufficient value exist or are likely to exist in the foreseeable future, in which case it is written off over a two year period commencing with the start of the contracts to which the costs relate. During 2001 all research and development expenditure was fully written off.

Foreign currencies

Transactions in foreign currencies during the year are recorded in sterling at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. All exchange differences are taken to the profit and loss account.

The balance sheets of IQE Inc (formerly Quantum Epitaxial Design Inc) are translated into sterling at the closing rates of exchange for each year whilst the profit and loss accounts are translated into sterling at the average rates of exchange for the year. The resulting translation differences are taken direct to reserves.

Pension costs

The Group operates defined contribution pension schemes. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the schemes.

Deferred taxation

Deferred taxation is provided on timing differences, arising from the different treatment of items for accounting and taxation purposes, which are expected to reverse in the future without replacement, calculated at the rates at which it is expected that tax will arise.

Government grants

Government grants receivable in connection with expenditure on tangible fixed assets are accounted for as deferred income, which is credited to the profit and loss account by instalments over the expected useful economic life of the related assets on a basis consistent with the depreciation policy.

Revenue grants for the reimbursement of costs charged to the profit and loss account are credited to the profit and loss account in the year in which the costs are incurred.

Leases

Assets held under finance leases and hire purchase contracts are capitalised at their fair value on the inception of the leases and depreciated over the shorter of the period of the lease and the estimated useful economic lives of the assets. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding and are charged to the profit and loss account.

Operating lease rentals are charged to profit and loss in equal annual amounts over the lease term.

Financial instruments

The only derivative instruments utilised by the Group are forward exchange contracts. The Group does not enter into speculative derivative contracts. Forward exchange contracts are used for hedging purposes to alter the risk profile of an existing underlying exposure of the Group in line with the Group's risk management policies.

2. Segmental analysis

Turnover and (loss)/profit on ordinary activities before interest and taxation are analysed by activity and geographical location as follows:

	<i>Turnover</i>		<i>Operating (loss)/profit</i>		<i>Net assets</i>	
	<i>2001</i>	<i>2000</i>	<i>2001</i>	<i>2000</i>	<i>2001</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
III-V epitaxy	33,962	29,128	(3,053)	1,688	84,168	75,078
Silicon epitaxy	524	–	(766)	–	7,736	–
III-V materials/substrates	7,561	989	(407)	307	11,048	5,976
Goodwill	–	–	(1,835)	(209)	34,660	36,543
Total by activity	42,047	30,117	(6,061)	1,786	137,612	117,597
United Kingdom	28,623	16,701	(4,136)	1,992	90,888	76,672
United States	13,424	13,416	(1,925)	(206)	46,724	40,925
Total by geographical location	42,047	30,117	(6,061)	1,786	137,612	117,597

3. Analyses of continuing and acquired operations

	<i>2001</i>		<i>2000</i>			
	<i>Continuing</i>	<i>Acquisitions</i>	<i>Total</i>	<i>Continuing</i>	<i>Acquisitions</i>	<i>Total</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Turnover	34,486	7,561	42,047	29,128	989	30,117
Cost of sales	(26,148)	(6,233)	(32,381)	(19,230)	(555)	(19,785)
Gross profit	8,338	1,328	9,666	9,898	434	10,332
Operating expenses						
Distribution expenses	(2,708)	–	(2,708)	(2,027)	(25)	(2,052)
Research and development	(3,574)	(218)	(3,792)	(1,848)	(22)	(1,870)
Other administrative expenses	(5,520)	(1,113)	(6,633)	(4,311)	(104)	(4,415)
Goodwill amortisation	(1,835)	–	(1,835)	(209)	–	(209)
Exceptional items	(759)	–	(759)	–	–	–
	(14,396)	(1,331)	(15,727)	(8,395)	(151)	(8,546)
Operating (loss)/profit	(6,058)	(3)	(6,061)	1,503	283	1,786

Wafer Technology International Limited and Wafer Technology Limited were acquired on 22 November 2000.

4. Operating (loss)/profit

	2001 £'000	2000 £'000
Operating (loss)/profit is after charging/(crediting):		
Depreciation of tangible fixed assets:		
– Owned assets	5,733	2,616
– Leased assets	690	223
Amortisation of goodwill	1,833	209
Auditors' remuneration	288	473
Operating lease rentals:		
– Plant and machinery	597	423
– Other	474	210
Exchange (gains)/losses	<u>(188)</u>	<u>51</u>

The aggregate remuneration for audit and other services payable to Deloitte & Touche and other overseas auditors is analysed below:

	2001 £'000	2000 £'000
Payable to Deloitte & Touche:		
– Group audit services	75	74
– Company audit services	3	3
– Reporting accountants and other regulatory services	4	8
– Tax services	88	14
– Other services	71	274
Payable to other overseas auditors	<u>47</u>	<u>100</u>
	<u>288</u>	<u>473</u>

5. Information regarding directors and employees

Directors' emoluments:

	<i>Basic</i>	<i>Fees</i>	<i>Bonus</i>	<i>Car</i>	<i>Benefits</i>	<i>Total</i>		<i>Pension</i>	
	<i>Salary</i>			<i>allowance</i>		<i>remuneration</i>		<i>contributions</i>	
	2001	2001	2001	2001	2001	2001	2000	2001	2000
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Executive Directors									
Dr A W Nelson	104	–	–	18	7	129	170	7	7
Dr M D Scott	73	–	–	–	12	85	113	7	7
T L Hierl	122	–	–	–	6	128	117	1	–
S T Massie	87	–	–	–	5	92	102	1	–
M S M Lamb	60	–	–	–	6	66	5	9	1
S Byars (appointed 01.01.01)	141	–	–	–	10	151	–	12	–
R J G Clarke (appointed 08.03.01)	98	–	–	–	7	105	–	9	–
Non-Executive Directors									
Dr G H H Ainsworth	–	9	–	–	–	9	10	–	–
G Bressner	–	–	–	–	–	–	–	–	–
	<u>685</u>	<u>9</u>	<u>–</u>	<u>18</u>	<u>53</u>	<u>765</u>	<u>517</u>	<u>46</u>	<u>15</u>

5. Information regarding directors and employees (continued)

A benchmarking of Directors' remuneration was carried out during the year in order to align them with industry peers and best practice, and the following Directors were awarded basic salary increases as shown below:

Dr A W Nelson	£130,000 (2000: £79,000)
Dr M D Scott	£90,000 (2000: £73,000)
S T Massie	£106,346 (2000: £102,000)
M S M Lamb	£75,000 (2000: £60,000)

However, these Directors together with S Byars elected to waive a proportion of their salaries as part of the Group's cost saving initiatives. In addition, T L Hierl's salary was frozen at last year's level, and all Directors agreed to waive bonuses due to them for 2001.

Dr Nelson's car allowance of £18,375 (2000: £24,500) is in lieu of a fully expensed company car.

Dr Ainsworth received £6,641 (2000: £8,655) for out of pocket expenses incurred in services on behalf of the company.

Share options:

The following Directors' share options were in existence at 31 December 2001:

	<i>At 1 January 2001</i>	<i>Granted</i>	<i>At 31 December 2001</i>	<i>Exercise price</i>	<i>Date from which exercisable</i>	<i>Expiry date</i>
S Byars	–	250,000	250,000	£2.15	02.01.02 to 02.01.04	02.01.11
R J G Clarke	–	250,000	250,000	£2.04	08.03.04	08.03.11
S T Massie	336,100	–	336,100	\$0.13	24.10.98 to 24.10.01	24.10.07
S T Massie	672,200	–	672,200	\$0.13	14.12.99 to 14.12.02	14.10.08
S T Massie	250,000	–	250,000	\$1.41	05.11.02	05.11.09
Dr G H H Ainsworth	75,000	–	75,000	£4.13	16.05.03 to 16.05.10	16.05.10

The above options are granted under a share option scheme adopted on 26 May 2000.

No other Director held share options at any point during the year.

No Directors exercised any options during the year.

	<i>2001 £'000</i>	<i>2000 £'000</i>
Employee costs		
Wages and salaries	13,225	7,623
Social security costs	1,153	1,061
Other pension costs	654	243
	<u>15,032</u>	<u>8,927</u>
	<i>2001 No.</i>	<i>2000 No.</i>
The average number of employees, including Directors, during the year was as follows:	<u>448</u>	<u>322</u>

6. Interest payable and similar charges

	2001 £'000	2000 £'000
Bank loans	2	–
Other loans	364	415
Finance lease interest	432	7
	<u>798</u>	<u>422</u>

7. Taxation

	2001 £'000	2000 £'000
United Kingdom corporation tax at 30% (2000: 30%)	–	49
United Kingdom deferred tax	(373)	1,141
Overseas corporation tax	85	–
Adjustments in respect of prior years provision:		
Overseas corporation tax	18	(124)
United Kingdom deferred tax	–	118
	<u>(270)</u>	<u>1,184</u>

8. Dividends

No dividend has been paid or proposed in 2001 (2000: £nil).

9. Profit of parent company

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent Company is not presented as part of these accounts. The parent Company's profit for the financial year amounted to £939,000 (2000: £3,509,000).

10. Earnings per ordinary share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares during the year. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares in issue on the assumption of conversion of all dilutive potential ordinary shares.

The Company carried out a 10 for 1 share split in September 2000. In accordance with the provisions of FRS14 "Earnings Per Share", for the purpose of calculating earnings per share, the number of ordinary shares is adjusted as if the share split had taken place at 1 January 2000.

	2001 £'000	2000 £'000
Basic and diluted earnings attributable to ordinary shareholders	<u>(5,580)</u>	<u>1,810</u>
	<i>No.</i>	<i>No.</i>
Weighted average number of ordinary shares	164,951,834	146,203,992
Diluted share options	4,366,065	6,924,456
Adjusted weighted average number of ordinary shares	<u>169,317,899</u>	<u>153,128,448</u>
Earnings per share	<u>(3.38p)</u>	<u>1.24p</u>
Diluted earnings per share	<u>(3.38p)</u>	<u>1.18p</u>

10. Earnings per ordinary share (continued)

The Group has incurred losses in the year and as such the only options that would be considered to be dilutive under FRS 14 would be out of the money options. Option holders are unlikely to exercise out of the money options and as such these are not considered dilutive. Therefore, no adjustment has been made to diluted earnings per share for out of the money share options.

11. Exceptional items

Exceptional items comprise legal fees of £759,046 (2000: £nil) in respect of a claim by IQE (Europe) against Rockwell regarding a declaratory judgement that the processes of IQE (Europe) did not infringe a Rockwell-owned MOCVD patent, which expired on 11 January 2000, together with claims for damages related to this matter. There is a counter claim by Rockwell alleging breaches of a licence agreement by IQE (Europe) Limited. Two legal opinions obtained in the US by IQE (Europe) clearly support the Company's view that its processes were not covered by Rockwell's MOCVD patent, the validity of which is separately being disputed by other companies in the US.

It is uncertain whether the claim and counter claim will ultimately go to trial or what the outcome will be.

