

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.** If you are in doubt as to the action to be taken, you should consult your stockbroker, solicitor, accountant or other independent financial advisor authorised under the Financial Services Act 1986.

Copies of this document, which comprises a prospectus relating to IQE plc in accordance with the Listing Rules made under section 142 of the Financial Services Act 1986 (and from 1 December 2001 under section 74(4) of the Financial Services and Markets Act 2000) and a circular to the shareholders of the Company, have been delivered to the Registrar of Companies in England and Wales for registration in accordance with section 149 of that Act.

If you have sold or otherwise transferred all of your Ordinary Shares in the Company, you should immediately forward this document to the purchaser or transferee or the stockbroker, bank or other agent through whom the sale or transfer was effected, for onward transmission to the purchaser or transferee.



**IQE plc**

*(Incorporated in England and Wales under the Companies Act 1985 with Registered No. 3745726)*

**PROPOSED PLACING AND OPEN OFFER OF 13,152,247 NEW ORDINARY SHARES  
AT 155P PER SHARE ON THE BASIS OF 2 OFFER SHARES FOR  
EVERY 25 ORDINARY SHARES**

**PROPOSED SUBSCRIPTION BY MOTOROLA OF 4,428,620 NEW ORDINARY SHARES  
AT 155 P PER SHARE AND ISSUE OF 4,428,620 SHARE WARRANTS TO MOTOROLA**

**CREATION OF AN EQUITY DRAW DOWN FACILITY FOR UP TO £14 MILLION  
AND ISSUE OF 2,000,000 SHARE WARRANTS PURSUANT THERETO**

**PUBLICATION OF UNAUDITED THIRD QUARTER RESULTS  
FOR THE PERIOD ENDED 30 SEPTEMBER 2001**

### **Share Capital immediately following the Placing and Open Offer and Motorola Subscription**

	Ordinary Shares of 1p each		Issued and Fully Paid	
<i>Number</i>	<i>Authorised</i>	<i>Amount</i>	<i>Number</i>	<i>Amount</i>
300,000,000		£3,000,000	181,983,957	£1,819,839.57

The above statistics are based upon the assumption set out in the notes to the Placing and Open Offer and Motorola Subscription statistics on page 4.

Application will be made to the UK Listing Authority for all of the New Ordinary Shares to be admitted to the Official List. Applications will also be made to the London Stock Exchange for the New Ordinary Shares to be issued to be admitted to trading on its market for listed securities and to Nasdaq Europe<sup>SM</sup> for the New Ordinary Shares to be issued to be admitted to listing on its market. Admission to the Official List, together with admission to trading on the London Stock Exchange's market for listed securities, constitutes official listing on a stock exchange in the United Kingdom. It is expected that admission to the Official List, the London Stock Exchange and Nasdaq Europe will become effective, and dealings in the New Ordinary Shares will commence, on 12 December 2001. The Existing Ordinary Shares are currently and will remain traded on the Official List and Nasdaq Europe.

In connection with the Placing and Open Offer, Beeson Gregory may over-allot or effect transactions that stabilise or maintain the market price of the Ordinary Shares at levels which might not otherwise prevail in the open market. Such transactions may be effected on the London Stock Exchange or otherwise. Such stabilisation, if commenced, may be discontinued at any time. In connection with the Placing and Open Offer, the Company has granted to Beeson Gregory an option, exercisable upon notice by Beeson Gregory for 30 days after the date of Admission, to subscribe or procure subscribers, at the Placing Price, for up to that number of new Ordinary Shares equal to 15 per cent. of the Offer Shares.

The New Ordinary Shares of the Company and new Ordinary Shares issued pursuant to the Over Allotment Option (if any) will, following issue, rank *pari passu* in all respects with the existing issued ordinary share capital of the Company including the right to receive all dividends after the date of this document or other distributions hereafter declared or paid on the Ordinary Shares of the Company.

The New Ordinary Shares have not been marketed and will not be available in whole or in part to the public in conjunction with the application referred to above and will not be registered under the securities laws of any other jurisdiction. The New Ordinary Shares have not and will not be registered under the US Securities Act of 1933 and may not be offered or sold in the US unless pursuant to an applicable exemption.

Beeson Gregory, which is regulated by The Securities and Futures Authority Limited, is acting for the Company and no one else in relation to the issue of New Ordinary Shares and will not be responsible to anyone other than the Company for providing the protections afforded to customers of Beeson Gregory or for providing financial advice in relation to the issue or any transaction or arrangement referred to herein.

Notice of an Extraordinary General Meeting of IQE plc to be held at 10.00 a.m. on 10 December 2001 at The Hilton Hotel, Kingsway, Cardiff is set out at the end of this document. To be valid, the enclosed form of proxy for use at that meeting should be completed in accordance with the instructions printed thereon and returned as soon as possible (whether or not you intend to attend the EGM or take up your entitlement under the Open Offer) and, in any event, so as to reach the Company's Registrars, Capita IRG Plc, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TH, not later than 10.00 a.m. on 8 December 2001.

If you are a Qualifying Shareholder and wish to apply for Offer Shares, you should complete the enclosed Application Form and return it, together with the appropriate payment, by post, or by hand (during normal business hours) to New Issues Department, Capita IRG Plc, PO Box 166, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TH, or by hand only (during normal business hours) to Capita IRG Plc, Guildhall House, 81-87 Gresham Street, London EC2 to arrive no later than 5.00 p.m. on 5 December 2001. The procedure for application and payment is set out in Part II of this document and in the Application Form. A reply-paid envelope is provided for your convenience. The right to apply for Offer Shares may not be assigned, transferred or split except to satisfy *bona fide* market claims.



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## **DIRECTORS, SECRETARY AND ADVISERS**

**Directors**  
Dr Andrew William Nelson O.B.E. (Aged 46), Chairman and Chief Executive Officer  
Thomas Lawrence Hierl (Aged 49), Chief Technical Officer  
Dr Michael Darak Scott (Aged 44), Sales and Marketing Director  
Richard John George Clarke (Aged 46), Finance Director  
Stephen Byars (Aged 43), Managing Director IQE (Europe) Limited  
Scott Tucker Massie (Aged 40), President IQE, Inc.  
Martin Steven Mark Lamb (Aged 41), Managing Director Wafer Technology Limited  
Dr Godfrey Howard Harrison Ainsworth, (Aged 46) Non-executive Director  
Glen Bressner (Aged 40), Non-executive Director

The business address of each of Drs Nelson, Scott and Ainsworth and Messrs Clarke and Byars is IQE plc, Pascal Close, Cypress Drive, St Mellons, Cardiff, CF3 0EG.

The business address of each of Messrs Hierl, Bressner and Massie is IQE Inc., 119 Technology Drive, Bethlehem, Pennsylvania 18015, USA.

The business address of Mr Lamb is Wafer Technology Limited, 34 Maryland Road, Tongwell, Milton Keynes, MK15 8HJ.

### **Company Secretary and Registered Office**

J Leslie Coventry  
Pascal Close  
Cypress Drive  
St Mellons  
Cardiff CF3 0EG  
UK  
Tel: +44 (0) 29 2083 9400

### **Solicitors to the Company relating to English Law**

M and A Solicitors  
Kenneth Pollard House  
5-19 Cowbridge Road East  
Cardiff CF11 9AB  
UK

### **Sponsor, Financial Adviser and Broker**

Beeson Gregory Limited  
The Registry  
Royal Mint Court  
London EC3N 4LB  
UK

### **Counsel to the Company relating to US Law**

Pepper Hamilton LLP  
Suite 400  
1235 Westlake Drive  
Berwyn  
Pennsylvania 19312-2401  
USA

### **Auditor**

Deloitte & Touche  
Blenheim House  
Fitzalan Court  
Newport Road  
Cardiff CF24 0TS  
UK

### **Solicitors to the Sponsor**

Dechert  
2 Serjeants' Inn  
London EC4Y 1LT  
UK

### **Principal Bankers to the Company**

Barclays Bank plc  
Ty Glas Avenue  
Cardiff CP14 5FG  
UK

### **Registrars**

Capita IRG Plc  
Bourne House  
34 Beckenham Road  
Beckenham  
Kent BR3 4TU  
UK



## EXPECTED TIMETABLE OF PRINCIPAL EVENTS

2001

Record Date for the Open Offer	Close of business on 8 November
Latest time and date for splitting of Application Forms (to satisfy <i>bona fide</i> market claims)	5.00 p.m. on 3 December
Latest time for receipt of Application Forms and payment under the Open Offer	5.00 p.m. on 5 December
Latest time and date for return of form of proxy	10.00 a.m. on 8 December
Extraordinary General Meeting	10.00 a.m. on 10 December
Allotment and issue of New Ordinary Shares (conditional on Admission occurring)	10 December
New Ordinary Shares are admitted to the Official List and dealings commence	12 December
New Ordinary Shares are admitted to listing on Nasdaq Europe	12 December
Completion of the Motorola Subscription, Placing and Open Offer and Draw Down Facility	12 December
Despatch of definitive Share Certificates for New Ordinary Shares	By 14 December

**If you have any queries on the procedure for acceptance and payment or on the procedure for splitting Application Forms, you should contact New Issues Department, Capita IRG Plc, PO Box 166, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TH (Telephone 0870 162 3100 or if calling from outside the United Kingdom on (+44) 20 8639 2157).**

### PLACING AND OPEN OFFER AND MOTOROLA SUBSCRIPTION STATISTICS

The Placing Price and Motorola Subscription Price has been set at 155p per Ordinary Share. The number of Placing Shares is subject to negotiations between Beeson Gregory and the Company following completion of the book building process. Following the outcome of these negotiations, the Company will issue a supplementary prospectus announcing the number of Placing Shares.

The statistics set out below are based upon the assumption that the Offer Shares are taken up in full.

Number of Ordinary Shares in issue immediately prior to the Placing and Open Offer and Motorola Subscription	164,403,090
Number of Offer Shares	13,152,247
Number of Motorola Subscription Shares	4,428,620
Number of Ordinary Shares in issue immediately following the Placing and Open Offer and Motorola Subscription	181,983,957
Number of Ordinary Shares under option immediately prior to the Placing and Open Offer and Motorola Subscription	9,030,695
Number of Ordinary Shares under warrant granted under the Motorola Subscription Agreement	4,428,620
Number of Ordinary Shares under warrant granted under the Draw Down Facility	2,000,000
Number of Ordinary Shares under option and warrant immediately after the Placing and Open Offer and Motorola Subscription	15,459,315

Notes:

- (1) The Placing and Open Offer and Motorola Subscription statistics do not include the use of the Draw Down Facility. It is not anticipated that any draw down will be necessary at Completion under the Draw Down Facility even assuming that there is no take up under the Placing and Open Offer. The price at which shares will be subscribed under the Draw Down Facility will be dependent on the prevailing price at the time of a draw down notice. By virtue of the floor price of 50p per share, the maximum number of shares that could be issued would be limited to 28,000,000.
- (2) The Placing and Open Offer and Motorola Subscription statistics assume no exercise of options or the issue of the Option Shares prior to Admission.
- (3) The options granted immediately prior to the Placing and Open Offer and Motorola Subscription were all granted to employees and Directors of the Group.



## DEFINITIONS

The following terms and expressions have the following meanings when used in this prospectus:

“Act”	the Companies Act 1985 of England and Wales, as amended;
“Admission”	the admission of the New Ordinary Shares to the Official List, the admission of the New Ordinary Shares to trading on the London Stock Exchange’s market for listed securities and admission of the New Ordinary Shares to trading on Nasdaq Europe becoming effective, in each case, expected to occur on 12 December 2001;
“Application Form”	the application form accompanying this document for use by Qualifying Shareholders in respect of the Open Offer;
“Articles”	the Articles of Association of the Company;
“Beeson Gregory”	Beeson Gregory Limited;
“Board”	the board of directors of the Company;
“Caislean”	Caislean Investments Limited of 10th Floor, 2 George Yard, Lombard Street, London EC3V 9DH;
“Clearstream”	Clearstream International;
“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;
“Completion”	completion of the Motorola Subscription pursuant to and in accordance with the terms of the Motorola Subscription Agreement;
“CREST”	the system operated by CRESTCo Limited in accordance with which listed securities may be held and transferred in uncertificated form;
“Directors”	the directors of the Company;
“Draw Down Facility”	the agreement for the provision by the Equity Providers of a draw down facility to the Company dated 13 November 2001;
“Draw Down Shares”	the Ordinary Shares proposed to be subscribed for by the Equity Providers pursuant to the Draw Down Facility;
“EBITDA”	earnings before interest tax depreciation and amortisation;
“EPIH”	EPI Holdings Limited, a company incorporated in England and Wales under company number 3170421 whose registered office is Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG;
“EPIH Agreement”	an agreement dated 3 May 1999 between (1) the Company and (2) the then shareholders of EPIH further details of which are set out in paragraph (a) of section 4 of Part VIII;
“EPI Inc”	Epitaxial Products, Inc. a company incorporated in the state of Delaware, US with its principal place of business at 119 Technology Drive, Bethlehem, Pennsylvania, 18015, US;
“Equity Providers”	together Marblegate and Caislean;



“Equity Providers’ Share Warrant Instruments”	the instruments proposed to be executed by the Company constituting the Equity Providers’ Share Warrants;
“Equity Providers’ Share Warrants”	the warrants to subscribe for the Equity Providers’ Warrant Shares constituted by the Equity Providers’ Share Warrant Instruments and to be granted to the Equity Providers in accordance with the provisions of the Draw Down Facility;
“Equity Providers’ Warrant Shares”	up to 2,000,000 new Ordinary Shares for which the Equity Providers are entitled to subscribe pursuant to the Equity Providers’ Share Warrants;
“Euroclear”	Euroclear Bank, the operator of the Euroclear system;
“Evaluation Program Agreement”	the agreement whereby the Company will be authorised to provide sample wafers made using the Technology to potential customers dated 13 November 2001 and entered into between the Company and Motorola;
“Existing Ordinary Shares”	the 164,403,090 Ordinary Shares in issue immediately prior to the issue of the New Ordinary Shares;
“Existing Shareholders”	the Ordinary Shareholders immediately prior to the Motorola Subscription;
“Extraordinary General Meeting” or “EGM”	the extraordinary general meeting of the Company to be held at the Hilton Hotel, Kingsway, Cardiff on 10 December 2001 at 10.00 a.m. and at which the Resolution will be proposed;
“Group”	the Company and its subsidiaries;
“IAS”	International Accounting Standards;
“Initial Cooperation and Services Agreement”	the cooperation and services agreement dated 30 March 2001 entered into between the Company and Motorola;
“Interim Agreement”	an interim letter agreement dated 14 September 2001, entered into between the Company and Motorola;
“Interim Statement”	the interim statement of the Group’s second quarter and interim results for the period ended 30 June 2001 as set out in Part IV of this document;
“IQE Europe” or “EPI”	IQE (Europe) Limited (formerly known as Epitaxial Products International Limited), a company incorporated in England and Wales under company number 2107558 whose registered office is Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG;
“IQE Silicon Compounds”	IQE Silicon Compounds Limited, a company incorporated in England and Wales under company number 3986643 whose registered office is Beech House, Cypress Drive, St Mellons, Cardiff, CF3 0LW;
“Issue”	the issue of the New Ordinary Shares by the Company;
“Licence Agreement”	the commercial licence agreement for the use of the Technology in favour of IQE and granted by Motorola dated 13 November 2001;
“London Stock Exchange”	London Stock Exchange plc;
“Marblegate”	Marblegate Investments LLC of 17c Curzon Street, 2nd Floor, London W1Y 7FE or a wholly owned subsidiary or a limited liability partnership of it;



“Merger”	the acquisition by the Company of the entire issued share capital of both EPIH (pursuant to the EPIH Agreement) and QED (pursuant to the QED Agreement) on 16 and 20 May 1999 respectively;
“Motorola”	Motorola, Inc., a Delaware corporation having its principal office at 1303 E.Algonquin Road, Schaumburg, Illinois 60196, or (a) subsidiary/subsidiaries of Motorola, Inc;
“Motorola Share Warrant”	the warrant to subscribe for the Motorola Warrant Shares and to be granted to Motorola in accordance with the provision of the Motorola Subscription Agreement;
“Motorola Share Warrant Instrument”	the instrument proposed to be executed by the Company constituting the Motorola Share Warrant;
“Motorola Subscription”	the subscription by Motorola for 4,428,620 of the New Ordinary Shares pursuant to, and in accordance with, the Motorola Subscription Agreement;
“Motorola Subscription Agreement”	the agreement for the subscription of 4,428,620 of the New Ordinary Shares by Motorola dated 13 November 2001 and entered into between the Company and Motorola;
“Motorola Subscription Price”	155p per Motorola Subscription Share;
“Motorola Subscription Shares”	4,428,620 of the New Ordinary Shares proposed to be issued to Motorola pursuant to the terms of the Motorola Subscription Agreement;
“Motorola Transaction”	the transaction contemplated pursuant to the Motorola Subscription Agreement;
“Motorola Warrant Shares”	up to 4,428,620 new Ordinary Shares to be subscribed for by Motorola pursuant to the Motorola Share Warrant;
“Nasdaq Europe” or “Nasdaq Europe <sup>SM</sup> ”	Nasdaq Europe SA/NV or the system operated by Nasdaq Europe SA/NV (formerly known as EASDAQ) as the context requires;
“Nasdaq Europe Admission”	the admission of the Ordinary Shares to listing on Nasdaq Europe on 27 May 1999;
“Nasdaq Europe Rules” or the “Nasdaq Europe Rule Book”	the rule book published by Nasdaq Europe and approved by Ministerial Decree dated 11 May 2001, as it may be amended from time to time;
“NEPA”	Mid-Atlantic Venture Funds, formerly NEPA Venture Fund L.P., with which Mr Glen Bressner is associated;
“New Ordinary Shares”	up to 17,580,867 new Ordinary Shares in aggregate proposed to be issued pursuant to the terms of the Motorola Subscription Agreement together with the Offer Shares;
“Offer Shares”	up to 13,152,247 of the New Ordinary Shares to be issued pursuant to the Placing and Open Offer;
“Official List”	the Official List of the UK Listing Authority;
“Open Offer”	the conditional offer to Qualifying Shareholders to subscribe for the Offer Shares on the terms and conditions set out in the letter from Beeson Gregory in Part II of this document; 6.B.15(b)
“Option Shares”	the new Ordinary Shares which may be issued pursuant to the Over Allotment Option;



“Ordinary Shareholders” or “Shareholders”	the persons who are registered as holders of Ordinary Shares from time to time;
“Ordinary Shares”	ordinary shares of 1p each in nominal value in the capital of the Company;
“Over Allotment Option”	an option, exercisable up to 30 days following Admission, to be granted by the Company to Beeson Gregory to subscribe for, or procure subscribers for, up to that number of Ordinary Shares equal to 15 per cent. of the number of Ordinary Shares taken up in aggregate in the Open Offer and placed in the Placing;
“Phase II Co-operation and Services Agreement”	the further co-operation and services agreement dated 13 November 2001 entered into between the Company and Motorola;
“Placing”	the conditional placing of certain of the Offer Shares by Beeson Gregory pursuant to the Placing Agreement;
“Placing Agreement”	the conditional agreement proposed to be entered into on or about 6 December 2001 between the Company and Beeson Gregory relating to the Placing as described in section 15 of Part VIII of this document;
“Placing Price”	155p being the price per share at which Offer Shares are being offered pursuant to the Placing and Open Offer and at which Option Shares (if any) will be subscribed;
“Placing Shares”	Offer Shares not taken up under the Open Offer which are placed by Beeson Gregory pursuant to the Placing Agreement;
“Q3”	the three months up to a period ended 30 September;
“QED” or “IQE US”	IQE, Inc., (formerly known as Quantum Epitaxial Designs, Inc.), a company incorporated in the Commonwealth of Pennsylvania, US with its principal place of business at 119 Technology Drive, Bethlehem, Pennsylvania 18015, US;
“QED Agreement”	an agreement dated as of 3 May 1999 and amended as of 20 May 1999 among (1) the Company (2) EQ Compounds, Inc., a wholly owned subsidiary of the Company (3) QED and (4) Thomas Hierl further details of which are set out in paragraph (a) of section 4 of Part VIII;
“Qualifying Shareholders”	Shareholders on the register of members of the Company at the close of business on the Record Date, other than any citizen or resident of the US and certain overseas Shareholders as referred to in the letter from Beeson Gregory in Part II of this document;
“Record Date”	8 November 2001;
“Resolution”	the special resolution to increase the Company’s share capital, give the Directors authority to allot the New Ordinary Shares, the Draw Down Shares and Warrant Shares and disapply pre-emption rights in respect of the same as set out in the notice of Extraordinary General Meeting on page 157 of this document;
“Securities Act”	the United States Securities Act of 1933, as amended;
“Share Option Schemes”	the share option schemes described in section 9 of Part VIII;





“Share Warrant Holder”	the holder from time to time of Share Warrants;
“Share Warrant Instruments”	the Motorola Share Warrant Instrument and the Equity Providers’ Share Warrant Instruments;
“Share Warrants”	the warrants to subscribe for Ordinary Shares to be granted to Motorola and the Equity Providers respectively comprising the Motorola Share Warrant and the Equity Providers’ Share Warrants;
“special resolution”	a resolution passed by such a majority as is required for the passing of an extraordinary resolution and at a general meeting of members of which not less than 21 days notice, specifying the intention to propose the resolution as a special resolution, has been duly given;
“Sponsor”	Beeson Gregory;
“Sterling” “pence” and “p”	the lawful currency of the UK;
“subsidiary”	a subsidiary or subsidiary undertaking, in each case as defined by the Act;
“Technology” or “the new Technology”	the technology to be licensed to IQE pursuant to the Licence Agreement, comprising certain technology owned by Motorola relating to the manufacture of high quality compound semiconductor epitaxial layers on silicon substrates;
“Technology Programme”	the programme implemented by Motorola and IQE for the development and commercialisation of the Technology;
“Transactions”	the transactions relating to the New Ordinary Shares, the Draw Down Facility and the Warrant Shares as contemplated by this document;
“UK”	the United Kingdom of Great Britain and Northern Ireland;
“UK GAAP”	Generally Accepted Accounting Principles in the UK;
“UK Listing Authority”	United Kingdom Listing Authority;
“US” or “USA”	the United States of America;
“US\$” and “US dollars” and “cents” and “c”	the lawful currency of the US;
“US GAAP”	Generally Accepted Accounting Principles in the US;
“Wafer Technology”	Wafer Technology Limited, a company incorporated in England and Wales under company number 1829722 whose registered office is Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG;
“Warrant Shares”	the Motorola Warrant Shares and the Equity Providers’ Warrant Shares;
“WTI”	Wafer Technology International Limited, a company incorporated in England and Wales under company number 2928144 whose registered office is Pascal Close, Cypress Drive, St Mellons, Cardiff CF3 0EG.



## GLOSSARY OF SPECIALIST TERMS

Ångstrom (Å)	measure of thickness being one ten billionth of one metre
atomic spacing	the distance between atoms in a semiconductor layer
atomic structure	the combination of atoms to make a structure
bespoke	made to order, custom built, tailor-made
BiCMOS	Bipolar Complementary Metal Oxide Semiconductor
Bluetooth wireless technology	short-range radio technology which enables devices to detect each other and communicate without the need to be physically connected
CD	Compact Disc
CD-ROM	Compact Disc -Read Only Memory
compound semiconductor	a semiconductor formed from more than one element, typically comprising a mixture of elements from group III and group V of the periodic table
Czochsalski crystal growth	a method of producing high purity single crystals which are then sliced to produce substrates
DERA	Development, Evaluation and Research Agency
device	a component made by subsequent processing of the epitaxial layer structure
device structure	the term used to describe the particular series of epitaxial layers on a substrate crystal. They are typically specified by their thickness, composition, electrical and opto-electronic properties
DVD	Digital Versatile Disc
epilayer	an abbreviation for epitaxial layer
epitaxial layer(s)	the thin film(s) deposited on the surface of a substrate crystal by the epitaxy process. Typically measuring between 30 Å and tens of micron(s), epitaxial layers essentially replicate the crystal structure of the substrate and are formed by an ordered mixture of the constituent elements
epitaxy	the process of depositing a thin layer of single crystal upon a substrate such that the deposited layer(s) have essentially the same crystalline structure as the substrate
epiwafer or epitaxial wafer	term used to describe the substrate crystal with epitaxial layers deposited thereon (see also “wafer”)
FET	a Field Effect Transistor, a commonly used electronic component

foundry	a company or organisation providing a large scale outsourcing manufacturing service of a particular type of product. Another term for “independent” and “merchant”
GaAs	Gallium Arsenide, one of the most common binary compound semiconductors
GaAs on Silicon Wafers	the epitaxial wafers to be produced under the Licence Agreement using the Technology
GPRS	general packet radio switching, one of the new generation of wireless radio technology devices
gradient freeze crystal	a particular form of the technique used for the production of single crystals which are then sliced to produce substrates
groups III to V	the elements comprised in groups III, IV and V of the periodic table
HBT	Heterojunction Bipolar Transistor, a commonly used electronic component in mobile telephone and other high speed systems
HEMT	a High Electron Mobility Transistor, a commonly used electronic component
HD-DVD	High Definition – Digital Versatile Disc
independent	a business concentrating on only one tier of the manufacturing chain. Another term for “foundry” and “merchant”
InP	Indium Phosphide, another commonly used binary compound semiconductor
integrated circuit	a combination of electronic devices integrated onto a single substrate or chip
Internet	a global data and communications network and infrastructure for the rapid delivery of information throughout the world
ion implant	a technique for embedding foreign atoms into a host crystal to alter its electronic properties
LEDs	Light Emitting Diode(s), currently the most widespread device application of compound semiconductors
LPE	Liquid Phase Epitaxy, one of the mature epitaxial growth techniques
MBE	Molecular Beam Epitaxy, an advanced method of producing a diverse range of semiconductor epitaxial wafers, as described on page 47
merchant	a business concentrating on only one tier of the manufacturing chain. Another term for “foundry” and “independent”
metamorphic structure	a single (or several) semiconductor layer(s) deposited on a substrate with a different atomic spacing to the resulting structure



metrology	the study of measuring tools (e.g. gauges) and their capabilities
micron ( $\mu\text{m}$ )	measure of thickness, one millionth of one metre
MOCVD	Metal Organic Chemical Vapour Deposition, another common term to describe MOVPE
MOVPE	Metal Organic Vapour Phase Epitaxy, an advanced method of producing a diverse range of semiconductor epitaxial wafers, as described on page 46
nanometer (nm)	measure of thickness, one billionth of one metre
opto-electronic device	a device or structure in which light and electricity interact to produce, detect or manipulate light
opto-electronics	the field of application which uses a combination of light and electronics
periodic table	an arrangement of chemical elements based on the periodic law
photonics	the technology of generating and harnessing light and other forms of radiant energy whose quantum unit is the photon
processing	the combination of etching, patterning and metal deposition which is used to transform an epitaxial layer structure into a device
pure play	a business which concentrates its activities in only one tier of the manufacturing and production chain
reactor	the equipment used to produce epitaxial layers on the substrate
semiconductor	a material with resistivity which lies somewhere between that of a conductor and an insulator. By adding small amounts of impurity to the semiconductor, the resistivity of the semiconductor can be changed by many orders of magnitude
silicon	a non-metallic chemical element in the carbon family (group IVa of the periodic table)
silicon compounds	a substance made of atoms of two or more elements, one of which is silicon, chemically combined in fixed ratios
silicon germanium or SiGe	a compound semiconductor based on the elements of silicon and germanium
substrates	the term used to describe the base wafer used for the epitaxial substrate crystal growth process. It is typically a disc measuring 2", 3", 4" or 6" in diameter and 250-650 $\mu\text{m}$ thick. It is usually a single crystal, meaning all of the atoms comprising the substrate are in perfect alignment with one another in an ordered structure
VCSEL	Vertical Cavity Surface Emitting Laser, an opto-electronic component used in optical fibre systems and other applications

VPE	Vapour Phase Epitaxy, one of the mature epitaxial growth techniques
wafer	term used to describe the substrate crystal in the form of thinly sliced discs or the substrate disc with one or more epitaxial layers deposited upon it. Typically, wafers are discs 2" 3", 4" or 6" in diameter and measure between 250 $\mu\text{m}$ and 650 $\mu\text{m}$ in thickness.
3G	an advanced wireless radio protocol



## PART I

### LETTER FROM THE CHAIRMAN

## IQE PLC

*(Incorporated in England and Wales under the Companies Act 1985 with Registered No. 3745726)*

#### *Directors*

A W Nelson O.B.E. – Chairman and Chief Executive Officer  
T L Hierl – Chief Technical Officer  
M D Scott – Sales and Marketing Director  
R J G Clarke – Finance Director  
S Byars – Managing Director IQE (Europe) Limited  
S T Massie – President IQE Inc.  
M S M Lamb – Managing Director Wafer Technology Limited  
G H H Ainsworth – Non-executive Director  
G Bressner – Non-executive Director

#### *Registered Office*

Pascal Close  
Cypress Drive  
St Mellons  
Cardiff  
CF3 0EG  
UK

14 November 2001

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

Dear Sir or Madam

I am taking this opportunity of writing to you to appraise you of an opportunity available to the Group which the Board believes to be extremely exciting, relating to a potentially breakthrough new semiconductor technology developed by Motorola and initially announced by Motorola on 4 September 2001. Further details of this are referred to on page 15 of this document under “Background to the Transactions”.