12. Intangible fixed assets

The Group	<i>Goodwill</i> <i>£'000</i>
Cost	
At 1 January 2001	36,752
Adjustment due to deferred consideration (note 14)	(50)
At 31 December 2001	<u>36,702</u>
Accumulated amortisation	
At 1 January 2001	209
Charge for the year	<u>1,835</u>
At 31 December 2001	<u>2,044</u>
Net book value	
At 31 December 2001	<u>34,658</u>
At 31 December 2000	<u>36,543</u>

The above goodwill relates to the acquisition of 100 per cent. of the issued share capital of Wafer Technology International Limited and Wafer Technology Limited that was acquired on 22 November 2000.

13. Tangible fixed assets

<i>The Group</i>	<i>Freehold land & buildings £'000</i>	<i>Short leasehold improve- ments £'000</i>	<i>Fixtures & fittings £'000</i>	<i>Plant & machinery £'000</i>	<i>Assets in the course of construction £'000</i>	<i>Total £'000</i>
Cost						
At 1 January 2001	3,673	2,424	2,390	29,015	25,468	62,970
Additions	2,414	38	588	11,442	17,742	32,224
Disposals	–	–	(24)	–	–	(24)
Transfers	576	2,704	(76)	18,181	(21,385)	–
Exchange difference	–	50	23	222	414	709
At 31 December 2001	<u>6,663</u>	<u>5,216</u>	<u>2,901</u>	<u>58,860</u>	<u>22,239</u>	<u>95,879</u>
Depreciation						
At 1 January 2001	259	467	923	13,473	–	15,122
Charge for the year	239	235	435	5,514	–	6,423
Disposals	–	–	(23)	–	–	(23)
Exchange difference	–	12	9	143	–	164
At 31 December 2001	<u>498</u>	<u>714</u>	<u>1,344</u>	<u>19,130</u>	<u>–</u>	<u>21,686</u>
Net book value						
At 31 December 2001	<u>6,165</u>	<u>4,502</u>	<u>1,557</u>	<u>39,730</u>	<u>22,239</u>	<u>74,193</u>
At 31 December 2000	<u>3,414</u>	<u>1,957</u>	<u>1,467</u>	<u>15,542</u>	<u>25,468</u>	<u>47,848</u>

The net book value of fixtures and fittings includes £45,320 (2000: £60,427) and the net book value of plant and machinery includes £12,228,915 (2000: £3,239,646) in respect of assets held under finance leases.

<i>The Company</i>	<i>Freehold land & buildings £'000</i>	<i>Short leasehold improve- ments £'000</i>	<i>Fixtures & fittings £'000</i>	<i>Plant & machinery £'000</i>	<i>Assets in the course of construction £'000</i>	<i>Total £'000</i>
Cost						
At 1 January 2001	–	–	–	–	–	–
Additions	–	–	138	–	–	138
At 31 December 2001	<u>–</u>	<u>–</u>	<u>138</u>	<u>–</u>	<u>–</u>	<u>138</u>
Depreciation						
At 1 January 2001	–	–	–	–	–	–
Charge for the year	–	–	14	–	–	14
At 31 December 2001	<u>–</u>	<u>–</u>	<u>14</u>	<u>–</u>	<u>–</u>	<u>14</u>
Net book value						
At 31 December 2001	<u>–</u>	<u>–</u>	<u>124</u>	<u>–</u>	<u>–</u>	<u>124</u>
At 31 December 2000	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>

14. Investments held as fixed assets

	<i>2001</i>
	<i>£'000</i>
Company	
Cost and net book value at 1 January 2001	42,340
Additions in the year	32,822
Adjustment due to deferred consideration	(50)
Cost and net book value at 31 December 2001	<u>75,112</u>

The investment in Wafer Technology International Limited and Wafer Technology Limited includes a deferred consideration element of 500,000 ordinary shares in IQE plc. The market share value at 31 December 2001 was £1.875 per share (2000: £1.975).

	<i>£'000</i>
The above is represented by investments in the following 100 per cent. owned subsidiaries:	
IQE Inc (formerly Quantum Epitaxial Designs Inc)	33,259
EPI Holdings Limited	600
Wafer Technology International Limited and Wafer Technology Limited	41,251
Shares in IQE plc held on behalf of Employee Benefit Trust	2
	<u>75,112</u>

During the year, the Company converted loan balances of £32,822,000 due from IQE Inc into a combination of preference and ordinary shares. The combination of preference and ordinary shares was as follows:

	<i>No. of</i>	<i>2001</i>
	<i>Shares</i>	<i>£'000</i>
Preference shares	5,000	17,729
Ordinary shares	100	15,093
	<u> </u>	<u>32,822</u>

Investment in own shares

The IQE plc Employee Benefit Trust was established to manage the IQE plc All Employee Share Ownership Plan (the Plan) for UK employees. The Trustees of the Plan purchase the Company's ordinary shares in the open market with financing provided by the employees. The Trust will contribute an equal number of matching shares at no cost to the employees and these will be generated from new issues made by the Company to the Trust. At 31 December 2001, the Company had issued 250,000 ordinary shares of 1p each to the Trust to establish the Plan and allocated 7,422 matching shares.

The cost of the shares expected to be awarded under the Plan is amortised evenly over the period from the original grant of the particular award to the time of vesting. This is normally a period of three years. Other administrative costs are charged to the profit and loss account as incurred.

14. Investments held as fixed assets (continued)

The Company has not paid a dividend in the year. The market value of IQE plc ordinary shares at 31 December 2001 was £1.875 per share.

<i>Group & Company</i>	<i>Shares held in trust No.</i>	<i>Nominal value £'000</i>	<i>Cost £'000</i>	<i>Amortisation £'000</i>	<i>Net book value £'000</i>
At 1 January 2001	—	—	—	—	—
Awarded by the Company	250,000	2	2	—	2
At 31 December 2001	<u>250,000</u>	<u>2</u>	<u>2</u>	<u>—</u>	<u>2</u>

The IQE plc General Employee Benefit Trust was established during the year to manage a Deferred Share Bonus Plan for UK and US employees. The Company will issue shares to the Trust, which in turn will grant those shares to employees in lieu of salary and bonus sacrifices.

The Deferred Share Bonus Plan had not commenced at 31 December 2001.

15. Stocks

	<i>2001</i>		<i>2000</i>	
	<i>The Group £'000</i>	<i>The Company £'000</i>	<i>The Group £'000</i>	<i>The Company £'000</i>
Raw materials and consumables	10,239	—	6,796	—
Work in progress and finished goods	2,038	—	1,089	—
	<u>12,277</u>	<u>—</u>	<u>7,885</u>	<u>—</u>

16. Debtors

	<i>2001</i>		<i>2000</i>	
	<i>The Group £'000</i>	<i>The Company £'000</i>	<i>The Group £'000</i>	<i>The Company £'000</i>
Trade debtors	6,138	—	8,419	—
Amounts owed by Group undertakings	—	42,049	—	41,387
Other debtors and prepayments	1,357	—	1,532	139
Corporation tax	—	—	360	122
	<u>7,495</u>	<u>42,049</u>	<u>10,311</u>	<u>41,648</u>

Amounts owed by Group undertakings are due after more than one year.

17. Creditors: Amounts falling due within one year

	<i>2001</i>		<i>2000</i>	
	<i>The Group £'000</i>	<i>The Company £'000</i>	<i>The Group £'000</i>	<i>The Company £'000</i>
Other loans	674	—	508	—
Trade creditors	6,674	—	13,446	—
Amounts due under hire purchase and finance leases	2,543	—	753	—
Other taxation and social security	316	—	460	131
Corporation tax	65	—	—	—
Accruals and deferred income	1,672	563	2,238	371
	<u>11,944</u>	<u>563</u>	<u>17,405</u>	<u>502</u>

18. Creditors: Amounts falling due after more than one year

	2001		2000	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Amounts due under hire purchase and finance leases	5,313	–	1,911	–
Other loans	2,898	–	3,527	–
Deferred income	174	–	69	–
	<u>8,385</u>	<u>–</u>	<u>5,507</u>	<u>–</u>

19. Borrowings

	<i>The Group</i>	
	2001 £'000	2000 £'000
Other loans		
Other loans are payable as follows:		
Within one year	674	508
Between one and two years	774	661
Between two and five years	827	1,295
Over five years	1,297	1,571
	<u>3,572</u>	<u>4,035</u>
Hire purchase and finance lease repayments		
Hire purchase and finance lease repayments are payable as follows:		
Within one year	2,543	753
Between one and two years	2,617	793
Between two and five years	2,696	1,118
	<u>7,856</u>	<u>2,664</u>

Other loans comprise a loan from 3i of £1,140,000 (2000: £1,235,000), a loan from the WDA of £1,466,792 (2000: £1,482,551), and a loan from Copelco of £965,698 (2000: £1,316,714).

Interest is charged on the 3i loan at a rate equal to the base rate and a margin of 2.5 per cent. per annum. The loan is secured by a fixed and floating charge over the assets of the Group and is repayable by 12 annual instalments of £95,000, which commenced on 13 August 2000.

Interest is charged on the WDA loan at a maximum rate of 8.5 per cent. per annum. The loan is secured on the Group's property and is repayable by 32 instalments, quarterly in arrears, commencing on 1 October 2001.

Interest is charged on the Copelco loan at 10.86 per cent. per annum. The loan is secured on equipment and is repayable by monthly instalments of \$63,924 per month with a final instalment in January 2003 of \$767,076.

Amounts due under hire purchase and finance leases are secured on the related assets.

20. Deferred taxation

	<i>At 1 January 2001 £'000</i>	<i>Credited to profit & loss account £'000</i>	<i>At 31 December 2001 £'000</i>
UK deferred tax	1,590	(373)	1,217

The amounts of deferred taxation provided and unprovided in the accounts are:

	<i>2001 £'000</i>	<i>Provided 2000 £'000</i>	<i>2001 £'000</i>	<i>Unprovided 2000 £'000</i>
The Group				
Capital allowances in excess of depreciation	2,238	1,736	190	(540)
Other timing differences	(1,021)	(146)	(627)	-
	<u>1,217</u>	<u>1,590</u>	<u>(437)</u>	<u>(540)</u>

21. Share capital

	<i>2001 Number of shares</i>	<i>2001 £'000</i>	<i>2000 Number of shares</i>	<i>2000 £'000</i>
Authorised				
Ordinary shares of 1p each	300,000,000	3,000	250,000,000	2,500
Allotted, called up and fully paid				
Ordinary shares of 1p each	182,383,507	1,824	163,250,498	1,633

The authorised share capital was increased to 300,000,000 1p ordinary shares on 10 December 2001.

4,428,620 1p ordinary shares were issued to Motorola during the year for cash at a premium of £6,820,075. Also during the year 13,152,247 1p ordinary shares were issued under an open offer and placing for cash at a total premium of £20,254,460. Options were exercised in the year at a premium of £108,763.