Your Board has announced today that the Company has entered into a series of commercial agreements with Motorola relating to the further development and licensing of this new Technology and, as a result of which, it has also entered into the following:

1. Conditional agreements with Motorola pursuant to which:
  - Motorola will subscribe for 4,428,620 of the New Ordinary Shares at a price of 155p per share, representing an aggregate subscription of £6,864,361.
  - Motorola will, in addition, be granted the Motorola Share Warrant entitling Motorola to subscribe in whole or in part for the Motorola Warrant Shares at any time during the period of 5 years from the date of Completion. The initial price for the Motorola Warrant Shares will be 155p per Ordinary Share. Subject to certain conditions, this price will increase at a rate of up to 5 per cent. for each year that the Motorola Share Warrant remains unexercised.
2. Conditional agreements with the Equity Providers pursuant to which:
  - The Equity Providers will make available to the Company an equity draw down facility of up to £14,000,000. This, subject to certain restrictions, can be drawn down at the Company’s discretion by the Company issuing Ordinary Shares to the Equity Providers in return for funds. The price to be paid by the Equity Providers for the Draw Down Shares to be issued will be 93 per cent. of a price calculated over a period of time following notice of exercise of the Company’s draw down option.



- The Equity Providers will in addition be granted the Equity Providers' Share Warrants entitling them to subscribe in whole or in part for the Equity Providers' Warrant Shares at any time during the period of 3 years from the date of Completion. The price for the Equity Providers' Warrant Shares will be 178.25p per Warrant Share, representing 115 per cent. of the Placing Price.

In conjunction with the conditional agreements referred to above, the Company proposes to raise approximately £17,650,000 (net of the expenses of the Transactions) by means of an Open Offer of 13,152,247 of the New Ordinary Shares at 155p per share. Under the terms of the Open Offer, details of which are set out in the letter from Beeson Gregory in Part II of this document, Qualifying Shareholders may subscribe for 13,152,247 Offer Shares at 155p per share on the basis of 2 Offer Shares for every 25 existing Ordinary Shares held at close of business on the Record Date. Any Offer Shares not taken up by Qualifying Shareholders may be placed by Beeson Gregory, as agent for the Company, for the benefit of the Company at the Placing Price.

The Transactions are conditional upon the approval of the Company's Shareholders at an Extraordinary General Meeting which has been convened for 10 December 2001.

The purpose of this document is to provide you with information on the Transactions, to set out the reasons why your Board believes they are in the best interests of the Company and to recommend that you vote in favour of the Resolution to give effect to them.

#### **Background to the Transactions**

IQE was contacted in November 2000 by Motorola to ascertain IQE's interest in forming a strategic business relationship to help Motorola further develop and commercialise a potentially breakthrough new semiconductor technology which Motorola had developed at its research laboratories. Motorola explained that IQE was being approached as a business partner to participate in the development of the Technology and to enable commercialisation of the same to be achieved.

The Technology has the potential to be one of the most important technological discoveries in the semiconductor field for many years as it could enable a wide range of compound semiconductor epitaxial structures to be grown directly onto silicon substrates. Whilst there have been many previous attempts to produce high quality epitaxial structures directly on to silicon substrates, none have proceeded to successful commercialisation. This has been principally due to a large mismatch between the underlying crystalline structure of silicon and the various semiconductor compounds. The new Technology is based on introducing an intermediate layer of certain oxide materials between the silicon and the compound materials which allow strong bonding between both.

Some of the benefits of this new Technology could include (but are not limited to):

- reducing the cost of compound semiconductor components by replacing the costly GaAs substrates with less costly silicon. By way of example, a 6" GaAs substrate costs US\$400-500, whereas the equivalent size silicon substrate costs only US\$20-30. By utilising much cheaper silicon substrates, together with the new Technology, should mean that replacement GaAs on silicon substrates could be manufactured at significantly less than the cost of conventional GaAs substrates. If the new Technology could be extended to InP, even greater cost savings could potentially be made as a 4" InP substrate costs approximately US\$1,100;
- allowing compound semiconductor device and integrated circuit manufacturing on much larger and less brittle substrates. Currently commercial availability of GaAs substrates is limited to 6" and InP substrates to 4" compared with the availability of up to 12" silicon substrates which allows greater economies of scale to be achieved and should lead to higher fabrication yields; and
- the potential integration of advanced compound semiconductor devices with mature silicon processing technologies, allowing a completely new family of circuits with optical and electronic functions to be built on a single wafer. High levels of semiconductor component integration are



the bedrock of improved performance, lower power consumption, fewer parts and therefore lower cost. Increasing integration has been the key driver behind the success of the silicon industry for the past 30 years.

Motorola is in the process of compiling a comprehensive intellectual property portfolio, and to date has filed more than 270 patent applications, with the objective of licensing the Technology as widely as possible and promoting its adoption.

However, an essential pre-requisite in facilitating such adoption as a widely accepted standard is the availability of epitaxial wafers based on the new Technology. Given IQE's leading position within the global outsource epi-wafer market and its experience and expertise in epitaxial wafer development, IQE is well suited to play a pivotal role in the further development and commercialisation of the Technology.

Consequently, Motorola and IQE entered into the Initial Co-operation and Services Agreement under which IQE agreed to provide certain services in order to further develop the Technology towards commercial production of GaAs on Silicon Wafers based on the new Technology. This culminated in a public announcement relating specifically to the Technology and IQE's role in its development on 4 September 2001, confirming that Motorola had created the world's first 8" GaAs on Silicon Wafers and working with the Company, created the world's first 12" GaAs on Silicon Wafers. Motorola has since made working power amplifiers from GaAs on Silicon Wafers and has successfully completed numerous wireless calls using these devices in several mobile phones.

Motorola and IQE now wish to move quickly to commercially exploit the new Technology to its maximum effect.

To achieve this and to ensure controlled production, Motorola has granted IQE a licence, which includes a 15 month period of exclusivity and a most favoured licence status (for such 6" GaAs on Silicon Wafers as further discussed below), to produce epitaxial wafers using the Technology and to enter into evaluation programmes with customers of IQE and Motorola, with the objective of developing commercial products based on the new Technology. Motorola will then provide licences to these customers to produce commercial devices based on the Technology for sale into the open market.

It is intended that this process will lead to eventual full-scale production and roll-out. If the Technology does become widely accepted it will have a significant effect on the current wafer manufacturing technology employed within the industry.

From IQE's perspective, it wishes to ensure that it is at the forefront of this new Technology and to secure as significant a first mover advantage as possible.

To that end, the Board is pleased to announce that IQE and Motorola have entered into the following agreements, namely:

- the Licence Agreement;
- the Phase II Co-operation and Services Agreement;
- the Evaluation Program Agreement; and
- the Motorola Subscription Agreement.

#### **Licence Agreement**

Under the terms of the Licence Agreement, the Company has been granted a licence to use the Technology to manufacture GaAs on Silicon Wafers of up to 12" in diameter which, for all such wafers of up to 6" in diameter, will be exclusive to the Company for the merchant market for a period of up to 15 months (commencing on 1 November 2001) and will be irrevocable save in the case of the Company's breach or insolvency. The Company is required to achieve commercial production of epi-wafers based on the Technology within nine months of the commencement of the exclusivity period or it will lose the right to the balance of the exclusivity period. IQE will therefore have a major lead over its competitors as long as the exclusivity period





remains effective. In being the only company able to commercially supply these wafers to the merchant market during the first 15 months (subject to the above), IQE has a unique opportunity to establish itself as the major global source of wafers based on this new Technology. IQE will pay royalties to Motorola at an agreed rate by reference to products sold, although, whilst the Licence Agreement also allows the Company to manufacture larger GaAs on Silicon Wafers of up to 12" in size, the royalty rates for these sizes have yet to be determined.

#### **Phase II Cooperation and Services Agreement**

The Company and Motorola have entered into the Phase II Cooperation and Services Agreement pursuant to which the Company will continue to support Motorola's further development and commercialisation of the existing Technology and for a range of further III-V materials on silicon including the development of InP on silicon materials systems and the development of InGaAs/GaN on silicon material systems. Under the terms of this agreement, Motorola will continue to fund various costs incurred by IQE in performing the services and so that any intellectual property created as a result of the provision of the services will similarly be owned by Motorola. By virtue of its continuing development role for Motorola, IQE should be in the leading position to take advantage of future commercialisation of such other materials at the appropriate time.

#### **Evaluation Program Agreement**

In conjunction with the Licence Agreement and the Phase II Cooperation and Services Agreement, the Company and Motorola entered into an evaluation program agreement pursuant to which the parties have set out the basis upon which the Company will be authorised to provide sample GaAs on Silicon Wafers to mutually agreeable potential customers for non-commercial evaluation purposes. The Company has agreed to provide Motorola with a percentage of the revenues that it receives from such potential customers, either from sales of sample GaAs on Silicon Wafers or from engineering and other related services. The evaluation program agreement is intended to cover the supply of such sample wafers to potential customers for such time as they have a limited evaluation licence from Motorola. Once customers have obtained a full commercial licence to manufacture devices from Motorola, commercial supplies of GaAs on Silicon Wafers will be made to customers by IQE under the terms of the Licence Agreement.

During the first twelve months, IQE expects to derive the following additional revenue streams directly related to the above agreements reached with Motorola in respect of the Technology:

- development revenue from Motorola under the terms of the Phase II Co-operation and Services Agreement;
- development contract revenues from customers of both Motorola and IQE who have shown a high degree of interest in evaluating the Technology;
- the sale of evaluation wafers to customers of both Motorola and IQE; and
- the commercial sale of production wafers to licensed device manufacturers under the terms of the Licence Agreement.

#### **Motorola Subscription Agreement**

In so far as it will be important for the early industry adoption of the Technology that a reasonable supply of GaAs on Silicon Wafers is made available from IQE, it is recognised that additional specialist manufacturing facilities may need to be added to IQE's existing production capacity (some of which will also be used for this purpose). Any additional manufacturing capacity would require significant investment by IQE at the appropriate time. Partly for this reason, Motorola has conditionally agreed to make the investment under the terms of the Motorola Subscription Agreement which will assist the Company to secure the necessary



additional funds which the Company has identified would be needed if the adoption of the new Technology proceeded rapidly. (Further details of the Motorola Subscription are set out below within this letter).

In order to secure the balance of such funds, the Company has also conditionally entered into the Draw Down Facility allowing it to access up to £14,000,000 of additional equity money (further details of which are set out below within this letter) at times of the Company's choosing. Motorola has made it a condition of the Motorola Subscription Agreement that the Draw Down Facility had been entered into and not terminated before Completion in order to ensure it is satisfied that the Company has access to sufficient capital to enable it to properly commercialise the Technology as envisaged by both Motorola and the Company.

However, to ensure that the Company's Qualifying Shareholders will also have the opportunity to further invest alongside Motorola at this exciting stage of the Company's future development, the Company proposes to offer such Shareholders the right to subscribe, in aggregate, for up to 13,152,247 of the New Ordinary Shares (further details of which are set out below within this letter). To the extent Qualifying Shareholders take up the Open Offer, the Company may not need to exercise the Draw Down Facility. In any event, the Company does not envisage drawing down any sum pursuant thereto in the immediate future regardless of the take up of the Placing and Open Offer but its availability gives the Company additional security with regard to its future funding requirements.

#### **Opportunities and Reasons for the Transactions**

The opportunity to be at the forefront of developing the Technology and exploiting it in conjunction with Motorola, especially in light of the period of exclusivity granted for GaAs on Silicon Wafers having a diameter of up to 6", is believed by your Board to be highly significant and advantageous. The inability to take full advantage of the period of exclusivity for lack of available funds could, in the opinion of your Board, be damaging to the Company as it would allow a competitor of IQE, who subsequently acquires a licence of the Technology, to close the technology gap much quicker than would otherwise be the case, thereby leaving IQE in a less advantageous position. For this reason, your Board believes it is very important that IQE secures rapid access to the appropriate funding.

Some of the major opportunities to IQE presented by the Technology and the licensing of it are as follows:

- the period of exclusivity granted by the Licence Agreement affords IQE first mover advantage and the opportunity to establish itself as the major global source of GaAs on Silicon Wafers, thereby augmenting IQE's position as a leading pure play epi wafer supplier to the global compound semiconductor industry;
- your Board believes that it is likely that a market will develop for the supply of virtual substrates (consisting of the silicon substrate, an intermediate layer and a thin layer of compound semiconductor). The Company believes it has the opportunity to become the premier supplier in the world of these virtual substrates driven by the Company's first to market advantage and the anticipated reluctance of component and device manufacturers to invest in new specialist manufacturing capabilities to produce new substrates when wafers are readily available from outside sources;
- your Board believes that IQE will be well placed to leverage its position as the world's largest pure play epitaxial wafer foundry business by producing its traditional wide range of epitaxial services to new customers based on the new materials; and



- your Board also believes that it is likely that it will open up a new market for a completely new family of compound semiconductor structures not bound by the restrictions of the atomic spacing of GaAs and InP substrates and of integrated semiconductor circuits which could combine optical and electronic functions on the same chip.

From Motorola's perspective, the Company understands that it wanted to work with a partner which it felt confident could participate in the development of the Technology, in which it had a direct investment through an equity shareholding and which had adequate capital resources to make any necessary investment to commercialise the Technology.

In deciding to proceed with the Transactions and to recommend them to Existing Shareholders, the Board considered the following factors:

- opportunity: for the reasons stated above, it was felt that this was an opportunity which IQE could not afford to lose nor ignore;
- dilution: whilst the Motorola Subscription and issue of the Share Warrants does involve a dilution for Existing Shareholders, the Board does not consider the dilution to be significant when considered against the advantages which the Board believes the Company will acquire as a result of the Transactions, the Phase II Cooperation and Services Agreement, the Evaluation Program Agreement and the Licence Agreement. The Motorola Subscription in particular demonstrates commitment to, and confidence in, the Technology, whilst the Motorola Subscription Price is at the prevailing market price for the Ordinary Shares at the date of the Motorola Subscription Agreement. In addition, Qualifying Shareholders are being given the opportunity to also participate in the fund-raising. The availability of the Draw Down Facility also provides the Company with additional comfort with regard to its funding requirements with no immediate dilution for Existing Shareholders. As a result of the various issues of Ordinary Shares contemplated, the Resolution contains an appropriate authority disapplying pre-emption rights in respect of the allotment and issue of the New Ordinary Shares, the Draw Down Shares and the Warrant Shares;
- capital cost: to exploit the Technology and to fully secure its commercial advantage, IQE may need to add large scale specialist manufacturing facilities to its existing production capacity, requiring significant capital investment over the next few years. The Motorola Subscription and the Draw Down Facility (regardless of the take up of the Open Offer) will enable IQE to properly prepare for commercialisation and be in a secure financial position to exploit it;
- independence: the issue of IQE's independence from a customer perspective was also considered at length. A large part of IQE's success has been built on the clear strategy of being a pure play materials supplier, thereby not competing with its customers and of being independent. Although an investment will be made by Motorola, IQE will nevertheless continue to remain independent with no Motorola representation at any operating or board level within the Group. Your Board has made sure that Motorola is aware of and recognises this requirement for independence, so that customers can therefore continue to be assured of IQE's independence whilst gaining access to the Technology; and



- technology partner: without compromising independence from IQE's perspective, having Motorola as a shareholder should clearly help in fostering a long term partnership with regard to the further development and exploitation of the Technology. In addition, this relationship has been instrumental in enabling IQE to negotiate a favourable licence arrangement including provisions granting it:
  - a lead period of exclusivity for 15 months over any other licensee in the merchant market for GaAs on Silicon Wafers of up to 6" in diameter;
  - most favoured licensee status intended to ensure that no other licensee would be granted more favourable terms for the manufacture of GaAs on Silicon Wafers of up to 6" in diameter than it by Motorola; and
  - a licence to manufacture GaAs on Silicon Wafers of up to 12" in diameter.

It is believed that it will also place IQE in a strong position to take further advantage of future developments by Motorola of the Technology and related applications, especially having regard to the continued services being provided by IQE under the Phase II Cooperation and Services Agreement.

In summary, your Board believes the Transactions protect Existing Shareholders' interests by enabling the Company to secure sufficient financial resources to exploit the Technology thereby maximising its competitive advantage, whilst also providing Qualifying Shareholders with the opportunity to participate at the same time and at the same price as Motorola. As a condition to them entering into the Motorola Subscription Agreement and the Draw Down Facility respectively, Motorola and the Equity Providers required an entitlement to benefit from IQE's future capital growth in the form of the Share Warrants.

## **Terms of the Transactions**

### **1. The Motorola Subscription**

Under the terms of the Motorola Subscription Agreement, Motorola has agreed to subscribe a total of £6,864,361 for 4,428,620 of the New Ordinary Shares at a subscription price of 155p per New Ordinary Share.

Completion of the Motorola Subscription is conditional, *inter alia*, upon the passing of the Resolution by the Shareholders at the Extraordinary General Meeting and Admission taking place. It is anticipated that, subject to satisfaction of the conditions, the Motorola Subscription will be completed on 12 December 2001.

Under the terms of the Motorola Subscription Agreement, it is proposed that Motorola will be granted the Motorola Share Warrant enabling it to subscribe at any time, in whole or in part, within the five year period following Completion, for up to 4,428,620 additional Ordinary Shares at an initial price of 155p per Ordinary Share, which will increase (subject to certain conditions) at a rate of up to 5 per cent. for each year that any part of the Motorola Share Warrant remains unexercised.

Further information on the Motorola Subscription Agreement and the Motorola Share Warrant Instrument are set out in Part III "Information on the Group – The Motorola Subscription, the Draw Down Facility and the Share Warrants" and in section 14 of Part VIII "General Information – Material Contracts" of this document.



## **2. The Draw Down Facility**

Under the terms of the Draw Down Facility, the Equity Providers have agreed to make available an equity draw down facility of up to £14,000,000 which, subject to certain restrictions as mentioned below, can be drawn down at times of the Company's choosing by the Company issuing Ordinary Shares to the Equity Providers in return for funds.

Under the terms of the Draw Down Facility Agreement, the Company can, from time to time, serve notice on the Equity Providers stating the number of Ordinary Shares which the Company wishes to issue to the Equity Providers. The price to be paid by the Equity Providers for such Ordinary Shares will be equal to 93 per cent. of the average of the volume weighted price for such 12 days in the 17 trading day period immediately following the Company serving such draw down notice as Marblegate may select. The Equity Providers will (subject to certain conditions) be bound to take up at least two-thirds of the number of Ordinary Shares stipulated under the notice but, at their option, may take up to 100 per cent. of the same. The number of Ordinary Shares stipulated by the Company may not exceed 150 per cent. of the average daily trading volume in number of Ordinary Shares on the Official List (excluding block trades) for the 30 previous days, but there is no restriction on the number of draw downs (providing that no draw down can be made if the closing bid price of the Shares is not above 50p on the day of delivery of a draw down notice and if any draw down is outstanding). The facility itself will be available to the Company for a period of 3 years from the date it is entered into or until the £14,000,000 has been subscribed for.

The Draw Down Facility is also conditional, *inter alia*, upon approval of the Resolution.

Under the terms of the Draw Down Facility, it is proposed that the Equity Providers will be granted the Equity Providers' Share Warrants enabling them to subscribe at any time within the three year period following Completion for the Equity Providers' Warrant Shares, in whole or in part, at a price of 178.25p per Warrant Share, being 115 per cent. of the Placing Price.

Further information on the Draw Down Facility and the Equity Providers' Share Warrants are set out in Part III "Information on the Group - The Motorola Subscription, the Draw Down Facility and the Share Warrants" and section 14 of Part VIII "General Information – Material Contracts" of this document.

## **3. Placing and Open Offer**

Details of the Placing are set out on page 58 of this document. Details of the Open Offer are set out in the letter from Beeson Gregory in Part II of this document. Under the terms of the Open Offer, Qualifying Shareholders may subscribe for 13,152,247 of the New Ordinary Shares at 155p per share on the basis of 2 Offer Shares for every 25 existing Ordinary Shares. Completion of the Open Offer is conditional, *inter alia*, upon approval of the Resolution.

### **Effect of Implementation of the Transactions**

Shareholders attention is drawn to the table on page 4 of this document which sets out certain statistics resulting from the implementation of the Transactions.

### **Information on Motorola**

Motorola, whose principal executive offices are located in Schaumburg, Illinois, USA, is a global leader in providing integrated communications solutions and embedded electronic solutions. These include:

- software-enhanced wireless telephone, two-way radio and messaging products and systems, as well as networking and Internet-access products, for consumers, network operators and commercial, government and industrial customers;
- end-to-end systems for the delivery of interactive digital video, voice and high-speed data solutions for broadband operators;



- embedded semiconductor solutions for customers in the networking and computing, transportation, wireless communications and digital consumer/home networking markets; and
- embedded electronic systems for automotive, industrial, transportation, navigation, communications and energy systems markets.

Motorola had a worldwide turnover of US\$37.5 billion in 2000.

### **Information on the Equity Providers**

#### **MARBLEGATE**

Marblegate is a subsidiary of Highbridge Capital Corporation (the "Fund"), an asset management company primarily investing in the global equity and corporate securities markets. The Fund is managed by Highbridge Capital Management, LLC ("Highbridge"), a private New York based money management firm founded and wholly owned by Glenn Dubin and Henry Swieca. Current assets under management of Highbridge are in excess of US\$3.5 billion.

The Fund's investors include global financial institutions, corporate pensions, endowments, foundations and private investors worldwide. Highbridge has offices in New York, London and Tokyo.

#### **CAISLEAN**

Caislean which is headquartered in Chicago, is an investment fund specialising in equity and equity linked transactions. Caislean's investors are high net worth individuals in the United States. Citadel Investment Group (Europe) Ltd. ("CIGE"), based in London, serves as an investment adviser to Caislean. CIGE is an affiliate of Citadel Limited Partnership, a global investment firm that manages in excess of US\$6.5 billion.

### **Current Trading & Prospects**

Concurrently with the Motorola announcements, IQE has today announced its Q3 2001 results as set out in full in Part VII of this document. As previously indicated in the Interim Statement set out in full in Part VI of this document, the Group is currently operating in an extremely difficult trading environment, further exacerbated by recent events within the global economy.

The compound semiconductor industry, along with the wider semiconductor industry is undergoing one of the sharpest declines in the history of the sector. Despite this challenging environment, the Group's Q3 2001 sales were slightly higher than previously indicated, at £8.234m, representing a 28 per cent. increase over Q3 2000 (£6.431m) but down 37 per cent. on the previous quarter. For the first nine months of 2001, sales were £34.351m, up by 75 per cent. compared with the previous year (2000: £19.639m). As a result of the downturn in Q3 2001 sales from the previous quarter, the Group incurred an operating loss (before goodwill and exceptional items) of £2.228m, (Q3 2000: profit £0.380m) partly reflecting a large increase in research and development expenditure (Q3 2001: £1.602m, Q3 2000: £0.289m) to support the exciting new product developments which the Group has embarked upon. However, taken as a whole, for the first nine months, the Group remained profitable (before goodwill and exceptional items) at £0.328m (2000: £1.167m), with an EBITDA of £4.791m (2000: £2.808m).

The Group experienced a small net cash outflow from operations in Q3 2001 of £1.230m, and capital expenditure reduced to £3.475m compared with £8.844m in the previous quarter. A significant part of this expenditure is related to equipment required to support the new technology development announced today with Motorola.

Overall, during Q3 2001, the new development contracts at IQE (Europe) were not sufficient to offset the dramatic decline in production orders from opto-electronic manufacturers, who are currently suffering from a significant inventory backlog. However, major progress was made in new product developments for next generation systems, particularly in long wavelength 1.3mm VCSELs, where successful devices have now been demonstrated, and in Avalanche Photo Detectors (APDs) where a new product has been launched with world class device results. The InGaP HBT product from IQE (Europe) has also met with significant success and is being qualified by a number of manufacturers worldwide.



In the wireless marketplace, the Group is now seeing definite signs of improvement to trading conditions, with some significant production orders now being negotiated with customers. In addition, new product development continues to be successful, particularly with InP HBTs which are now designed in to several new customer products. Strong work continues on supporting the breakthrough new GaAs on silicon technology, as further detailed in today's announcements.

Wafer Technology continues to perform well on specialist wafer products, although their more mature business has also suffered as a consequence of the very difficult market conditions. Margins were adversely impacted in Q3 2001 due to high metal prices but these are now returning to historical levels. Overall, Wafer Technology is outperforming its competitors in the marketplace and business has held up reasonably well.

IQE Silicon Compounds has now signed up a further 5 customer non-disclosure agreements making 32 in total and has run qualification wafers for 16 customers. The initial qualifications are now completing and as a result, the company recently received its first production orders from large European IC manufacturers. Despite the overall industry decline, progress continues to be positive with excellent feedback on the new SiGe products and the successful completion of further qualification programmes will lead to accelerating production over the next few quarters.

Overall, the current trading environment continues to be extremely challenging, particularly in the opto-electronic sector. Continued weakness in this area is being offset to an extent by the improving environment in the wireless sector and the success of IQE Silicon Compounds in winning production orders. Consequently, in order to conserve cash, the Group has taken a number of cost control initiatives, which are anticipated to help the Group move back towards profitability in the coming quarters.

Notwithstanding the difficulties in the current commercial marketplace, IQE has clearly established a very strong position as a leading global outsource wafer supplier into the compound semiconductor industry, as evidenced by Motorola's unique choice of IQE to further develop and commercialise the Technology which is believed by the Board to be one of the most exciting discoveries within the semiconductor field for many years.