The movement in ordinary shares during the year was:

	<i>At 1 January 2001 No.</i>	<i>Shares issued No.</i>	<i>At 31 December 2001 No.</i>
Brought forward	163,250,498	-	163,250,498
Issued to Motorola	-	4,428,620	4,428,620
Open offer and placing	-	13,152,247	13,152,247
Options exercised	-	1,302,142	1,302,142
Other	-	250,000	250,000
	<u>163,250,498</u>	<u>19,133,009</u>	<u>182,383,507</u>

21. Share capital (continued)

Under the Company's share option scheme adopted on 26 May 2000, employees held options at 31 December 2001 for 8,387,295 unissued 1p ordinary shares as follows:

<i>Number of shares</i>	<i>Option price per shares</i> £	<i>Option period ending</i>
982,444	0.01 – 0.09	31 December 2007
1,090,190	0.01 – 0.09	31 December 2008
3,625,941	0.01 – 2.79	31 December 2009
33,060	0.01	31 December 2010
1,744,160	0.96 – 7.82	31 December 2010
911,500	1.22 – 6.33	31 December 2011

The movements on share options during the year were as follows:

	<i>Options</i> <i>No.</i>
At 1 January 2001	9,328,082
Granted	937,500
Exercised	(1,302,142)
Cancelled	<u>(576,145)</u>
At 31 December 2001	<u>8,387,295</u>

During the year the Company issued a share warrant. The warrant is capable of being exercised at any time during the period of five years from 10 December 2001.

The warrant is for up to 4,428,620 new ordinary shares, ranking *pari passu* with existing ordinary shares, and may be exercised in whole or in part, although if exercised in part it must be exercised in minimum tranches of 442,862 shares.

Upon the occurrence of certain adjustment events including any allotment or issue of equity shares or any sub-division, consolidation or redesignation of equity shares, the nominal value and subscription price of the warrant shares shall be adjusted in such manner as the auditors of the Company certify to be necessary in order that the subscription rights after such adjustment will carry the same entitlement to participate in the profits and assets of the Company as they did prior to such adjustments and the aggregate subscription price payable by the share warrant holder shall be as nearly as possible the same as it was prior to such adjustment.

The initial subscription price of the warrant shares is £1.55 per share. The applicable subscription price is capable of increase over the term of the warrant. Any adjustment to the prevailing subscription price will occur with effect from each anniversary of 10 December ("an anniversary date") and will depend upon the average mid market price for an ordinary share on the twenty trading days immediately preceding the relevant anniversary date ("the actual share price"). There will also be a maximum "cap" for the subscription price (the "maximum share price") equal to £1.55 increased on each anniversary date by a sum equal to five per cent of £1.55. If on any anniversary date the actual share price is below the prevailing subscription price there will be no increase to the prevailing subscription price. If the actual share price is higher than the prevailing subscription price, the subscription price will automatically increase to the lower of the actual share price and the maximum share price.

22. Reconciliation of operating (loss)/profit to net cash inflow from operating activities

	2001	2000
	£'000	£'000
Operating (loss)/profit	(6,061)	1,786
Depreciation charges	6,423	2,839
Amortisation of goodwill	1,835	209
Loss on sale of fixed assets	-	29
Movement in stocks	(4,392)	(4,013)
Movement in debtors	2,882	(1,157)
Movement in creditors	(7,857)	11,280
Government grant release	(504)	(24)
Government grant received	608	-
Net cash (outflow)/inflow from operating activities	<u>(7,066)</u>	<u>10,949</u>

23. Reconciliation of net cash flow to movement in net funds

	2001	2000
	£'000	£'000
Movement in cash in the year	(8,979)	31,395
Loan repayments	463	417
Loans received	1,863	24
Change in net funds resulting from cash flows	<u>(6,653)</u>	<u>31,836</u>
Inception of new finance leases	(7,055)	(2,590)
Net movement for year	(13,708)	29,246
Net funds at 1 January 2001	32,813	3,571
Exchange differences	-	(4)
Net funds at 31 December 2001	<u>19,105</u>	<u>32,813</u>

24. Analysis of net funds

	<i>At</i>		<i>Other</i>	<i>At</i>
	<i>1 January</i>	<i>Cash flow</i>	<i>non-cash</i>	<i>31 December</i>
	<i>2001</i>	<i>£'000</i>	<i>movements</i>	<i>2001</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Cash in hand and at bank	39,512	(8,979)	-	30,533
Debt due after one year	(3,527)	629	-	(2,898)
Debt due within one year	(508)	(166)	-	(674)
Finance leases	(2,664)	1,863	(7,055)	(7,856)
	<u>32,813</u>	<u>(6,653)</u>	<u>(7,055)</u>	<u>19,105</u>

25. Additional information on subsidiary undertakings

<i>Name</i>	<i>Class of capital</i>	<i>Portion of shares held</i>	<i>Activity</i>	<i>Country of incorporation</i>
IQE Inc	Common Stock of \$0.001	100%	Manufacture of advanced semiconductor materials	USA
EPI Holdings Limited	Ordinary shares of £1	100%	Holding Company	UK
IQE (Europe) Limited	Ordinary shares of £1	100%*	Manufacture of advanced semiconductor materials	UK
Epitaxial Products Inc. Wafer Technology International Limited	Common stock of \$10	100%	Sales office	USA
Wafer Technology Limited	Ordinary shares of £1	100%	Holding Company	UK
Wafer Technology Limited	Ordinary shares of £1	100%*	Manufacture of semiconductor compounds and ultra high purity materials	UK
IQE Silicon Compounds Limited	Ordinary shares of £1	100%	Manufacture of silicon epitaxy	UK

The proportion of voting rights of subsidiaries held by the Group is the same as the proportion of shares held.

* Indirect holdings

26. Financial instruments

The Group's policies with regard to derivatives and financial instruments are set out in the Financial Review and the accounting policies.

The Group does not trade in financial instruments.

The Group enters into forward currency contracts with its bankers in order to fix exchange rate risks associated with currency shortfalls over a rolling twelve month period in respect of Dollar and Yen inflows (and to a lesser extent other currencies). The Group had entered into the following forward contracts at 31 December 2001:

	<i>Amount</i>	<i>Period</i>	<i>Rate</i>
Bank to buy	\$3,350,000	Jan/Nov 2002	\$1.4027/\$1.4840

There were no material gains or losses brought forward or carried forward at the year end. Gains and losses are recognised in the year and are disclosed in note 4.

The currency profile of the Group's trade debtors and trade creditors is as follows:

	<i>31 December 2001</i>		<i>31 December 2000</i>	
	<i>Trade debtors</i>	<i>Trade creditors</i>	<i>Trade debtors</i>	<i>Trade creditors</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Sterling	54	1,691	641	1,906
US\$	5,720	4,791	6,968	5,975
Yen	236	64	175	291
Other	128	128	635	5,274
Total	<u>6,138</u>	<u>6,674</u>	<u>8,419</u>	<u>13,446</u>

26. Financial instruments (continued)

The interest rate profile of the Group's financial assets and liabilities is as follows:

	<i>Assets</i> <i>floating rate</i> £'000	<i>Assets</i> <i>fixed rate</i> £'000	<i>Liabilities</i> <i>floating rate</i> £'000	<i>Liabilities</i> <i>fixed rate</i> £'000	<i>Total</i> £'000
At 31 December 2001					
Sterling	2,212	27,500	1,140	9,323	19,249
US\$	716	-	-	966	(250)
Yen	100	-	-	-	100
Other	5	-	-	-	5
	<u>3,033</u>	<u>27,500</u>	<u>1,140</u>	<u>10,289</u>	<u>19,104</u>
Comprising					
Cash at bank	3,033	27,500	-	-	30,533
Other loans	-	-	1,140	10,289	11,429
Total	<u>3,033</u>	<u>27,500</u>	<u>1,140</u>	<u>10,289</u>	<u>19,104</u>
At 31 December 2000					
Sterling	3,770	33,500	1,235	4,147	31,888
US\$	1,762	295	-	1,317	740
Yen	113	-	-	-	113
Other	72	-	-	-	72
	<u>5,717</u>	<u>33,795</u>	<u>1,235</u>	<u>5,464</u>	<u>32,813</u>
Comprising					
Cash at bank	5,717	33,795	-	-	39,512
Other loans	-	-	1,235	5,464	6,699
Total	<u>5,717</u>	<u>33,795</u>	<u>1,235</u>	<u>5,464</u>	<u>32,813</u>

The weighted average interest rate for the fixed rate liabilities is 9.61 per cent. and the weighted average period for which interest rates are fixed is 3.5 years. Further details of the financial liabilities at 31 December 2001 are shown in notes 18 and 19.

There is no significant difference between the book value and the fair value of the Group's financial assets and liabilities.

27. Related party transactions

The Group incurred professional fees during the year of £16,957 (2000: £109,798) payable to Gambit Corporate Finance.

Dr Godfrey Ainsworth, who is a Director of IQE plc, is a partner in Gambit Corporate Finance.

28. Operating lease commitments

The Group was committed at 31 December 2001 to making the following payments during the next year in respect of operating leases:

	<i>Land & buildings</i>		<i>Plant & machinery</i>	
	<i>2001</i>	<i>2000</i>	<i>2001</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Annual commitments which expire:				
Within one year	4	28	2	7
In the second to fifth year	1,471	373	628	657
	<u>1,475</u>	<u>401</u>	<u>630</u>	<u>664</u>

29. Capital commitments

The Group had the following capital commitments as at 31 December 2001:

	<i>2001</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>
Authorised and contracted for	<u>1,119</u>	<u>16,690</u>

The Group has entered into a supply agreement allowing it to purchase reactors at a discount from list price. Under this agreement, at 31 December 2001 the Group has agreed to purchase a further nine reactors at a contracted price of £10,880,000. The Group may be liable to repay the discount from list price it received on previous reactors purchased under this agreement should it not comply with its contracted purchase commitment. The total discount received at 31 December 2001 was £1,547,000.

30. Contingent liability

A claim has been made against the Group alleging breaches of a licence agreement. The Group is vigorously defending this action and at this stage the outcome is uncertain. Due to the uncertainty of the outcome it is not possible to conclude as to whether a probable transfer of economic benefits will be required to settle any obligation nor can a reliable estimate be made of the amount of such an obligation should such an obligation result from the claim. Accordingly, under the provisions of Financial Reporting Standard Number 12, no provision for any potential future liability that may arise from the claim has been made in these accounts.

As discussed in note 11, the Group has expensed in the year legal fees totalling £759,046 in respect of defending this claim. In the view of the Directors, the Group may incur further legal costs of up to £1,000,000 in the year ended 31 December 2002 should this legal action continue.

31. Post balance sheet event

Following the year end 1,972,837 1p ordinary shares were issued for cash at a premium of £3,057,897.

APPENDIX III

IQE PLC ANNUAL REPORT AND FINANCIAL STATEMENTS 2000

Directors' report

The Directors present their annual report and the audited financial statements for the year ended 31 December 2000.

Activities

The principal activity of the Group during the year was the manufacture of advanced semiconductor materials.

Review of developments and future prospects

The Group's activities and future prospects are detailed in the chairman's statement, the operations report and the financial review and should be read as part of this report.

Dividends

The Directors do not recommend the payment of a dividend.

Directors

The Directors in office during the year and their beneficial interests in the Company's issued ordinary share capital were as follows:

	<i>Ordinary shares of 1p each 2000 No.</i>	<i>Ordinary shares of 10p each 1999 No.</i>
Dr A W Nelson	26,057,970	2,998,590
Dr M D Scott	26,057,970	2,998,590
T L Hierl	16,489,230	1,902,228
S T Massie	108,620	20,568
M S M Lamb (appointed 22 November 2000)	3,341,250	See below
Dr G H H Ainsworth	5,410	541
G Bressner	-	-

S Byars was appointed a Director on 1 January 2001 and R J G Clarke was appointed a Director on 8 March 2001.

On appointment M S M Lamb held 3,341,250 1p ordinary shares in the Company.

S T Massie held options for 1,258,300 unissued ordinary 1p shares at 31 December 2000 (1999 – 125,830 options for unissued 10p ordinary shares) and Dr G H H Ainsworth held options for 75,000 unissued ordinary 1p shares at 31 December 2000 (1999 – nil). No other Director held share options at 31 December 2000. Further details are given in note 5 to the accounts.

Research & Development

During the year the Group incurred costs in respect of research and development of £1,870,000 (1999 – £1,302,000). All research and development expenditure is charged to the profit and loss account in the period it is incurred.

Payment terms

During the year ended 31 December 2000, it was the Group's policy to follow the "Better Payment Practice Code". The Group agrees payment terms in advance with individual suppliers and abides by the terms. The Group's average number of days purchases outstanding in respect of trade creditors at 31 December 2000 was 45 days (1999 – 38 days).

Employment policies

It is the policy of the Group that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

The Group remains committed to its policy of keeping employees fully informed about all matters, which concern them. Formal communications are used to achieve this objective, including notice board announcements and newsletters. Employee involvement takes different forms in each subsidiary, ranging from formal committee meetings to less formal discussion groups.

Schemes have been implemented to ensure that employees are properly rewarded for performance and loyalty.

Going concern

The Directors, after making enquiries, have deliberated on the future prospects of the Group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these accounts.

Euro

Directors and senior staff of the Group have continued to review the business in the light of the new European currency. The Group will continue to experience Sterling/Euro exchange rate fluctuations with customers and suppliers whilst the UK remains outside the Euro.

Auditors

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

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 the Group as at the end of the financial year and of the profit or loss of the Group 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;
- prepare the financial statements on the ongoing basis unless it is inappropriate to presume that the Company 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 the Group and enable them to ensure that the financial statements comply with the Companies Act. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board of Directors
and signed on behalf of the Board

Leslie Coventry

Secretary

20 March 2001

Report of the remuneration committee

The Committee

The Remuneration Committee consists of the Non-Executive Directors and is chaired by G Bressner. The Committee complies with Schedule A of the Best Practice Provisions annexed to the Listing Rules of the London Stock Exchange.

The Committee is responsible for the determination of remuneration policy for the Executive Directors. It has access to and takes professional advice.

The fees of the Non-Executive Directors are determined by the Board.

Policy

In establishing its policy, the Committee has given full consideration to Schedule B of the Best Practice Provisions annexed to the Listing Rules of the London Stock Exchange. The basic objective of the policy is that Executive Directors should receive remuneration which is appropriate to their position of responsibility, and which will attract, motivate and retain Executives of the necessary calibre. Remuneration of the Executive Directors consists of annual salary, bonus, taxable benefits in kind and pension contributions.

Basic salary & performance bonus

There is an annual review at which the Committee approves the basic salary for each Executive Director. Details of Directors' salaries, benefits, bonuses and share options can be found on the following page.

Benefits

Benefits for Executive Directors comprise fully expensed Company cars, medical health insurance and daily allowances for domestic and foreign business travel.

Share options

Executive Directors hold share options under The IQE plc Share Option Scheme. The Committee grants options to Executive Directors and other employees to encourage long term commitment to the Company.

Service contracts

The Executive Directors have entered into service agreements with the Company which are terminable by either party on twelve months' notice. Each of the agreements contains post termination restrictive covenants which place limitations of solicitation of customers and employees of the Group and on acting in competition with the business of the Group.

Pensions

The Executive Directors are members of the Group pension schemes. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service.

There have been no changes in the terms of Directors' pension entitlements during the year. There are no unfunded pension promises or similar arrangements for Directors.

Remuneration

	Salary 2000 £'000	Fees 2000 £'000	Bonus 2000 £'000	Benefits 2000 £'000	Total 2000 £'000	Total 1999 £'000	Pension Contribution	
							2000	1999
							£'000	£'000
Executive Directors								
Dr A W Nelson	104	–	59*	7	170	87	7	7
Dr M D Scott	73	–	28*	12	113	85	7	7
T L Hierl	117	–	–	–	117	118	–	–
S T Massie	102	–	–	–	102	84	–	–
M S M Lamb (appointed 22 November 2000)	4	–	–	1	5	–	1	–
Non-Executive Directors								
Dr G H H Ainsworth	–	10	–	–	10	9	–	–
G Bressner	–	–	–	–	–	–	–	–
	<u>400</u>	<u>10</u>	<u>87</u>	<u>20</u>	<u>517</u>	<u>374</u>	<u>15</u>	<u>14</u>

Dr Nelson's salary includes a car allowance of £24,500 (1999 – £ nil) in lieu of a fully expensed company car.

Share options

At 31 December 2000 the following Directors' share options were in existence:

Director	1 January 2000	Granted	10 for 1 share split	No of options 31 December 2000	Exercise price	Date from which exercisable	Expiry date
S T Massie	33,610	–	302,490	336,100	\$0.130	24.10.98 to 24.10.01	24.10.07
S T Massie	67,220	–	604,980	672,200	\$0.130	14.12.98 to 14.12.02	14.12.08
S T Massie	25,000	–	225,000	250,000	\$1.410	5.11.02	5.11.09
Dr G H H Ainsworth	–	7,500	67,500	75,000	£4.13	16.5.03 to 16.5.10	16.5.10

The above options are granted under a share option scheme adopted on 26 May 1999.

No other Director held share options at any point during the year.

No Directors exercised any options during the year.

*Includes adjustment in respect of prior years.

Corporate governance report

Corporate governance

The Combined Code on Corporate Governance, issued by the UK Listing Authority, brings together the recommendations of the Cadbury, Greenbury, Hampel and Turnbull committees and establishes Principles of Good Governance and the Code of Best Practice for listed companies. The paragraphs below, together with the Report of the Remuneration Committee, describe how these principles are applied within the Group.

The Board & its committees

The Board comprises seven Executive and two Non-Executive Directors. In the opinion of the Board, the two Non-Executive Directors, Dr G H H Ainsworth and Mr G Bressner, are independent of management and, notwithstanding Note 27 to the Accounts, free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

Dr Nelson currently acts as Chairman and Chief Executive Officer of the Company and the Board believes that this is appropriate at the present time given that there is a Non-Executive element to the Board. Dr Ainsworth is the recognised senior independent Non-Executive Director to whom concerns can be conveyed as required by the Code of Best Practice.

The Board normally meets at least four times a year, in advance of its quarterly reporting dates and where possible at least one meeting is held at the site of each of the Group's operating subsidiaries. A week before the Board meeting the Directors are supplied with comprehensive briefing papers on financial and commercial matters of a standard sufficient to enable the Board to discharge its duties.

Under the Company's Articles of Association each of the Directors is required ordinarily to retire by rotation once every three years.

Specific responsibilities have been delegated to the following Board Committees:

Audit Committee: The Audit Committee comprises the Non-Executive Directors, Dr G H H Ainsworth and G Bressner, under the chairmanship of Dr Ainsworth. The Audit Committee meets at least four times a year and more frequently if required. The Audit Committee has specific written terms of reference which deal with its authority and duties. The Group's external auditors normally attend the meetings by invitation. The Committee receives and considers reports relating to the monitoring of the adequacy of the Group's internal controls, the suitability of its accounting policies and financial reporting, the audit arrangements and matters arising from the external auditors work. Where appropriate, the Committee makes recommendations to the Board on these matters. Although there is currently no internal audit function, the Audit Committee regularly reviews the need to implement one.

Remuneration Committee: The Remuneration Committee comprises the Non-Executive Directors, Dr G H H Ainsworth and G Bressner, under the chairmanship of G Bressner, and meets periodically as required. The Remuneration Committee has specific written terms of reference which deal with its authority and duties. It is responsible for providing advice and recommendations to the Board on Executive Directors' remuneration, and the terms of service and setting the remuneration of the Executive Directors.

The Board has not established a Nomination Committee as the Board considers itself to be small. However, the Remuneration Committee is responsible for Nominations.

Shareholder communications

The Chief Executive, supported by senior management, regularly meets with, and makes presentations to major institutional shareholders. Institutional shareholders are also invited to visit the Group's operating subsidiaries. The Board is aware that not all of the Company's private investors have access to market information. Shareholders are sent copies of annual and interim reports and, when appropriate, circulars. Notice is given in the annual report and accounts of the date and location of the Annual General Meeting at which shareholders are invited to ask questions concerning the Company's business.

The Company has a web site on which it publishes quarterly financial data and other significant announcements as well as providing details on the Group's facilities and products. The web site address is shown on the back cover of the annual report and accounts.

Internal control

The Board seeks to maintain a sound system of internal control to safeguard shareholders' investment and the Group's assets.

The Board attaches considerable importance to the Group's system of internal control and risk management and acknowledges that it is responsible for the system and for reviewing its effectiveness. Such a system can only provide reasonable assurance and not absolute assurance against material misstatement or loss, as it is designed to manage rather than to eliminate risk.

The Directors have reviewed the effectiveness of the system of financial control for the year and have taken account of material developments up to the date of signing and rely on the following established framework.

The Board undertakes a series of reviews and regular meetings with the Audit Committee and external auditors to ensure that an ongoing process for identifying, evaluating and managing significant risks faced by the Group is in place. These risks include credit risk, market risk, operational risk and legal and compliance risk. This system has been in place since prior to the flotation on the London Stock Exchange on 19 May 2000 and up to the date of approval of the annual report and accounts. It is regularly reviewed by the Board and is in accordance with the Turnbull guidance.

The reviews cover all controls, including financial, operational and compliance controls and risk management.

Control procedures: The key procedures that the Directors have established with a view to providing effective financial control are as follows:

The Board considers the Group's strategic plan annually and within the framework of the plan, approves an annual budget. Operational and financial performance are monitored monthly against this budget and explanations are obtained for significant variances.

Monthly accounts which include key performance indicators are produced and circulated and reviewed against forecast. Results are analysed and discussed at frequent Board meetings.

Regular re-forecasting is carried out and reviewed by the Board.

All major investments, including acquisitions and major items of capital expenditure are subject to detailed financial review and authorisation by the Board.