As the overall semiconductor industry recovers, together with the exceptionally exciting opportunity open to the Group as a result of its agreements with Motorola relating to the commercialisation of the GaAs on silicon technology, and as outsourcing becomes a much more significant part of the compound semiconductor industry, your Board believes that IQE is well placed to build further upon its position as a leading outsource wafer supplier within the compound semiconductor industry.

## **Dividends**

Your Board anticipates that following Completion, earnings will be retained for development of the Group's business and will not be distributed for the foreseeable future.

## **Resolutions and Extraordinary General Meeting**

Your attention is drawn to the notice set out at the end of this document convening an Extraordinary General Meeting of the Company to be held at 10.00 a.m. on 10 December 2001 at which a special resolution will be proposed to:

- increase the Company's authorised share capital from £2,500,000 to £3,000,000 by the creation of an additional 50,000,000 Ordinary Shares to enable the Company to have sufficient share capital to issue the New Ordinary Shares and the Draw Down Shares and all of the Warrant Shares on exercise in full of the Draw Down Facility and the Share Warrants, respectively, and so as to maintain a reasonable margin of authorised but unissued and unreserved Ordinary Share capital following the Transactions;



- authorise the Directors to allot and issue the New Ordinary Shares, the Draw Down Shares and the Warrant Shares pursuant to Section 80 of the Companies Act 1985 (such authorisation to expire five years after the passing of the Resolution); and
- to disapply the pre-emption rights provisions of section 89 of the Companies Act 1985 in respect of the New Ordinary Shares, the Draw Down Shares and the Warrant Shares so that such shares shall not first be offered to Existing Shareholders.

### **Action to be taken in respect of the Extraordinary General Meeting**

A form of proxy for use at the Extraordinary General Meeting by Shareholders is enclosed with this document. Whether or not you intend to be present at the meeting, you are requested to complete and return the form of proxy in accordance with the instructions printed on it. To be valid, completed forms of proxy should be returned to the Company's registrars, Capita IRG Plc, at Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TU as soon as possible but, in any event, by no later than 10.00 a.m. on 8 December 2001. The completion and return of the form of proxy will not preclude you from attending and voting in person at the meeting should you wish to do so.

The action that you should take if you wish to subscribe for all or part of your entitlement under the Open Offer is set out in the letter from Beeson Gregory in Part II of this document and in the enclosed Application Form.

If you do not wish to subscribe for your entitlement under the Open Offer, you should not complete or return the enclosed Application Form. Whether or not you intend to subscribe for your entitlement under the Open Offer, you are requested to complete and return the form of proxy.

### **Additional Information**

Despite the general authority to allot Ordinary Shares and disapplication of pre-emption rights which were granted at the Company's Annual General Meeting held on 8 May 2001, the Board has no present intention of issuing further new Ordinary Shares save as set out in this document or otherwise save pursuant to the Share Option Schemes.

Your attention is drawn to the additional information set out in Parts II to VIII of this document.

### **Recommendation**

The Directors, who have been advised by Beeson Gregory, the Company's financial adviser, consider the Transactions to be in the best interests of the Company and its Shareholders as a whole. Your Directors unanimously recommend that you vote in favour of the Resolution to be proposed at the Extraordinary General Meeting as they intend to do in respect of their own beneficial holdings which, in aggregate amount to 70,389,825 Ordinary Shares representing approximately 43 per cent. of the Company's existing issued share capital.

The Transactions cannot be implemented unless the Resolution is approved at the Extraordinary General Meeting.

Shareholders are strongly recommended to take independent financial advice before taking up all or any of their entitlements under the Open Offer.

Yours faithfully

**Dr A. W. Nelson OBE**  
*Chairman and Chief Executive Officer*





## SUMMARY OF KEY INFORMATION

*This summary highlights information contained elsewhere in this prospectus but is not exhaustive and should be read together with the more detailed information regarding the Group, the Ordinary Shares, the financial information of the Group (and the notes thereto) in Parts V, VI and VII of this document and the other information contained in this prospectus.*

### **Introduction and Summary**

IQE and its subsidiaries as a group are the largest pure play outsource manufacturer of bespoke epitaxial wafers to the compound semiconductor industry. Compound semiconductors are one of the critical materials enabling the operation of many high technology systems of today. For example, the optical fibre communications, optical storage (CD, CD-ROM and DVD), LEDs and semiconductor lasers, are entirely dependent upon compound semiconductor materials for the fundamental operation of the components used. The electronics industry, which has traditionally relied upon silicon, is becoming increasingly dependent on compound semiconductors as the demand for more efficient, higher frequency and more powerful components for wireless, mobile and satellite communication systems increases. The unique properties of compound semiconductors, namely their ability to both efficiently emit and detect light, coupled with the inherent speed of electrons within these materials (which can be up to ten times faster than in silicon), have been key factors in their development. Compound semiconductors have therefore become essential in the communications network and infrastructure for the delivery of Internet services, wireless communications, next generation mobile and satellite telephone systems (in particular GPRS and 3G enabled phones for Internet access), fibre optic communications, high brightness LEDs, satellite solar cells, optical storage, medical applications and consumer and automotive electronics.

The Group was formed in May 1999 by the combination of two of the leading independent epitaxial wafer manufacturers, EPI (now known as IQE (Europe) Limited), a UK company specialising in the production of wafers by MOVPE, and QED (now known as IQE, Inc.), a US based company specialising in wafer production by MBE.

In November 2000, the Group acquired Wafer Technology, a substrate manufacturer in order to maintain a secure supply for the Group and its customers of outsource wafer products.

Also in November 2000, the Group formed a new subsidiary, IQE Silicon Compounds to provide sophisticated epitaxy services targeted towards the silicon industry although it did not trade as a limited entity until early 2001.

It is believed that the opportunity to be at the forefront of the Technology will considerably enhance IQE's position as the leading global outsource wafer supplier, particularly in view of the exclusivity period which has been negotiated. The Technology will be highly complementary to IQE's existing epiwafer products and will allow customers to develop processes very quickly, using both conventional technology and the Technology. The virtual substrates produced by the Technology will be used in the manufacture of full epitaxial structures using IQE's core business expertise and existing MOVPE and MBE manufacturing capacity.

In addition, wafers produced using the Technology will complement the product range of Wafer Technology which is mainly concentrated on wafer sizes of 4" and less, whereas the cost advantage of using the Technology becomes apparent when manufacturing larger wafer sizes.

### **The Group's Strategy**

The Group's goal is to maintain and further strengthen its position as a leading pure play global supplier of bespoke epiwafers to the compound semiconductor device manufacturing industry. The development and licensing of the Technology from Motorola is aimed at significantly enhancing this. Key elements of the Group's strategy include:



#### FOCUS ON HIGH VOLUME COMMERCIAL MARKETS

The Group intends to continue to focus on high volume commercial markets that the Board believes will grow significantly over the long term such as wireless communications, next generation mobile and satellite telephone systems (in particular GPRS and 3G enabled phones for Internet access), Internet infrastructure systems, fibre optic communications, high brightness LEDs, satellite solar cells, computers, optical storage, medical applications and consumer and automotive electronics.

#### MAINTAIN TECHNOLOGICAL LEADERSHIP

Based upon the MOVPE and MBE wafer production experience of the Group's founders and management, many of who have worked in these fields since their inception, and the technical proficiency of its staff, the Group will continually seek to maintain its technological leadership through the design and development of new technologies and products. The Group is also involved in a number of research and development projects in order to develop new wafer technologies and maintain its technological advantage. The licensing of the Technology will considerably enhance the Group's technological leadership and, during the term of the Phase II Co-operation and Services Agreement, further development of the Technology will take a high priority.

#### STRENGTHEN CUSTOMER RELATIONSHIPS AND ENSURE QUALITY PERFORMANCE

The Group seeks to develop multi-level working relationships during the early stages of the product development cycle with industry leaders in each of the Group's target markets. This strategy allows the Group to become an integral participant in the customers' device manufacturing process and make the Group's expertise a critical step of the design process.

#### CONTINUE TO PENETRATE THE IN-HOUSE VERTICALLY INTEGRATED CAPTIVE MARKET

The Board believes that the Group can significantly increase its market share and broaden its customer base by further penetrating the captive MOVPE and MBE wafer markets by being a cost effective alternative to the in-house manufacture of epitaxial wafers.

#### MAINTAIN A PURE PLAY SUPPLIER STATUS

The Group's strategy is to remain a pure play wafer foundry rather than vertically integrating into device, chip or component manufacture. The Board considers that customers strongly value the trust and confidence they have in IQE as a pure play supplier. This trust enables these customers to provide the Group with confidential device design information. In keeping with this philosophy, the terms of the Motorola Transaction have been carefully negotiated to maintain the Group's independence whilst allowing Motorola to achieve its objectives.

### **Products**

The Group currently supplies a wide range of bespoke compound semiconductor epiwafer products based mainly on GaAs and InP substrates. The principal end-user markets include next generation mobile and satellite telephone systems, Internet infrastructure systems, fibre optic communications, satellite systems, wireless communications, display and illumination technology, computer and consumer products, automotive applications and the medical industry. Each device structure is designed specifically for a given customer and therefore maintaining confidentiality is a key factor in supporting the Group's customer base.

The Group has recently established a new subsidiary, IQE Silicon Compounds, to provide bespoke epiwafers based on silicon substrates, including buried layer epitaxy and silicon germanium epitaxial structures. The Technology will complement IQE Silicon Compounds' operation by adding a different technology base and different materials to the Group's existing range of silicon products and services whilst the Group should be able to exploit the contacts that IQE Silicon Compounds has already made in the silicon industry.

Additionally, the Company acquired Wafer Technology in order to both secure the Group's ability to offer a source of critical substrate materials and to gain access to an additional customer base.



The Group therefore is able to offer its customer base an unparalleled range of wafer products across numerous material structures. The Board believes that the Technology will add a highly complementary range of new products to the existing product range and will provide IQE with a market position that is unrivalled by its competitors.

### **Reasons for the Transactions**

The licensing of the Technology is believed by the Board to represent a tremendous opportunity for the Company, especially given its perceived breakthrough nature and potential to be used for wide ranging applications. In particular, the exclusivity period negotiated pursuant to the Licence Agreement for GaAs on Silicon Wafers having a diameter of up to 6" should afford IQE first mover advantage and the opportunity to establish itself as the major global source of GaAs on Silicon Wafers. This should allow IQE to augment its position as a leading global pure-play wafer supplier.

In order to commercialise the Technology as soon as possible, large scale specialist manufacturing facilities may need to be added to IQE's existing production capacity. This may require significant investment by IQE. Motorola has conditionally agreed to make an investment under the terms of the Motorola Subscription Agreement which will assist the Company in securing the necessary additional funds which the Company has identified to meet its short and medium term requirements. The balance of the funds will be provided by the Placing and Open Offer and the Draw Down Facility. It was a condition to Motorola's subscription for the Motorola Ordinary Shares under the Motorola Subscription Agreement that IQE has guaranteed access to sufficient capital to enable it to properly commercialise the Technology.



## SUMMARY FINANCIAL INFORMATION

The following selected consolidated historical financial data of the Group should be read in conjunction with the Financial Information Relating to the Group in Part V, the Unaudited Second Quarter and Interim Results for the Period ended 30 June 2001 in Part VI and the Unaudited Third Quarter Results for the Period ended 30 September 2001 in Part VII of this Prospectus.

The Merger has been accounted for under merger accounting, whereby the financial information is disclosed as if EPIH and QED had always been part of the Group.

### CONSOLIDATED INCOME STATEMENT

£'000	Year ended 31 December			Six months ended	Nine months ended 30
	1998	1999	2000	30 June 2001	September 2001
	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>	<i>Unaudited</i>	<i>Unaudited</i>
Turnover	15,856	19,043	30,117	26,117	34,351
Gross profit	5,686	6,485	10,332	8,464	9,766
Operating Expenses	(4,516)	(5,031)	(8,337)	(5,908)	(9,438)
Exceptional Items	0	(171)	0	(274)	(506)
Goodwill Amortisation	0	0	(209)	(910)	(1,363)
Operating profit/(loss)	1,170	1,283	1,786	1,372	(1,541)
Profit/(loss) before tax	782	693	2,994	1,790	(1,221)
Profit/(loss) after tax	552	842	1,810	1,202	(1,173)
Undiluted earnings per share	0.53p	0.63p	1.24p	0.73p	(0.72p)
Dividend per share	0p	0.13p	0p	0p	0p

### CONSOLIDATED BALANCE SHEET

	As at 31 December			As at	As at 30
	1998	1999	2000	30 June 2001	September 2001
	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>	<i>Unaudited</i>	<i>Unaudited</i>
Current Assets	5,113	18,433	57,708	46,239	37,926
Fixed Assets	5,498	11,483	84,391	104,989	107,264
Total Assets	10,611	29,916	142,099	151,228	145,190
Current Liabilities	(4,835)	(4,518)	(17,405)	(21,358)	(15,274)
Long-Term Liabilities	(5,145)	(4,448)	(7,097)	(10,142)	(13,867)
Shareholders' Equity	631	20,950	117,597	119,728	116,048

#### NOTES:

The earnings per share on an undiluted basis and the profit/(loss) per share on a diluted basis are calculated on the basis set out in Part V.

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

The exceptional items in the year ended 31 December 1999 are comprised of costs associated with the acquisition of EPIH and QED by the Company and the Nasdaq Europe Admission.

The exceptional item in the six months ended 30 June 2001 is comprised of legal fees relating to a complaint lodged by IQE (Europe) against Rockwell Technologies LLC.