There is no internal audit function in place, although annual reviews are carried out to assess the need for one.

A formal framework of appropriate responsibility and authorisation is in place and is regularly reviewed for compliance and completeness.

The Directors confirm that they have carried out a review of the effectiveness of internal control as it operated during the year.

Risk management: Significant areas of risk have been identified by the Directors and senior managers of the Group and have been discussed and evaluated. Review and implementation of procedures to measure and reduce the risk areas are given a high priority by the Board and the Audit Committee and reviews are regularly carried out.

Compliance

Prior to the Company's listing on the London Stock Exchange on 19 May 2000, the Board reviewed those areas of Corporate Governance where the Company did not fully comply with the recommendations of the Combined Code because the necessary steps needed further consideration. The Board is satisfied that the Company complied throughout the year, and during the subsequent period up to and including the date of this report, with the Code provisions set out in Section 1 of the Combined Code on Corporate Governance issued by the Financial Services Authority except as set out below:

Combined code provision A.1.6

Training: The Company does not have a formal training programme for Directors either on appointment or subsequently, although all Directors are encouraged to obtain such training as they consider necessary at the expense of the Company.

Combined code provision A.2.1

Chairman and CEO: At the present stage of the Company's development, the Board considers it appropriate to combine the positions of Chairman and CEO.

However, as explained in the Listing Particulars issued by the Company at the time of its admission to the Official List of the London Stock Exchange, the Company is actively seeking to appoint an additional independent Non-Executive Director who would act as Chairman.

Combined code provision A.3.1

Board composition: Non-Executive Directors consists of less than one third of the Board. However, as stated above the Board is seeking to appoint a further Non-Executive Director.

Combined code provision D.3.1

Audit committee: The Audit Committee comprises the two Non-Executive Directors, which is less than the three prescribed by the Combined Code. However, as noted above, the Company is currently seeking to appoint an additional independent Non-Executive Director who would serve on the Committee.

Auditors' report to the members of IQE

We have audited the financial statements which have been prepared under the accounting policies set out on pages 139 and 140.

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the annual report, including preparation of the financial statements, which are required to be prepared in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the UK Listing Authority, 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 Group 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 or the Listing Rules regarding Directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Group's compliance with the seven provisions of the Combined Code specified for our review by the UK Listing Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the Company and the Group as at 31 December 2000 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Chartered Accountants and Registered Auditors
Blenheim House
Fitzalan Court
Newport Road
Cardiff
CF24 0TS

20 March 2001

Consolidated profit and loss account

Year ended 31 December 2000

	Note	2000 £'000	1999 £'000
Turnover	2		
Continuing operations		29,128	19,043
Acquisitions		989	–
Total turnover		<u>30,117</u>	<u>19,043</u>
Cost of sales	3	(19,785)	(12,558)
Gross profit	3	<u>10,332</u>	<u>6,485</u>
Operating expenses before goodwill and exceptional items:			
Distribution expenses	3	(2,052)	(1,414)
Administrative expenses:			
Research and development	3	(1,870)	(1,302)
Other administrative expenses	3	(4,415)	(2,315)
		<u>(8,337)</u>	<u>(5,031)</u>
Operating profit before goodwill and exceptional items		<u>1,995</u>	<u>1,454</u>
Other operating expenses:			
Goodwill amortisation	3	(209)	–
Exceptional items	3, 11	–	(171)
Operating profit	4		
Continuing operations		1,503	1,283
Acquisitions		283	–
Total operating profit		<u>1,786</u>	<u>1,283</u>
Other interest receivable and similar income		1,630	327
Interest payable and similar charges	6, 11	(422)	(917)
Profit on ordinary activities before taxation		<u>2,994</u>	<u>693</u>
Tax on profit on ordinary activities	7	(1,184)	149
Profit for the financial year		<u>1,810</u>	<u>842</u>
Dividends	8	–	–
Retained profit for the financial year		<u>1,810</u>	<u>842</u>
Earnings per ordinary share	10	1.24p	0.63p
Diluted earnings per ordinary share	10	1.18p	0.59p

Consolidated statement of total recognised gains and losses

Year ended 31 December 2000

	2000 £'000	1999 £'000
Profit for the financial year	1,810	842
Currency translation differences on foreign currency net investments	680	96
Total recognised gains and losses relating to the year	<u>2,490</u>	<u>938</u>

Combined statement of movements in shareholders' funds and statement of movements on reserves

	<i>Issued</i>		<i>Shares</i>		<i>Profit</i>	<i>Exchange</i>	<i>Total</i>	<i>Total</i>
	<i>Share</i>	<i>Share</i>	<i>to be</i>	<i>Merger</i>	<i>and loss</i>	<i>rate</i>	<i>2000</i>	<i>1999</i>
	<i>Capital</i>	<i>premium</i>	<i>issued</i>	<i>reserve</i>	<i>account</i>	<i>reserve</i>	<i>£'000</i>	<i>£'000</i>
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
The Group								
Balance at 1 January 2000	1,359	18,907		(605)	1,281	8	20,950	631
Shares issued	274	94,084	-	-	-	-	94,358	20,440
Cost of shares issued	-	(1,189)	-	-	-	-	(1,189)	(1,214)
Adjustment in respect of further share capital issued by subsidiary	-	-	-	-	-	-	-	155
Deferred consideration on acquisition of subsidiary	-	-	988	-	-	-	988	-
Foreign exchange translation differences	-	-	-	-	-	680	680	96
Profit attributable to members of the Group	-	-	-	-	1,810	-	1,810	842
Balance at 31 December 2000	<u>1,633</u>	<u>111,802</u>	<u>988</u>	<u>(605)</u>	<u>3,091</u>	<u>688</u>	<u>117,597</u>	<u>20,950</u>
The Company								
Balance at 1 January 2000	1,359	18,907		-	692	-	20,958	-
Shares issued	274	94,084	-	-	-	-	94,358	21,480
Cost of shares issued	-	(1,189)	-	-	-	-	(1,189)	(1,214)
Deferred consideration on acquisition of subsidiary	-	-	988	-	-	-	988	-
Profit attributable to members of the Company	-	-	-	-	3,509	-	3,509	692
Balance at 31 December 2000	<u>1,633</u>	<u>111,802</u>	<u>988</u>	<u>-</u>	<u>4,201</u>	<u>-</u>	<u>118,624</u>	<u>20,958</u>

Consolidated balance sheet

31 December 2000

	Note	2000 £'000	1999 £'000
Fixed assets			
Intangible assets	12	36,543	–
Tangible assets	13	47,848	11,483
		<u>84,391</u>	<u>11,483</u>
Current assets			
Stocks	15	7,885	2,573
Debtors	16	10,311	7,743
Cash at bank		39,512	8,117
		<u>57,708</u>	<u>18,433</u>
Creditors: Amounts falling due within one year	17	<u>(17,405)</u>	<u>(4,518)</u>
Net current assets		<u>40,303</u>	<u>13,915</u>
Total assets less current liabilities		<u>124,694</u>	<u>25,398</u>
Creditors: Amounts falling due after more than one year	18	(5,507)	(4,117)
Provision for liabilities and charges	20	(1,590)	(331)
Total assets less liabilities		<u>117,597</u>	<u>20,950</u>
Capital and reserves			
Called-up share capital	21	1,633	1,359
Merger reserve		(605)	(605)
Share premium		111,802	18,907
Shares to be issued		988	–
Profit and loss account		3,091	1,281
Exchange rate reserve		688	8
Total equity shareholders' funds		<u>117,597</u>	<u>20,950</u>

These financial statements were approved by the Board of Directors on 20 March 2001.

Signed on behalf of the Board of Directors

Dr A W Nelson

R J G Clarke

Parent company balance sheet

31 December 2000

	Note	2000 £'000	1999 £'000
Fixed Assets			
Investments	14	<u>42,340</u>	<u>1,039</u>
Current assets			
Debtors	16	41,648	13,197
Cash at bank and in hand		<u>35,138</u>	<u>6,871</u>
		76,786	20,068
Creditors: Amounts falling due within one year	17	<u>(502)</u>	<u>(149)</u>
Net current assets		<u>76,284</u>	<u>19,919</u>
Total assets less current liabilities		<u>118,624</u>	<u>20,958</u>
Capital and reserves			
Called-up share capital	21	1,633	1,359
Share premium account		111,802	18,907
Shares to be issued		988	—
Profit and loss account		<u>4,201</u>	<u>692</u>
Total equity shareholders' funds		<u>118,624</u>	<u>20,958</u>

These financial statements were approved by the Board of Directors on 20 March 2001.

Signed on behalf of the Board of Directors

Dr A W Nelson

R J G Clarke

Consolidated cash flow statement

Year ended 31 December 2000

	Note	2000 £'000	1999 £'000
Net cash inflow/(outflow) from operating activities	22	<u>10,949</u>	<u>(2,877)</u>
Returns on investments and servicing of finance			
Interest received		1,630	327
Interest paid		<u>(422)</u>	<u>(917)</u>
Net cash inflow/(outflow) from returns on investments and servicing of finance		<u>1,208</u>	<u>(590)</u>
Taxation			
United Kingdom corporation tax paid		<u>(144)</u>	<u>(282)</u>
Capital expenditure			
Payments to acquire tangible fixed assets		(33,566)	(9,540)
Proceeds from sale of tangible fixed assets		<u>-</u>	<u>2,127</u>
Net cash outflow from capital expenditure		<u>(33,566)</u>	<u>(7,413)</u>
Acquisitions and disposals			
Payments to acquire investments in subsidiaries	12	(14,501)	-
Net cash acquired with subsidiary	12	<u>533</u>	<u>-</u>
Net cash outflow from acquisitions and disposals		<u>(13,968)</u>	<u>-</u>
Financing			
Issue of ordinary share capital		67,357	19,381
Advances of new loans		-	3,032
Repayment of loans		<u>(441)</u>	<u>(3,475)</u>
Net cash inflow from financing		<u>66,916</u>	<u>18,938</u>
Increase in cash	23	<u>31,395</u>	<u>7,776</u>

Notes to the accounts

Year ended 31 December 2000

1. Accounting policies

The financial statements are prepared in accordance with applicable accounting standards under UK GAAP. The particular accounting policies adopted are described below.

Accounting convention

The financial information is prepared under the historical cost convention and in accordance with applicable accounting standards, which have been applied on a consistent basis during the year under review.

Basis of consolidation

The financial information consolidates the financial statements of the Company and all of its subsidiaries.

The acquisition of EPI Holdings Limited and IQE Inc (formerly Quantum Epitaxial Designs, Inc) by IQE plc, a new holding company established for that purpose, on 16 May 1999 has been accounted for under merger accounting, whereby the financial information is disclosed as if the companies had always been part of the Group.

The acquisition of IQE Europe Limited (formerly known as Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc by EPI Holdings Limited, a new company established for that purpose, on 27 March 1996 and the acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited on 22 November 2000 have been accounted for under acquisition accounting, whereby these companies became part of the Group on the date of acquisition.

Turnover

Turnover represents amounts invoiced, exclusive of value added taxation.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use, as defined by Financial Reporting Standard Number 15.

Depreciation has been calculated so as to write down the cost of assets to their residual values over the following estimated useful economic lives:

Freehold buildings	25 years
Short leasehold improvements	5 – 27 years
Plant and machinery	5 – 7 years
Fixtures and fittings	4 – 5 years
Motor vehicles	4 years

No depreciation is provided on land or assets in the course of construction.

Goodwill

On the acquisition of a business, fair values are attributed to the Group's share of the net tangible assets acquired. Where the cost of acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill. The goodwill arising on the acquisition of Epitaxial Products International Limited and its subsidiary Epitaxial Products Inc. by EPI Holdings Limited was written off directly to reserves in the year of acquisition. Goodwill of £284,000 remains eliminated in the profit and loss reserve and will be charged to the profit and loss account on the subsequent disposal of IQE (Europe) Limited (formerly Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc. Following the issue of Financial Reporting Standard 10, goodwill arising in accounting periods ending on or after 23 December 1998 must be classified as an asset on the balance sheet and amortised over its useful life. The goodwill arising on the acquisition of Wafer Technology International Limited and its subsidiary Wafer

Technology Limited has been capitalised and is being amortised over its useful life which is considered by the Directors to be 20 years.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Research and development

Research and development expenditure is fully written off when incurred.

Foreign currencies

Transactions in foreign currencies during the year are recorded in sterling at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. All exchange differences are taken to the profit and loss account.

The balance sheets of IQE Inc. (formerly Quantum Epitaxial Designs, Inc) are translated into sterling at the closing rates of exchange for each year whilst the profit and loss accounts are translated into sterling at the average rates of exchange for the year. The resulting translation differences are taken direct to reserves.

Pension costs

The Group operates defined contribution pension schemes. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the schemes.

Deferred taxation

Deferred taxation is provided on timing differences, arising from the different treatment of items for accounting and taxation purposes, which are expected to reverse in the future without replacement, calculated at the rates at which it is expected that tax will arise.

Government grants

Government grants receivable in connection with expenditure on tangible fixed assets are accounted for as deferred income which is credited to the profit and loss account by instalments over the expected useful economic life of the related assets on a basis consistent with the depreciation policy.

Revenue grants for the reimbursement of costs incurred are deducted from the costs to which they related, in the year in which the costs are incurred.

Leases

Assets held under finance leases and hire purchase contracts are capitalised at their fair value on the inception of the leases and depreciated over the shorter of the period of the lease and the estimated useful economic lives of the assets. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding and are charged to the profit and loss account.

Operating lease rentals are charged to profit and loss in equal annual amounts over the lease term.

Financial instruments

The only derivative instruments utilised by the Group are forward exchange contracts. The Group does not enter into speculative derivative contracts. Forward exchange contracts are used for hedging purposes to alter the risk profile of an existing underlying exposure of the Group in line with the Group's risk management policies.

2. Segmental analysis

Analyses of geographical location and class of business for turnover and analysis of class of business for profit on ordinary activities before taxation have not been given as, in the opinion of the Directors, the disclosure of this information would be seriously prejudicial to the interests of the Group (Schedule 4, Part III, Section 55(5) Companies Act 1985 and Statement of Standard Accounting Practice Number 25).

3. Analyses of continuing and acquired operations

			2000 £'000	1999 £'000
	<i>Continuing</i>	<i>Acquisitions</i>	<i>Total</i>	<i>Continuing</i>
Turnover	29,128	989	30,117	19,043
Cost of sales	(19,230)	(555)	(19,785)	(12,558)
Gross profit	9,898	434	10,332	6,485
Operating expenses				
Distribution expenses	2,027	25	2,052	1,414
Research and development	1,848	22	1,870	1,302
Other administrative expenses	4,311	104	4,415	2,315
Goodwill amortisation	209	-	209	-
Exceptional items	-	-	-	171
	<u>8,395</u>	<u>151</u>	<u>8,546</u>	<u>5,202</u>
Operating profit	<u>1,503</u>	<u>283</u>	<u>1,786</u>	<u>1,283</u>

4. Operating profit

	2000 £'000	1999 £'000
Operating profit is after charging/(crediting):		
Depreciation of tangible fixed assets:		
- Owned assets	2,616	1,479
- Leased assets	223	30
Amortisation of goodwill	209	-
Auditors' remuneration		
- Audit fees	112	45
- Company audit fees	3	3
- Other services	358	346
Operating lease rentals		
- Plant and machinery	423	71
- Other	210	133
Exchange losses/(gains)	<u>51</u>	<u>(74)</u>

5. Information regarding directors and employees

Directors' emoluments:

	Salary	Fees	Bonus	Benefits	Total	Total	Pension	
	2000	2000	2000	2000	2000	1999	contributions	
	£'000	£'000	£'000	£'000	£'000	£'000	2000	1999
Executive Directors								
Dr A W Nelson	104	–	59*	7	170	87	7	7
Dr M D Scott	73	–	28*	12	113	85	7	7
T L Hierl	117	–	–	–	117	118	–	–
S T Massie	102	–	–	–	102	84	–	–
M S M Lamb (appointed 22 November 2000)	4	–	–	1	5	–	1	–
Non-Executive Directors								
Dr G H H Ainsworth	–	10	–	–	10	9	–	–
G Bressner	–	–	–	–	–	–	–	–
	<u>400</u>	<u>10</u>	<u>87</u>	<u>20</u>	<u>517</u>	<u>383</u>	<u>15</u>	<u>14</u>

Dr Nelson's salary includes a car allowance of £24,500 (1999 – £ nil) in lieu of a fully expensed company car.

Directors' share options:

Director	1 January	Granted	10 for 1	Exercised	Lapsed	31 December
	2000		share split			2000
S T Massie	33,610	–	302,490	–	–	336,100
S T Massie	67,220	–	604,980	–	–	672,200
S T Massie	25,000	–	225,000	–	–	250,000
Dr G H H Ainsworth	–	7,500	67,500	–	–	75,000

Directors' share options:

Director	31 December	Exercise	Date from	Expiry
	2000		Price	
			Exercisable	Date
S T Massie	336,100	\$0.1302	24.10.98 to 24.10.01	24.10.07
S T Massie	672,200	\$0.130	14.12.99 to 14.12.02	14.10.08
S T Massie	250,000	£1.410	05.11.02	05.11.09
Dr G H H Ainsworth	75,000	£4.13	16.05.03 to 16.05.10	16.05.10

The above options are granted under a share option scheme adopted on 26 May 1999.

On 11 September 2000 the Company carried out a 10 for 1 share split.

*Includes adjustment in respect of prior years.

5. Information regarding directors and employees (continued)

	2000 £'000	1999 £'000
Employee costs		
Wages and salaries	7,623	5,104
Social security costs	1,061	813
Other pension costs	243	175
	<u>8,927</u>	<u>6,092</u>
	2000 No.	1999 No.
The average number of employees, including Directors, during the year was as follows:	<u>322</u>	<u>197</u>

6. Interest payable and similar charges

	2000 £'000	1999 £'000
Bank loans	–	107
Other loans	415	803
Finance lease interest	7	7
	<u>422</u>	<u>917</u>

7. Taxation

	2000 £'000	1999 £'000
United Kingdom corporation tax at 30% (1999 – 30%)	49	(133)
United Kingdom deferred tax	1,141	398
Overseas corporation tax	–	(407)
Adjustments in respect of prior years provision:		
United Kingdom corporation tax	(124)	120
United Kingdom deferred tax	118	(127)
	<u>1,184</u>	<u>(149)</u>

The high taxation charge is due to tax losses available for carry forward within the Group which cannot be recognised as deferred tax assets under UK GAAP.

8. Dividends

No dividend has been paid or proposed in 2000 (1999 – £nil).

9. Profit of parent company

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent company is not presented as part of these accounts. The parent company's profit for the financial year amounted to £3,509,000 (1999 – £692,000).

10. Earnings per ordinary share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares during the year. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares in issue on the assumption of conversion of all dilutive potential ordinary shares.

In September 2000 the Company carried out a 10 for 1 share split. In accordance with the provisions of FRS14 "Earnings per share", for the purpose of calculating earnings per share, the number of ordinary shares is adjusted as if the share split had taken place at 1 January 1999.

	<i>2000</i>	<i>1999</i>
	<i>£'000</i>	<i>£'000</i>
Basic and diluted earnings attributable to ordinary shareholders	<u>1,810</u>	<u>842</u>
	<i>No.</i>	<i>No.</i>
Weighted average number of ordinary shares	146,203,992	132,717,220
Diluted share options	<u>6,924,456</u>	<u>10,748,380</u>
Adjusted weighted average number of ordinary shares	153,128,448	143,465,600
Earnings per share	<u>1.24p</u>	<u>0.63p</u>
Diluted earnings per share	<u>1.18p</u>	<u>0.59p</u>

11. Exceptional items

Included within other operating expenses are amounts totalling £nil (1999 – £171,138) in respect of costs associated with the acquisition of EPI Holdings Limited and IQE Inc (formerly Quantum Epitaxial Designs, Inc) by IQE plc and the subsequent flotation of IQE plc.

Included within interest payable are amounts totalling £nil (1999 – £328,050) in respect of the early settlement of certain bank loans arising out of the acquisition of EPI Holdings Limited and IQE Inc (formerly Quantum Epitaxial Designs, Inc) by IQE plc and the subsequent flotation of IQE plc.

12. Intangible fixed assets

The Group

	<i>Goodwill</i> £'000
Cost	
At 1 January 2000	–
Additions in the year	36,752
At 31 December 2000	<u>36,752</u>
Accumulated amortisation	
At 1 January 2000	–
Charge for the year	209
At 31 December 2000	<u>209</u>
Net book value	
At 31 December 2000	<u>36,543</u>
At 31 December 1999	<u>–</u>

100% of the issued share capital of Wafer Technology International Limited and Wafer Technology Limited was acquired on 22 November 2000 for a consideration of £41,301,000. This acquisition has been accounted for using the acquisition method of accounting. The amount of goodwill arising as a result of the acquisition is £36,752,000. This has been capitalised in the Group balance sheet. The consideration included a deferred consideration of 500,000 ordinary 1p shares in IQE plc to be issued within 14 days following 28 February 2002. The market value per share at 31 December 2000 was £1.975.

The following table summarises the adjustments made to the book value of the major categories of assets and liabilities acquired to arrive at the fair values included in the consolidated financial statements at the date of acquisition.