## PART II



## Beeson Gregory Limited

THE REGISTRY ROYAL MINT COURT  
LONDON EC3N 4LB  
TEL: 020 7488 4040  
FAX: CORPORATE 020 7481 3762  
FAX: DEALERS 020 7702 4288

<http://www.beeson-gregory.co.uk>

To Qualifying Shareholders

14 November 2001

Dear Sir or Madam,

## PROPOSED OPEN OFFER TO QUALIFYING SHAREHOLDERS

### Introduction

As explained in the letter from your Chairman set out in Part I of this document, IQE has entered into conditional agreements with regard to the Motorola Subscription and the Draw Down Facility and now intends to raise approximately £17,650,000 (net of the expenses of the Transactions) by means of a Placing and Open Offer. Under the Open Offer, Qualifying Shareholders may subscribe for an aggregate of up to 13,152,247 Offer Shares at a price of 155p per such share.

### The Open Offer

Subject to the terms and conditions set out below and in the Application Form, Beeson Gregory, on behalf of and as agent for the Company, hereby invites Qualifying Shareholders to apply for Offer Shares at a price of 155p per share, payable in full in cash on application, free of all expenses, on the basis of:

#### 2 Offer Shares for every 25 existing Ordinary Shares

held by them and registered in their names on the Record Date and so in proportion for any other number of Ordinary Shares then held. Entitlements of Qualifying Shareholders will be rounded down to the nearest whole number of new Ordinary Shares, and fractional entitlements to Offer Shares will not be allocated to Qualifying Shareholders but will be aggregated and sold in the market and the proceeds retained for the benefit of the Company.

Qualifying Shareholders may apply for any whole number of Offer Shares up to their maximum entitlement as indicated in Box B in the accompanying Application Form which has been based on the number of Ordinary Shares registered in his or her name on the Record Date, as shown in Box A. Any Qualifying Shareholder who purports to apply for more than his or her maximum entitlement will be deemed to have applied only for his or her maximum entitlement. Any monies paid in excess of such entitlement will be returned by post to the applicant (at the applicant's risk) without interest.

The Offer Shares are to be issued credited as fully paid and will rank *pari passu* in all respects with existing Ordinary Shares including the right to all dividends and other distributions declared, made or paid after the date of this document.

The Open Offer is conditional upon the passing of the Resolution and Admission becoming effective by no later than 8.00 a.m. on 12 December 2001 (or such later time and/or date, being no later than 3.00 p.m. on 31 January 2002, as the Company and Beeson Gregory may agree). Details of the Placing are set out in "The Placing" in Part III of this document on page 57. The Open Offer is not conditional upon the Placing becoming unconditional.



Applications for Offer Shares will be irrevocable and may only be made on the enclosed Application Form which is personal to the Qualifying Shareholder(s) named on it and may not be assigned or transferred except to satisfy *bona fide* market claims in relation to purchases through the market prior to the date on which the Ordinary Shares are marked “ex” the entitlement to the Open Offer. Applications may be split, but only to satisfy *bona fide* market claims, up to 5.00 p.m. on 3 December 2001. Qualifying Shareholders who have sold or transferred all or part of their registered shareholding should complete Box I on the accompanying Application Form and send it to the stockbroker, bank or other agent through whom the sale was effected for transmission to the purchaser or transferee, since the invitation to apply for Open Offer Shares may represent a benefit which can be claimed from them by the buyers or transferees of the Ordinary Shares under the rules of the UK Listing Authority.

Qualifying Shareholders should be aware that the Open Offer is not a “rights issue”. Entitlements under the Open Offer are not transferable and the Application Form is not a document of title and cannot be traded. Temporary documents of title will not be issued. Any entitlement to Offer Shares which is not taken up under the Open Offer will not be sold in the market for the benefit of Qualifying Shareholders, but may be placed by Beeson Gregory, as agent for the Company and for the benefit of the Company pursuant to the Placing Agreement.

Application will be made to the UK Listing Authority for the Offer Shares to be admitted to the Official List and to the London Stock Exchange for the Offer Shares to be admitted to trading on its market for listed securities and to Nasdaq Europe for the Offer Shares to be admitted to listing on its market. The Offer Shares will be issued fully paid and will rank *pari passu* in all respects with the Motorola Subscription Shares and the Existing Ordinary Shares.

### **Procedure for Application and Payment**

The Application Form enclosed with this document shows the number of Ordinary Shares registered in your name at the close of business on the Record Date. It also shows your maximum entitlement to Offer Shares and the amount payable upon application if you decide to apply for your maximum entitlement.

If you wish to apply for Offer Shares, you should complete and sign the enclosed Application Form in accordance with the instructions thereon and herein and send it, together with the appropriate remittance, by post, or by hand (during normal business hours) to New Issues Department, Capita IRG Plc, PO Box 166, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TH, or by hand only (during normal business hours) to Capita IRG Plc, Guildhall House, 81-87 Gresham Street, London EC2 in either case so as to arrive no later than 5.00 p.m. on 5 December 2001. Application Forms will not be accepted after this time. If you post your Application Form within the United Kingdom by first class post, you are recommended to allow at least three working days for delivery.

Beeson Gregory and the Company reserve the right to treat an Application Form as valid and binding on the persons by whom, or on whose behalf, it is lodged even if it is not completed in accordance with the relevant instructions or not accompanied by a valid power of attorney, where required, or verification of identity where required as described below in this Part II, or which otherwise does not strictly comply with the terms and conditions for application. Applications will be irrevocable and will not be acknowledged.

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 5.00 p.m. on 5 December 2001 from an authorised person (as defined in the Financial Services Act 1986), specifying the Offer Shares concerned and undertaking to lodge the relevant Application Form in due course.

All documents and remittances sent by or to an applicant, or as he may direct, will be sent through the post at his or her own risk. No receipts will be issued for any amounts paid on application.

Payment must be made by cheque or bankers’ draft which should be made payable to “Capita IRG Plc” - A/c IQE plc and crossed “Account payee”. Cheques and bankers’ drafts must be drawn in sterling on a branch in the United Kingdom, Channel Islands and Isle of Man of a bank or building society which is either a settlement member of the Cheque & Credit Clearing Company Limited or the CHAPS & Town



Clearing Company Limited or a member of the committees of Scottish or Belfast Clearing Houses or which has arranged for its cheques or bankers' drafts to be cleared through the facilities provided for the members of any of those companies or committees and must bear the appropriate sorting code in the top right-hand corner. No application will be considered unless these requirements are fulfilled.

Cheques and bankers' drafts will be presented for payment upon receipt and it is a condition of the Open Offer as regards each Qualifying Shareholder that such Qualifying Shareholder's cheques are honoured on first presentation and, if any cheque or bankers' draft is not so honoured, the application to which it relates will not be treated as valid.

Please note that, in order for an application to be valid, the relevant cheque or bankers' draft must be cleared by 5.00 p.m. on 5 December 2001. Applicants for Offer Shares should therefore lodge their applications as soon as possible to allow their cheques or bankers' drafts to be cleared by that time. The Company reserves the rights to have cheques or bankers' drafts specially cleared.

All documents or remittances sent by or to an applicant, or as he may direct, will be sent by post at his own risk.

If the conditions of the Open Offer have not been fulfilled on or before 8.00 a.m. 12 December 2001, application monies will be returned, without interest, by non-transferable cheque in favour of the applicant by post as soon as practicable thereafter.

By completing and delivering an Application Form, you (as the applicant(s)):

- (a) agree that all applications, and contracts resulting therefrom, under the Open Offer shall be governed by, and construed in accordance with, English law; and
- (b) confirm that in making the application you are not relying on any information or representation other than such as may be contained in this document and you accordingly agree that no person responsible solely or jointly for this document or any part thereof shall have any liability for any information or representation not contained in this document.

**Your attention is drawn to the Chairman's letter which precedes this letter.**

**If you are in any doubt about the action you should take, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser immediately.**

**If you do not wish to apply for any of the Offer Shares, you should not complete or return the enclosed Application Form. You are nevertheless requested to complete and return the enclosed form of proxy for use at the Extraordinary General Meeting.**

### **Money Laundering Regulations 1993**

It is a term of the Open Offer that, to ensure compliance with the Money Laundering Regulations 1993, Capita IRG Plc may, at its absolute discretion, require verification of the identity of the person by whom or on whose behalf an Application Form is lodged with payment (the "applicant").

If the value of an application exceeds €15,000 (approximately £9,000) (or is one of a series of linked applications, the aggregate value of which exceeds that amount), verification of the identity of the applicant for the Offer Shares will be required if payment is made other than by the applicant (or one of the joint applicants). Accordingly, if the value at the Placing Price of the Offer Shares for which you are applying exceeds €15,000 (approximately £9,000), payment should be made by means of a cheque drawn by the person named in the Application Form (or one of the joint applicants) or (where an Application Form has been transferred and/or split to satisfy *bona fide* market claims in relation to transfers of existing Ordinary Shares through the market prior to 5.00 p.m. on 3 December 2001) by the person named in Box F or Box I (where applicable) on the Application Form. If this is not practicable and you use a cheque drawn by a third party (for example, a building society cheque or banker's draft), you should:



- (a) write the name, address and date of birth of the person named in the Application Form (or one of the joint applicants) or (where an Application Form has been transferred and/or split to satisfy *bona fide* market claims in relation to transfers of existing Ordinary Shares through the market prior to 5.00 p.m. on 3 December 2001) by the person named in Box F or Box I (where applicable) on the Application Form on the back of the cheque, building society cheque or banker's draft;
- (b) if a building society cheque or banker's draft is used, ask the building society or bank to endorse on the cheque or banker's draft the name and account number of the person whose building society or bank account is being debited, such endorsement being validated by a stamp and authorised signature.

If you deliver your Application Form personally by hand, you should ensure that you have with you evidence of your identity bearing your photograph (e.g. your passport) and evidence of your address.

If an applicant is lodging an Application Form as agent for one or more persons and is not a UK or EU regulated person or institution (e.g. a bank or broker), Capita IRG Plc is obliged to take reasonable measures to establish the identity of the person or persons on whose behalf the Application Form is being lodged. Accordingly, if you are making an application as agent for one or more persons, you should indicate on the Application Form whether you are a UK or EU regulated person or institution and specify your status. If you are not a UK or EU regulated person or institution, you should contact Capita IRG Plc and seek guidance.

In any event, if it appears to Capita IRG Plc that an applicant is acting on behalf of some other person, further verification of the identity of any person on whose behalf the applicant appears to be acting may be required.

In relation to any application in respect of which the necessary verification of the identity of the applicant or the person on whose behalf the applicant appears to be acting has not been received on or before the latest application date (expected to be 5.00 p.m. on 5 December 2001) (or such later date as the Company may in its absolute discretion determine) the Company may, in its absolute discretion, elect to treat the relevant application as invalid and/or delay the allotment and/or issue of the relevant Offer Shares until the necessary verification has been provided.

Neither the Company nor Beeson Gregory nor Capita IRG Plc will be responsible, or have any liability, for loss or damage (whether actual or alleged) arising from the election by the Company to treat an Application Form in respect of Offer Shares lodged by an applicant as invalid as a result of Capita IRG Plc at its discretion not having received adequate evidence as to the identity of the applicant and of any person for whom the applicant appears to be acting, reasonably satisfactory to Capita IRG Plc as set out above, or as a result of the Company or Beeson Gregory exercising any of their other discretions in relation to the Placing and Open Offer.

### **Overseas Shareholders**

The attention of Shareholders with a registered address overseas on the Record Date is drawn to the information set out in "Nature of the Issue" in Part III of this document on page 59, which identifies those shareholders to whom the Open Offer is not available and who accordingly will not be Qualifying Shareholders.

In particular, the offer and sale of the Offer Shares have not been and will not be registered under the Securities Act and therefore Shareholders who are citizens or residents of the US may not purchase Offer Shares in the Open Offer. Application forms from such Shareholders will not be accepted. Further, any Application Forms mailed from within the US will not be accepted. This document is being sent to such Shareholders solely in compliance with legal requirements relating to the Extraordinary General Meeting and is intended merely to inform such Shareholders about the matters to be voted on at the Extraordinary General Meeting and is not, nor is it intended to constitute, an offer to purchase any Offer Shares.





The Offer Shares may be offered and sold in the Placing in the US pursuant to an applicable exemption from registration under the Securities Act. Such Offer Shares cannot be resold or transferred in the US unless pursuant to an effective registration statement or pursuant to an applicable exemption from the Securities Act and in compliance with the securities laws of any applicable state.

### **Taxation**

Under current Inland Revenue practice, any Offer Shares subscribed for by a Qualifying Shareholder up to the amount of his entitlement will be treated as a reorganisation for the purposes of United Kingdom taxation of capital gains and so will not give rise to a disposal for tax purposes. The Offer Shares will be treated as the same asset acquired at the same time as the existing holding of the Existing Ordinary Shares and the subscription price will be added to the base cost of the enlarged holding.

For corporate shareholders, indexation allowance relating to the Offer Shares will be calculated based on the time when the consideration was actually given.

For individual shareholders, taper relief will apply instead of indexation allowance. Taper relief effectively reduces the capital gains tax rate applying on the sale of the Offer Shares. The extent of the relief varies according to the length of time the asset has been held. The rules relating to taper relief are complex but generally taper relief will apply to Offer Shares from the time of the acquisition of the original holding.

**The attention of UK and Belgian Qualifying Shareholders is drawn to section 13 of Part VIII of this document. If any Qualifying Shareholders are in doubt as to their tax position, they should consult an appropriate independent financial adviser immediately.**

### **Settlement and Dealings**

Subject to the Open Offer becoming unconditional, dealings for normal account settlement in the Offer Shares are expected to commence at 8.00 a.m. on 12 December 2001. Qualifying Shareholders who hold their existing Ordinary Shares in uncertificated form will be allotted Offer Shares in uncertificated form to the extent their entitlement to the Offer Shares arises as a result of holding Ordinary Shares in uncertificated form.

Notwithstanding any other provisions of this document, the Company reserves the right to allot and/or issue any Offer Shares in certificated form. The right may also be exercised if the correct details (such as member account ID and participant ID details) are not provided in Box G as requested on the Application Form.