	<i>Book amount</i> £'000	<i>Fair Value adjustment</i> £'000	<i>Fair Value to the Group</i> £'000
Tangible fixed assets	908	1,495	2,403
Current assets	2,894	–	2,894
Creditors	(869)	–	(869)
Taxation	121	–	121
	<u>3,054</u>	<u>1,495</u>	<u>4,549</u>
Goodwill			<u>36,752</u>
			<u>41,301</u>

12. Intangible fixed assets (continued)

Net cash flow effects of the acquisition are:

	2000 £'000
Net assets acquired:	
Tangible fixed assets	2,403
Stocks	1,299
Debtors	1,062
Cash at bank and in hand	533
Creditors	(869)
Taxation	121
	<u>4,549</u>
Goodwill	36,752
	<u>41,301</u>
Satisfied by:	
Cash	14,000
8,750,000 ordinary 1p shares in IQE plc (market value at 22 November 2000, £2.95 per share)	25,812
Deferred consideration:	
500,000 ordinary 1p shares in IQE plc (market value at 31 December 2000, £1.975 per share)	988
Costs of acquisition	501
	<u>41,301</u>

13. Tangible fixed assets

<i>The Group</i>	<i>Freehold land and buildings</i> £'000	<i>Short leasehold improvements</i> £'000	<i>Fixtures and fittings</i> £'000	<i>Plant and machinery</i> £'000	<i>Assets in the course of construction</i> £'000	<i>Total</i> £'000
Cost						
At 1 January 2000	2,578	536	1,422	18,336	533	23,405
Acquired with subsidiary	–	685	164	1,554	–	2,403
Additions	1,095	–	767	7,016	27,278	36,156
Disposals	–	–	–	(29)	–	(29)
Transfers	–	1,146	–	1,422	(2,568)	–
Exchange difference	–	57	37	716	225	1,035
At 31 December 2000	<u>3,673</u>	<u>2,424</u>	<u>2,390</u>	<u>29,015</u>	<u>25,468</u>	<u>62,970</u>
Depreciation						
At 1 January 2000	142	224	626	10,930	–	11,922
Charge for the year	117	223	280	2,219	–	2,839
Exchange difference	–	20	17	324	–	361
At 31 December 2000	<u>259</u>	<u>467</u>	<u>923</u>	<u>13,473</u>	<u>–</u>	<u>15,122</u>
Net book value						
At 31 December 2000	<u>3,414</u>	<u>1,957</u>	<u>1,467</u>	<u>15,542</u>	<u>25,468</u>	<u>47,848</u>
At 31 December 1999	<u>2,436</u>	<u>312</u>	<u>796</u>	<u>7,406</u>	<u>533</u>	<u>11,483</u>

The net book value of fixtures and fittings includes £60,000 (1999: £90,000) and the net book value of plant and machinery includes £3,240,000 (1999: £2,342,000) in respect of assets held under finance leases.

14. Investments held as fixed assets

	2000
	£'000
Cost and net book value at 1 January 2000	1,039
Additions in the period	41,301
Cost and net book value at 31 December 2000	<u>42,340</u>

The above additions relate to the acquisition of 100% of the ordinary share capital of Wafer Technology International Limited and the remaining 19% of the ordinary share capital of Wafer Technology Limited not already owned by Wafer Technology International Limited (see note 12).

£'000

The above is represented by investments in the following 100% owned subsidiaries:

IQE Inc.(formerly Quantum Epitaxial Designs Inc.)	439
EPI Holdings Limited	600
Wafer Technology International Limited and Wafer Technology Limited	41,301
	<u>42,340</u>

15. Stocks

	2000		1999	
	<i>The Group</i>	<i>The Company</i>	<i>The Group</i>	<i>The Company</i>
	£'000	£'000	£'000	£'000
Raw materials and consumables	6,796	-	2,239	-
Work in progress and finished goods	1,089	-	334	-
	<u>7,885</u>	<u>-</u>	<u>2,573</u>	<u>-</u>

16. Debtors

	2000		1999	
	<i>The Group</i>	<i>The Company</i>	<i>The Group</i>	<i>The Company</i>
	£'000	£'000	£'000	£'000
Trade debtors	8,419	-	3,045	-
Amounts owed by Group undertakings	-	41,387	-	13,177
Other debtors and prepayments	1,532	139	4,565	20
Corporation tax	360	122	133	-
	<u>10,311</u>	<u>41,648</u>	<u>7,743</u>	<u>13,197</u>

Amounts owed by Group undertakings are due after more than one year.

17. Creditors: Amounts falling due within one year

	2000		1999	
	<i>The Group</i>	<i>The Company</i>	<i>The Group</i>	<i>The Company</i>
	£'000	£'000	£'000	£'000
Other loans	508	-	504	-
Trade creditors	13,446	-	3,115	-
Amounts due under hire purchase and finance leases	753	-	18	-
Other taxation and social security	460	131	111	27
Corporation tax	-	-	-	122
Accruals and deferred income	2,238	371	770	-
	<u>17,405</u>	<u>502</u>	<u>4,518</u>	<u>149</u>

18. Creditors: Amounts falling due after more than one year

	2000		1999	
	<i>The Group</i> £'000	<i>The Company</i> £'000	<i>The Group</i> £'000	<i>The Company</i> £'000
Amounts due under hire purchase and finance leases	1,911	–	81	–
Other loans	3,527	–	3,943	–
Deferred income	69	–	93	–
	<u>5,507</u>	<u>–</u>	<u>4,117</u>	<u>–</u>

19. Borrowings

	<i>The Group</i>	
	2000 £'000	1999 £'000
Other loans		
Other loans are payable as follows:		
Within one year	508	504
Between one and two years	661	455
Between two and five years	1,295	1,594
Over five years	1,571	1,894
	<u>4,035</u>	<u>4,447</u>
Hire purchase and finance lease repayments		
Hire purchase and finance lease repayments are payable as follows:		
Within one year	753	18
Between one and two years	793	25
Between two and five years	1,118	56
	<u>2,664</u>	<u>99</u>

Other loans comprise a loan from 3i of £1,235,000 (1999 – £1,425,000), a loan from the WDA of £1,482,551 (1999 – £1,482,551) and a loan from Copelco of £1,316,714 (1999 – £1,540,000).

Interest is charged on the 3i loan at a rate equal to the base rate and a margin of 2.5% per annum. The loan is repayable by 13 annual instalments of £95,000, which commenced on 31 August 2000. The loan is secured by a fixed and floating charge over the assets of the Group.

Interest is charged on the WDA loan at a maximum rate of 8.5% per annum. The loan is secured on the Group's property. The loan is repayable by 32 instalments, quarterly in arrears, commencing 1 October 2001.

Interest is charged on the Copelco loan at 10.86% per annum. The loan is secured on equipment. The loan is repayable by monthly instalments of \$63,924 per month with a final instalment in January 2003 of \$767,076.

Amounts due under hire purchase and finance leases are secured on the related assets.

20. Deferred taxation

	<i>At 1 January</i> 2000 £'000	<i>Charged to</i> <i>profit and loss</i> <i>account</i> £'000	<i>At</i> <i>31 December</i> 2000 £'000
UK deferred tax	331	1,259	1,590

The amounts of deferred taxation provided and unprovided in the accounts are:

	<i>2000</i> £'000	<i>Provided</i> <i>1999</i> £'000	<i>2000</i> £'000	<i>Unprovided</i> <i>1999</i> £'000
The Group				
Capital allowances in excess of depreciation	1,736	381	(540)	-
Other timing differences	(146)	(50)	-	-
	<u>1,590</u>	<u>331</u>	<u>(540)</u>	<u>-</u>

21. Share capital

	<i>2000</i>		<i>1999</i>	
	<i>Number</i> <i>of shares</i>	<i>£'000</i>	<i>Number</i> <i>of shares</i>	<i>£'000</i>
Authorised				
Ordinary shares of 1p (1999 – 10p) each	250,000,000	2,500	19,000,000	1,900
Allotted, called up and fully paid				
Ordinary shares of 1p (1999 – 10p) each	163,250,498	1,633	13,595,167	1,359

During the year the Company carried out a 10 for 1 share split.

8,750,000 1p ordinary shares were issued in the year to acquire 100% of the ordinary share capital of Wafer Technology International Limited and Wafer Technology Limited at a total premium of £25,725,000.

Also during the year 1,482,222 10p ordinary shares (later split into 14,822,220 1p ordinary shares) and 3,726,608 1p ordinary shares were issued for cash at a total premium of £68,359,000.

The movement in ordinary shares during the year was:

	<i>At 1 January</i> 2000 <i>No.</i>	<i>Shares</i> <i>issued prior</i> <i>to split</i> <i>No.</i>	<i>10 for 1</i> <i>share split</i> <i>No.</i>	<i>Shares issued</i> <i>following</i> <i>share split</i> <i>No.</i>	<i>At</i> <i>31 December</i> £'000 <i>No.</i>
Brought forward	13,595,167	-	122,356,503	-	135,951,670
Secondary offering	-	1,263,157	11,368,413	-	12,631,570
Tracker funds	-	-	-	3,230,000	3,230,000
Wafer Technology International Limited acquisition	-	-	-	8,750,000	8,750,000
Options exercised	-	219,065	1,971,585	496,608	2,687,258
	<u>13,595,167</u>	<u>1,482,222</u>	<u>135,696,501</u>	<u>12,476,608</u>	<u>163,250,498</u>

21. Share capital (continued)

Under the Company's share option scheme adopted on 26 May 1999, employees held options at 31 December 2000 for 9,328,082 unissued ordinary shares as follows:

<i>Number of shares</i>	<i>Option price per shares</i> £	<i>Option period ending</i>
1,554,562	0.01 – 0.09	31 December 2007
1,659,250	0.01 – 0.09	31 December 2008
1,569,210	0.01 – 2.79	31 December 2009
33,060	0.01	31 December 2010
1,876,000	0.96 – 7.50	31 December 2010

The movements on share options during the year were as follows:

	<i>Options No.</i>
At 1 January 2000	10,380,990
Granted	2,340,560
Exercised	(2,687,258)
Cancelled	(706,210)
At 31 December 2000	<u>9,328,082</u>

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

	<i>2000</i> £'000	<i>1999</i> £'000
Operating profit	1,786	1,283
Depreciation charges	2,839	1,509
Amortisation of goodwill	209	–
Loss on sale of fixed assets	29	–
Increase in stocks	(4,013)	(982)
Increase in debtors	(1,157)	(4,851)
Increase in creditors	11,280	81
Government grant release	(24)	(29)
Government grant received	–	112
Net cash inflow/(outflow) from operating activities	<u>10,949</u>	<u>(2,877)</u>

23. Reconciliation of net cash flow to movement in net funds

	<i>2000</i> £'000	<i>1999</i> £'000
Increase in cash in the year	31,395	7,776
Loan repayments	441	3,611
Loans received	–	(2,908)
Change in net funds resulting from cash flows	<u>31,836</u>	<u>8,479</u>
Inception of new finance leases	(2,590)	(124)
Net movement for year	29,246	8,355
Net funds at 1 January 2000	3,571	(4,648)
Exchange differences	(4)	(136)
Net funds at 31 December 2000	<u>32,813</u>	<u>3,571</u>

24. Analysis of net funds

	<i>At 31 December 1999 £'000</i>	<i>Cash flow £'000</i>	<i>Other non-cash movements £'000</i>	<i>At 31 December 2000 £'000</i>
Cash in hand and at bank	8,117	31,395	–	39,512
Debt due after one year	(3,943)	416	–	(3,527)
Debt due within one year	(504)	–	(4)	(508)
Finance leases	(99)	25	(2,590)	(2,664)
	<u>3,571</u>	<u>31,836</u>	<u>(2,594)</u>	<u>32,813</u>

25. Additional information on subsidiary undertakings

<i>Name</i>	<i>Class of Capital</i>	<i>Portion of shares held</i>	<i>Activity</i>	<i>Country of Incorporation</i>
IQE Inc (formerly Quantum Epitaxial Designs, Inc.)	Common Stock of \$0.001	100%	Manufacture of advanced semiconductor materials	USA
EPI Holdings Limited	£1 ordinary shares	100%	Holding Company	UK
IQE (Europe) Limited (formerly Epitaxial Products International Limited)	£1 ordinary shares	100%*	Manufacture of advanced semiconductor materials	UK
Epitaxial Products, Inc.	Common stock of \$10	100%*	Sales office	USA
Wafer Technology International Limited	£1 ordinary shares	100%	Holding Company	UK
Wafer Technology Limited	£1 ordinary shares	100%*	Manufacture of semiconductor compounds and ultra high purity materials	UK
IQE Silicon Compounds Limited	£1 ordinary shares	100%	Manufacture of silicon epitaxy	UK

The proportion of voting rights of subsidiaries held by the Group is the same as the proportion of shares held.