For those Qualifying Shareholders who do not hold their existing Ordinary Shares in CREST or Euroclear/Clearstream or do not elect to have their Offer Shares credited to their relevant CREST or Euroclear/Clearstream account, definitive certificates in respect of Offer Shares are expected to be despatched by post by 14 December 2001. No temporary documents of title will be issued and, pending such despatch, transfers will be certified against the share register.

For those Qualifying Shareholders who validly elect to hold their Offer Shares in CREST or Euroclear/Clearstream, the relevant account will be credited on the day of Admission of the Offer Shares.

### **Other Information**

Your attention is drawn to the letter from your Chairman which is set out in Part I of this document which contains, *inter alia*, information on the reasons for the Placing and Open Offer, to the further information set out in Parts III to VIII of this document, and to the terms and conditions set out in the enclosed Application Form.

Yours faithfully

J.D. Freeman

*Director*

Beeson Gregory Limited



## PART III

### INFORMATION ON THE GROUP

#### Introduction and Summary

IQE and its subsidiaries as a group are the largest pure play out source manufacturer of bespoke epitaxial wafers to the compound semiconductor industry. Compound semiconductors are one of the critical materials enabling the operation of many high technology systems of today. For example, optical fibre communications, optical storage (CD, CD-ROM and DVD), LEDs and semiconductor lasers, are entirely dependent upon compound semiconductor materials for the fundamental operation of the components used. The electronics industry, which has traditionally relied upon silicon, is becoming increasingly dependent on compound semiconductors as the demand for more efficient, higher frequency and more powerful components for wireless, mobile and satellite communication systems increases. The unique properties of compound semiconductors, namely their ability to both efficiently emit and detect light, coupled with the inherent speed of electrons within these materials (which can be up to ten times faster than in silicon), have been key factors in their development. Compound semiconductors have therefore become essential in the communications network and infrastructure for the delivery of Internet services, wireless communications, next generation mobile and satellite telephone systems (in particular GPRS and 3G enabled phones for Internet access), fibre optic communications, high brightness LED's, satellite solar cells, optical storage, medical applications and consumer and automotive electronics.

A critical part of the manufacturing process of most compound semiconductor devices is the production of epitaxial wafers, which consist of numerous ultra thin layers of semiconductors deposited onto substrate crystals. The Group uses the two most sophisticated manufacturing technologies in the industry, Metal Organic Vapour Phase Epitaxy (MOVPE) (also known as Metal Organic Chemical Vapour Deposition (MOCVD)) and Molecular Beam Epitaxy (MBE), to produce a wide variety of highly uniform epitaxial wafers in large quantities. As an independent pure play epitaxial wafer foundry, the Directors believe that the Group provides a comprehensive and cost effective alternative to in-house manufacture for the semiconductor industry. The Group counts amongst its customers a significant proportion of the leading compound semiconductor device manufacturers worldwide.

Despite the immediate economic climate, the Directors believe that the medium to long term growth opportunities open to the Group are being driven by three principal factors: (i) the demand for optoelectronic components and systems driven by the increase in the need for high speed Internet services, and the need for increasingly powerful and higher frequency electronic systems, most of which use compound semiconductors; (ii) the move by device manufacturers from captive (in-house) epitaxial wafer supply to merchant (outsourced) supply, a process which the Directors believe may accelerate as a consequence of the current economic climate and as a result of technological advances within the industry, particularly any changes in wafer manufacturing technology which requires substantial capital investment; and (iii) the use of MOVPE and MBE as the key manufacturing technologies for the production of new compound semiconductor components, coupled with the displacement of existing technologies for more mature device sectors.

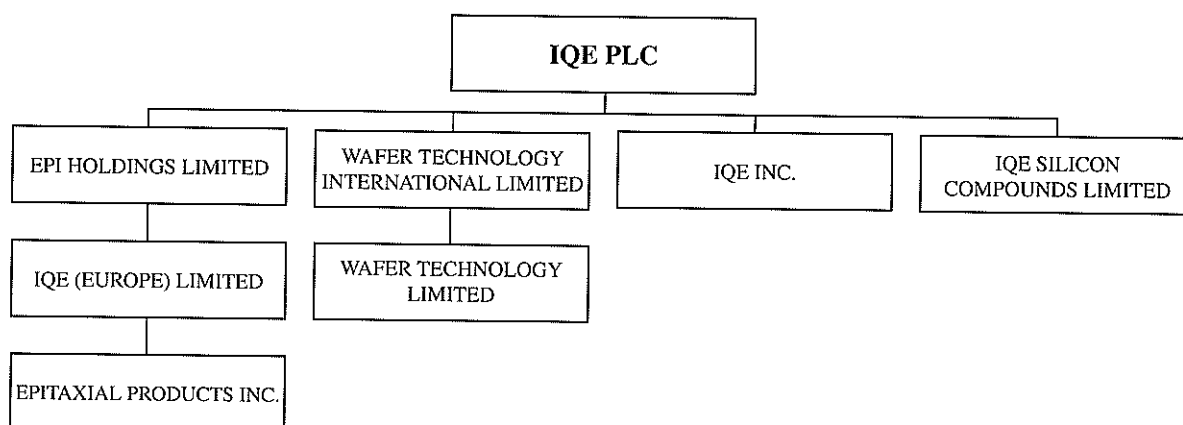
The Group was formed in May 1999 by the combination of two of the leading independent epitaxial wafer manufacturers, EPI (now known as IQE (Europe) Limited), a UK company specialising in the production of wafers by MOVPE, and QED (now known as IQE, Inc.), a US based company specialising in wafer production by MBE.

In November 2000, IQE acquired Wafer Technology, a supplier of III – V compound semiconductor substrates and high purity polycrystalline materials. The acquisition was strategic in that it allowed IQE to offer a unique and secure range of outsource wafer products to the compound semiconductor industry and also provided IQE with direct access to key InP wafer products which are not only critical for most optical fibre light emitting and detecting devices but which are also viewed as an essential material for the electronic components required for high speed communication systems.



Also in November 2000, IQE announced the formation of a new subsidiary, IQE Silicon Compounds, to be Europe's first independent provider of outsourced epitaxial services to the silicon based semiconductor industry (although, initially set up as a division of IQE Europe, IQE Silicon Compounds did not commence trading as a limited entity until early 2001). IQE Silicon Compounds' operation is highly complementary to IQE's existing compound semiconductor epiwafer products and services business based on substrates since the range of epi-services now required for the communications industries is growing. In particular, newer and more sophisticated products built on silicon wafers increasingly require complex epitaxial processes and a number of new materials such as SiGe are finding widespread applications, particularly in the fibre optic and wireless communication industries.

The following companies comprise the Group:



All of the subsidiaries are wholly owned, whether directly or indirectly by IQE plc.

Consequently, the Group now offers the semiconductor industry a comprehensive range of wafer products covering both opto-electronic and electronic applications, utilising the most sophisticated manufacturing technologies in the industry. By virtue of its diverse geographical market coverage, expert manufacturing capabilities and size, and production sites on two continents, the Directors believe the Group is well placed to strengthen its position as a leading independent global provider of advanced wafer products and epitaxial services to the semiconductor industry.

The addition of the Technology, with its evident potential to be used in applications across both the compound and silicon sectors of the semiconductor industry, should allow IQE to further strengthen its position, to attract new customers and enter new markets not currently accessible using existing technologies.

## Industry Overview

The demands of industry and consumers for ever more sophisticated, multi functional communications and electronic products has led to major changes in the communications and IT industries over the last few years. In particular, the increasing use of Internet services has led to great demand in recent years for communication systems with much higher levels of performance and functionality than in the past. Currently there is a need to build faster, less costly and more widely accepted optical fibre networks as data communications now represent more than half of all information carried on networks around the globe and Internet related traffic is increasing. Considerable efforts are being made to provide opto-electronic components and systems which can handle many more channels of information at much higher speeds than was previously thought possible. Likewise, the amount of information which is required to be stored, retrieved, transmitted and switched, both in homes and in industry has grown enormously in recent years and new optical storage technologies, such as CD, CD-ROM and DVD, have been developed to cope with demand. Mobile telephony systems including those allowing direct Internet access, satellite communications and power systems, automotive applications, office systems such as laser printing and fax machines and display technology, especially high visibility outdoor



screens and motorway signage, are just a few other areas of technology where the operating requirements of the electronic and opto-electronic components have become increasingly sophisticated, requiring a much higher level of performance than was achievable only a short time ago.

Compound semiconductors are critical to the operation of most of these systems and have therefore emerged as key enabling materials in facilitating the dramatic advancements and improvements in the previously mentioned applications. This results from the unique properties of these materials. Unlike silicon, which is a single element semiconductor and therefore has a fixed set of inherent electronic characteristics, compound semiconductors are made from a mixture of elements from the III-V columns of the Periodic Table.

Examples of compound semiconductors, and the III-V elements from which they derive are:

*Elements*

<b>Group III Elements</b>	
Al:	Aluminium
Ga:	Gallium
In:	Indium

<b>Group IV Elements</b>	
C:	Carbon
Si:	Silicon
Ge:	Germanium

<b>Group V Elements</b>	
N:	Nitrogen
P:	Phosphorous
As:	Arsenic
Sb:	Antimony

*Semiconductors*

<b>Compound Semiconductors (Groups III – V)</b>	
GaAs:	Gallium Arsenide
InP:	Indium Phosphide
GaN:	Gallium Nitride
InSb:	Indium Antimonide
AlGaAs:	Aluminium Gallium Arsenide
InGaAs:	Indium Gallium Arsenide
InGaAsP:	Indium Gallium Arsenide Phosphide
AlInGaP:	Aluminium Indium Gallium Phosphide

<b>Compound Semiconductors (Groups IV – IV)</b>	
SiGe:	Silicon Germanium
SiGeC:	Silicon Germanium Carbon
SiC:	Silicon Carbide

By combining these elements in a variety of ways to produce the compound semiconductors mentioned above, materials with a diverse range of opto-electronic and electronic properties can be produced. In particular, due to their physical properties, certain compound semiconductors are extremely efficient at generating light from electricity and converting light back into electricity, compared with existing alternatives, and have therefore been key materials enabling the operation of semiconductor lasers, LEDs and detectors which are at the heart of almost all opto-electronic systems, such as fibre optic communication systems, optical storage systems, display technology and satellite power systems. In the electronic domain, the range of electronic properties created by compound semiconductors, including the ability of electrons to travel much more quickly in these materials than in silicon by a factor of up to ten, has enabled the operation of much higher frequency, lower noise and more power efficient electronic systems. These qualities enabled significant improvements in the mobile telephony, satellite communication and wireless communication industries to take place, contributing to the ongoing communications revolution particularly with regard to the introduction of Bluetooth wireless technology, a new technology which has been developed as a standard by most of the world's leading wireless companies. In addition, compound semiconductors have been applied to a wide range of other industries. A summary of significant applications which incorporate compound semiconductors (not all of which incorporate the Group's products) are listed below:

**Automotive (Sensors)**

- Brake Lighting
- Indicators
- Instrumentation
- Internal Lighting
- Traffic Information
- GPS
- Proximity Radar
- Collision Avoidance
- Speed Controls
- Engine Controls
- Antilock Braking
- Brushless Motors

**Computer/Data Storage (Lasers)**

- High Speed Computers
- DVD
- CD-ROM CD
- Laser Printers
- Bar Code Readers
- Fax Machines

**Display / Illuminations (LED's)**

- Full Colour Displays
- Sports Stadia
- Traffic Signals
- Motorway Signage
- Information Boards
- White Light Sources
- Laser Pointers

**Medical (Lasers)**

- Laser Surgery
- Cosmetic Surgery
- Ophthalmics
- Dentistry
- Photo Dynamic Therapy
- Blood Monitoring

**Optical Fibre Communications (Lasers)**

- Internet
- Intranet
- High Speed Data Links
- Inter Office Networks
- Undersea Cables
- Optical Repeaters

**Satellite Communications (Solar Cells)**

- Direct Broadcast
- Satellite TV (DBS)
- Satellite Power Supplies
- (Solar Arrays)
- GPS
- VSAT

**Wireless Communications (Transistors)**

- Cellular Phones (Mobile)
- Pagers
- Navigations Systems
- Base Station Link



The manufacture of most compound semiconductor components differs very significantly from that of silicon components. In silicon technology, the functionality of the device or integrated circuit is created by taking the base silicon wafer and building many transistors on the wafer surface, which normally involves many more processing steps than for compound semiconductor technology. In contrast, the functionality of almost all compound semiconductor devices is created by a process called epitaxy. In this process, numerous ultra thin layers of different compositions (mixtures) of III-V elements are deposited (or 'grown') upon a substrate crystal. The epitaxy process is one of the most critical in the compound semiconductor manufacturing chain and traditionally has been carried out in-house as part of a company's vertically integrated manufacturing process. However, epitaxy is also one of the most expensive parts of the manufacturing chain, and due to significant developments over the last few years, now requires a high level of expertise which is not readily available in-house. The Board believes that one of the reasons why demand will grow for the Group's products is that many companies are looking for more cost effective out sourced solutions. With the launch of IQE Silicon Compounds, IQE has become well placed to exploit the demand for epitaxial services to the silicon based semiconductor industry. As the material requirements become even more sophisticated, to enable faster, more efficient circuits and components to be built, epitaxy is becoming evermore important as a critical step in the manufacturing chain.

Based upon independent research, the Directors estimate that the market for compound semiconductor devices which incorporate the type of wafers produced by the Group, to be worth \$14.2 billion in 2001.

The Company believes that the Technology will have a strong impact on the cost base of the compound semiconductor industry by permitting the replacement of certain costly substrates by much less expensive silicon substrates, particularly for the larger diameter wafers. In addition, the Technology should enable high levels of opto-electronic and other silicon compound semiconductor combinations which will facilitate a completely new range of applications, and which will further reduce overall system costs. By virtue of its position at the forefront of development of the Technology and the limited exclusivity granted under the licence arrangements, IQE expects to be very well placed to take advantage of both these developments.