* Indirect holdings

26. Financial instruments

The Group's policies as regards derivatives and financial instruments are set out in the Financial Review and the accounting policies on pages 139 and 140.

The Group does not trade in financial instruments.

Forward currency contracts are entered into with the Group's bankers in order to fix exchange rate risks associated with currency shortfalls over a rolling twelve month period in respect of dollar and yen inflows (and to a lesser extent other currencies). At 31 December 2000 the Group had entered into the following forward contracts in:

	<i>Amount</i>	<i>Period</i>	<i>Rate</i>
Bank to buy	\$4,750,000	Jan/Nov 2001	\$1.4142/1.5832
	Yen 170,000,000	Jan/Nov 2001	Y149/162
Bank to sell	Euro 3,040,252	Jan/March 2001	E1.5970

There were no material gains or losses brought forward or carried forward at the year end. Gains and losses are recognised in the year and are disclosed in note 4.

The currency profile of the Group's trade debtors and trade creditors is as follows:

	<i>Trade debtors</i>	<i>Trade creditors</i>
	<i>£'000</i>	<i>£'000</i>
Sterling	641	1,906
US\$	6,968	5,975
Yen	175	291
Other	635	5,274
Total	8,419	13,446

The interest rate profile of the Group's financial assets and liabilities is as follows:

	<i>Assets floating rate</i>	<i>Assets fixed rate</i>	<i>Liabilities floating rate</i>	<i>Liabilities fixed rate</i>	<i>Total</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Sterling	3,770	33,500	1,235	1,483	39,987
US \$	1,762	295	–	1,317	3,375
Yen	113	–	–	–	113
Other	72	–	–	–	72
	<u>5,717</u>	<u>33,795</u>	<u>1,235</u>	<u>2,800</u>	<u>43,547</u>
Comprising					
Cash at bank	5,717	33,795	–	–	39,512
Other loans	–	–	1,235	2,800	4,035
Total	<u>5,717</u>	<u>33,795</u>	<u>1,235</u>	<u>2,800</u>	<u>43,547</u>

For the fixed rate liabilities the weighted average interest rate is 9.61% and the weighted average period for which interest rates are fixed is 5.6 years.

Further details of the financial liabilities at 31 December 2000 are shown in notes 18 and 19.

There is no significant difference between the book value and the fair value of the Group's financial assets and liabilities.

27. Related party transactions

During the year the Group incurred professional fees of £109,798 (1999 – £343,415) and expenses of £8,655 (1999 – £Nil) payable to Gambit Corporate Finance. Dr Godfrey Ainsworth, who is a Director of IQE plc, is a partner in Gambit Corporate Finance.

28. Financial commitments

At 31 December 2000 the Group was committed to making the following payments during the next year in respect of financial commitment:

	<i>Land and buildings</i>		<i>Plant and machinery</i>	
	<i>2000</i>	<i>1999</i>	<i>2000</i>	<i>1999</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Annual commitments which expire:				
Within one year	28	–	7	15
In the second to fifth year	373	165	657	597
In more than five years	–	–	–	–
	<u>401</u>	<u>165</u>	<u>664</u>	<u>612</u>

29. Capital commitments

The Group had the following capital commitments as at 31 December 2000:

	<i>2000</i>	<i>1999</i>
	<i>£'000</i>	<i>£'000</i>
Authorised and contracted for	<u>16,690</u>	<u>14,653</u>

IQE plc

(Registered in England and Wales no. 3745726)

Notice of Extraordinary General Meeting

Notice is hereby given that an Extraordinary General Meeting of the Company ("the EGM") will be held at the Company's registered office being Pascal Close, Cypress Drive, St Mellons, Cardiff, CF3 0EG at 2.30 p.m. on 3 November 2003 to transact the following business:

SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolutions which will be proposed as to resolutions 1 and 3 as special resolutions and as to Resolution 2 as an ordinary resolution.

THAT, conditional on (and with effect from immediately prior to) Admission (as defined in the prospectus containing the notice of this meeting dated 7 October 2003 ("the Prospectus")) becoming effective:

1 Approval of Placing and Open Offer (as defined in the Prospectus)

1.1 Increase in authorised share capital

The authorised share capital of the Company be and is hereby increased from £3,000,000 to £5,000,000 by the creation of an additional 200,000,000 ordinary shares of 1 pence each in the capital of the Company ("ordinary shares") ranking *pari passu* with the existing ordinary shares, such shares to have the rights and be subject to the restrictions contained in the Company's articles of association from time to time.

1.2 Section 80 authority to allot ordinary shares pursuant to the Placing and Open Offer

In addition to any existing or subsequent authority conferred on the directors pursuant to section 80 of the Companies Act 1985 (as amended) ("the Act"), the directors be and they are hereby generally and unconditionally authorised pursuant to section 80 of the Companies Act 1985 ("the Act"), to allot relevant securities (as defined in section 80(2) of the Act) pursuant to the Placing and Open Offer up to an aggregate nominal value of £1,250,000 (being a maximum of 125,000,000 ordinary shares); provided that such authority shall expire on the date five years after the passing of this resolution unless previously revoked, varied or extended by the Company in general meeting, save that the Company may at any time prior to the expiry of such authority make an offer or enter into an agreement (subject to the foregoing limitations) which would or might require relevant securities to be allotted after expiry of such authority, and the directors may allot relevant securities (subject to the foregoing limitations) in pursuant of such an offer or agreement as if such authority had not expired.

1.3 Disapplication of pre-emption rights in respect of the issue of ordinary shares pursuant to the Placing and Open Offer

The directors be and are hereby empowered, pursuant to section 95(1) of the Act, to allot equity securities (as defined in section 94(2) of the Act) for cash, pursuant to the authority under section 80 of the Act conferred on the directors pursuant to paragraph 1.2 of this resolution, as if section 89(1) of the Act did not apply to any such allotment, such power to operate in addition to any previous or subsequent power given to the directors pursuant to section 95(1) of the Act and to expire on the date five years after the passing of this resolution, unless previously revoked, varied or extended by the Company in general meeting and provided that such power shall be limited to the allotment of equity securities pursuant to the Placing and Open Offer up to an aggregate nominal value of £1,250,000 (being a maximum of 125,000,000 ordinary shares); provided that the Company may at any time prior to the expiry of such power make an offer or enter into an agreement (subject to the foregoing limitations) which would or might require equity securities to be allotted after the expiry of such power and the directors may allot equity securities (subject to

the foregoing limitations) in pursuant of such an offer or agreement as if such power had not expired.

2 Section 80 authority to allot ordinary shares

THAT (subject to resolution number 1 above being duly passed) the Directors be generally and unconditionally authorised, pursuant to section 80 of the Act in substitution for the general authority granted by resolution dated 6 June 2003 (but in addition to any other existing authority to allot relevant securities including pursuant to resolution number 1 above) to allot relevant securities (as defined in section 80 of the Act) up to an aggregate number of 104,654,546 ordinary shares provided that such authority shall expire on the earlier of 15 months after the passing of this Resolution and the conclusion of the Annual General Meeting of the Company next following the passing of this Resolution, save that the Company may before expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry, and the Directors may allot relevant securities in pursuant of such an offer or agreement as if the authority conferred thereby had not expired.

3 Disapplication of pre-emption rights in respect of the issue of ordinary shares

THAT (subject to resolution number 1 above being duly passed) the Directors be empowered pursuant to section 95 of the Act in substitution for the general authority granted by resolution dated 6 June 2003 (but in addition to any other existing authority to disapply pre-emption rights including pursuant to resolution number 1 above) to allot equity securities (within the meaning of section 94 of the Act) of the Company pursuant to the general authority conferred by Resolution 2 above as if section 89(1) of the Act did not apply to any such allotment provided that such power shall be limited to:

- (i) the allotment (otherwise than pursuant to sub-paragraph (ii) below) of equity shares which are or are to be wholly paid up in cash up to an aggregate nominal number of 31,396,364 shares; and
- (ii) the allotment of equity securities in connection with a rights issue or any other pre-emptive offer in favour of holders of ordinary shares and other persons entitled to participate therein in proportion (as nearly as may be) to their respective holdings of ordinary shares (or as appropriate the number of ordinary shares which they are deemed to hold for such purpose) subject only to such exclusion or other arrangements as the Directors may consider appropriate to deal with fractional entitlements or legal or practical difficulties under the laws of or the requirements of any recognised regulatory body or any stock exchange in any overseas territory; and
- (iii) such power shall expire on the earlier of 15 months after the passing of this Resolution and the conclusion of the Annual General Meeting of the Company next following the passing of this Resolution, save that the Company may before such expiry make an offer or agreement which would or might require the allotment of relevant shares in pursuance of such offer or agreement as if the power conferred thereby had not been expired.

By order of the Board of Directors

J L COVENTRY

Company Secretary

7 October 2003

Registered Office:

Pascal Close

Cypress Drive

St Mellons

Cardiff

CF3 0EG

Notes:

- Members entitled to attend and vote at the Extraordinary General Meeting are entitled to appoint one or more proxies to attend and, upon a poll, to vote in their stead. A proxy need not be a member of the Company.
- To be valid, forms of proxy and the powers of attorney or other authorities under which they are signed, or notarised copies of those powers or authorities, should be sent to the Company's Registrar at Capita IRG Plc, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4BR to arrive no later than 48 hours before the time appointed for the Extraordinary General Meeting. Completion and return of forms of proxy will not preclude shareholders from attending and voting at the Extraordinary General Meeting in person should they wish to do so.
- Only holders of ordinary shares or their proxies are entitled to attend and vote at the Extraordinary General Meeting.

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