### **The Epitaxial Opportunity**

The market for compound semiconductor components leads directly to opportunities in the epitaxial wafer market. Based upon independent research, the Directors estimate that the world market for epitaxial wafers of the type produced by the Group is worth approximately \$2.98 billion in 2001.

The key factors driving this demand for epitaxial wafers are the markets for communications and IT systems directly in support of the infrastructure for the delivery of Internet services, as well as more efficient and higher functionality consumer and display products. Many of the end products which use compound semiconductors are currently using less efficient technology (ion implant, LPE or VPE), or are markets, where new and updated technology is used by the consumer to replace less technically sophisticated products. This has led to continued demand for high quality compound semiconductor epitaxial wafers.

However, whilst the demand for compound semiconductors produced by MOVPE and MBE has grown, epiwafer manufacturing capacity, with the associated high capital costs, long lead time to acquire and install production equipment and shortage of technically experienced personnel, has been lagging. Some device manufacturers have no in-house (captive) epitaxial research and development or production capacity. Others produce wafers for research and development purposes but do not have any in-house production capacity. Finally, many larger captive suppliers have in-house production capacity but either cannot always produce a sufficient volume of suitable epiwafers to meet their requirements or desire a second source supplier for strategic reasons.



The epitaxy process, although a critical part of the overall manufacturing cycle, is a large drain on resources, both financial and technical, for device manufacturing companies with their own epitaxy capabilities. The demands of end user markets for decreasing component prices and ever increasing levels of technical complexity have accelerated the need for cost effective solutions to the overall manufacturing process.

The Board believes that the most cost effective business strategy for users of epitaxial wafers is outsourcing the parts of the manufacturing chain which add the highest cost to the manufacturers' end product, usually because of the disproportionately high level of investment and resources required to keep up with technological changes in that part of the manufacturing chain. In the compound semiconductor industry, the epitaxy process is one of the most costly parts of the manufacturing process and therefore one of the most obvious for outsourcing. Consequently, the use of independent epitaxial wafer manufacturers provides a cost effective strategy for the compound semiconductor industry. The Board believes that the Group is well placed, by having the largest independent epiwafer manufacturing capacity worldwide and consequently the ability to achieve economies of scale, to take advantage of the industry demand. As the move to the use of foundries accelerates, the cost effectiveness of foundries should increase as economies of scale drive down manufacturing costs. This virtuous circle scenario leads the Board to believe that more companies will adopt the outsource foundry route as their own vertically integrated manufacturing model becomes increasingly less competitive. This has already occurred in the silicon industry with the rapid growth of wafer chip processing foundries such as TSMC, UMC and Chartered Semiconductor. Therefore, there is a clear precedent for outsourcing in the silicon industry and the interest already shown in IQE Silicon Compounds confirms the Board's decision to invest in specialist epiwafer foundry services for the silicon industry.

In the Board's view, this move to outsourcing will be further accelerated by the introduction of the Technology as the Board believes the device and component manufacturers across the entire semiconductor industry are likely to be reluctant to invest in the new and expensive specialist manufacturing capabilities required to manufacture GaAs on Silicon Wafers.

The demand for epiwafers from independent epitaxial wafer manufacturers is therefore, in the view of the Board, being driven in the medium to long-term by a number of factors, namely:

- (i) the general increase in demand for compound semiconductors to support both the deployment of increasing numbers of communication and IT systems and the development and commercialisation of new systems;
- (ii) the move of device manufacturers away from traditional in-house production of wafers to the use of independent supply;
- (iii) the increasing use of MOVPE and MBE as key epitaxy technologies for new products and the increased displacement of less efficient technologies (ion implant, LPE or VPE); and
- (iv) the industry shift in manufacturing based on 4" wafers to 6" wafers, in order to further reduce component costs (which will facilitate even wider deployment of high speed communication systems).

As a result, the semiconductor industry has a continued requirement for bespoke epitaxial wafer foundries which can deliver expert, reliable and cost effective wafer development and supply.

The Technology is expected to provide an even greater opportunity to reduce component and integrated circuit costs by allowing both larger wafer sizes (potentially up to 12") and much lower substrate costs. Additionally, much higher levels of electronic and optical component integration should be facilitated by the Technology allowing a substantial reduction in communication system costs.

### **The IQE Solution**

The Board believes that the Group is unique in the industry and uses its key strengths to provide an attractive and cost effective epiwafer manufacturing solution for the compound semiconductor industry.



The key strengths of the Group include the following:

*Product Range and Technical Capability:* With the complementary ranges of IQE Europe's opto-electronic products and QED's electronic products, together with the recent additions of Wafer Technology's range of specialist Group III – V substrates and IQE Silicon Compound's silicon operation, the Group is able to offer customers a wide range of compound semiconductor epiwafer structures using either MOVPE or MBE manufacturing technologies as well as silicon epitaxy services and a source of substrates. Thus, a customer need only deal with a single organisation, simplifying administrative, financial and technical issues and creating a 'one stop' epitaxial wafer foundry.

*Second Sourcing:* For most device manufacturers, second sourcing is required in order to protect their commercial interests and provide a guaranteed source of wafers for their production lines. At the present time, most of the larger device manufacturers are using outside foundries to provide this strategically important second source to their in-house production. The Group has manufacturing sites on two different continents and can provide product second sourcing to customers by MOVPE or MBE. In the future, the Group intends to have both types of production technology located in separate facilities as some companies are reluctant to rely on a single production site for any given technology. This capability will be achieved largely with the qualification of the first Aixtron 2600 reactor in Bethlehem, US, which has occurred in 2001. This will thereby provide a more complete second sourcing capability. This would remove an internal barrier to large companies outsourcing potentially all of their compound semiconductor epiwafer production needs to the Group, putting it in a highly competitive position.

In addition, there is currently a very strong move within the electronics sector of the compound semiconductor industry to add 6" wafer processing capability. This requires the adoption of a new generation of epitaxy equipment. Existing captive manufacturers may therefore be forced to reappraise their policy of in-house wafer manufacture when faced with the prospect of adding new, costly large scale production platforms, particularly in light of current industry dynamics. The Directors believe the Group will benefit from this reappraisal because they believe that the Group was the first merchant epitaxy company worldwide to implement a new generation of MBE and MOVPE production platforms that are capable of producing both 4" and 6" wafers in a cost effective manner. IQE believes that it currently has the largest manufacturing capability of any outsource epitaxy foundry. In addition, the Licence Agreement licences the Technology for use by IQE to produce GaAs on Silicon Wafers up to 12" which will allow the Group to exploit demand for these wafers.

*Synergistic Benefits:* The Group provides a scale of pure play epitaxy operation which is unique in the industry. The Group is currently the largest pure play merchant MOVPE and MBE foundry by reference to turnover. The Group commands a strong position with suppliers, customers and government organisations. As the Group further expands its manufacturing capabilities, the Board expects that the Group will be able to offer its customers a low cost of supply for advanced compound semiconductor epiwafer structures in the industry. In addition, by combining its R&D experience across both MOVPE and MBE technologies covering both electronic and opto-electronic device applications, the Group has a range of expertise which can cover most customer requirements. This diversity allows the Group's customers to access a large pool of knowledge at a fraction of the cost they would incur using their own resources and to concentrate their expertise on their own core business of device manufacture. This makes outsourcing to the Group a very attractive option compared to developing an in-house facility.

*Sales and Marketing:* IQE now has a highly developed and well established marketing and distribution network throughout the world. Prior to the Merger, QED had over 94 per cent. of its business in the US and had developed strong relationships with customers who comprise most of the major compound semiconductor device and system manufacturers in the US. IQE Europe has benefited significantly from an increased presence in the US market by combining its existing office with the existing QED sales group and QED now has a much higher global profile and presence by virtue of IQE Europe's sales and marketing network, which has provided QED with direct access to a significant number of the major electronic component manufacturers outside the US. The Group consequently has a sales





and marketing team with a combination of technical expertise, a global presence with strong links to most major compound semiconductor device manufacturers worldwide and a wide product, technical and capacity range significantly larger than that of any independent epiwafer foundry.

Since launching IQE Silicon Compounds early in 2001, a high profile within the silicon industry has already been achieved, to the extent that 32 of the major silicon manufacturers operating in Europe have signed, or are in the process of signing non-disclosure agreements with IQE with a view to disclosing their processes enabling IQE Silicon Compounds to become qualified with those companies. In addition, several major US corporations have opened discussions with IQE Silicon Compounds despite an intentionally low level of focus applied to that geographic region. Consequently, IQE is in a very powerful position to exploit the Technology from a marketing perspective with strong links having already been established between IQE and the major industry players.

### **The Group's Strategy**

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

#### **FOCUS ON HIGH VOLUME COMMERCIAL MARKETS**

The Group intends to focus on high volume commercial markets that your Board believes will grow significantly over the long term such as wireless communications, next generation mobile and satellite telephone systems (and in particular GPRS and 3G enabled phones for Internet access), Internet infrastructure systems, fibre optic communications, satellite solar cells, computers, optical storage, medical applications and consumer and automotive electronics. To meet the compound semiconductor wafer requirements for these markets, the Group intends to continue to invest in the latest generation multi-wafer MOVPE and MBE production equipment including 6" wafer equipment. In addition, by increasing production capacity and focusing its production on higher volumes, the Directors believe that the Group can reduce its cost per wafer and use its cost advantage to accelerate the use of its epiwafers in existing and new high volume markets.

The introduction of the Technology will assist the general goal of cost reduction by its very nature as it allows epitaxial wafers to be grown on much less expensive silicon substrates.

#### **MAINTAIN TECHNOLOGICAL LEADERSHIP**

Based upon the MOVPE and MBE wafer production experience of the Group's founders and management, many of whom have worked in these fields since their inception, and the technical proficiency of its staff, the Group will continually seek to maintain its technological leadership through the design and development of new technologies and products. It intends to refine its processes, and continue to expand its epitaxial growth capabilities in order to continue to offer additional bespoke products. The Group also intends to selectively pursue contract research programmes to help fund the development of new technical capabilities and products. In addition, to further increase production efficiencies, reduce unit costs and maintain a technological edge, the Group has been actively involved with suppliers, equipment manufacturers and characterisation equipment suppliers to develop the next generations of epitaxy and metrology equipment. The Group is also involved in a number of research and development projects in order to develop new wafer technologies and maintain its technological advantage. With the Group's acquisition of Wafer Technology it has secured direct access to InP wafer products which are essential to the development of the high speed communication industries.

The Company announced in August 2001 that it had signed a Heads of Agreement with QinetiQ (formerly the majority of DERA's business) to form a joint venture company to undertake research and development and to provide materials assessment services on behalf of the Company, QinetiQ and other customers globally. It is anticipated that the Company will be the significant majority holder of shares in the joint venture company.



The adoption of the Technology should further enhance the technological leadership of IQE and by virtue of the limited exclusivity period for the merchant market, should position IQE as the clear technical leader within the wafer supply industry.

#### STRENGTHEN CUSTOMER RELATIONSHIPS AND ENSURE QUALITY PERFORMANCE

The Group seeks to develop multi-level working relationships during the early stages of the product development cycle with industry leaders in each of the Group's target markets. This strategy allows the Group to become an integral participant in the customers' device manufacturing process and make the Group's expertise a critical step of the design process. In an effort to further strengthen its customer relationships, the Group is committed to satisfying its customers' evolving requirements and expectations. The Group's quality assurance programme includes wafer evaluation using sophisticated non-destructive measurement techniques and the incorporation of customers' quality assurance techniques and specifications to ensure that the Group maintains the consistent delivery of high quality products.

#### CONTINUE TO PENETRATE THE CAPTIVE IN-HOUSE VERTICALLY INTEGRATED MARKET

The Board believes that the Group can significantly increase its market share and broaden its customer base by further penetrating the captive MOVPE and MBE wafer markets by being a cost effective alternative to in-house production of epitaxial wafers. The Board estimates that approximately 81 per cent. of advanced compound semiconductor epitaxial wafers are produced by in-house/vertically integrated manufacturers and the balance by merchant suppliers such as the Group (and that this proportion will fall to 75 per cent. by the end of 2004). Due to the significant costs of developing and maintaining a captive production capacity and of upgrading to meet new technological advances, the Board believes that manufacturers utilising compound semiconductor wafers will increasingly rely on outsourcing to merchant suppliers to: (i) provide consistent quality epiwafers at low cost for their device production lines; (ii) fulfil variable production requirements; and (iii) access technical expertise and experience to aid in the rapid development of new products.

A recent example of this is the need for captive in-house manufacturers to move to much larger and more cost effective epitaxy equipment, as the electronics (wireless communication) industry moves from 4" to 6" wafer manufacturing. Captive suppliers will be faced with either replacing most of their existing, less cost effective epitaxy equipment with the new generation equipment, which is very expensive, or moving to outsource suppliers. Again, the Board believes that this move will be compounded to the extent of the wide adoption of the Technology. Any captive in-house manufacturer that wishes to have its own manufacturing capability will need to make a significant capital investment in new equipment.

#### MAINTAIN A PURE PLAY SUPPLIER STATUS

The Group's strategy is to remain a pure play wafer foundry rather than vertically integrating into device, chip or component manufacture. The Board considers that customers strongly value the trust and confidence they have in IQE as a pure play supplier. This trust enables these customers to provide the Group with confidential device design information. In addition, the Group has worked closely with many of its key suppliers over the past ten years, resulting in the Group obtaining access to the latest developments in reactor technology, raw material supply (substrates, chemicals) and characterisation techniques, enabling the Group to maintain an advantage over its competitors. The acquisition of Wafer Technology and the resulting availability of both epitaxial services and bulk materials within the Group places the Group in a strong position to take advantage of growth in demand. The availability of the Technology and the limited exclusivity period negotiated should compound this without leading to any loss of independence through Motorola's investment.

#### CONTINUED GROWTH STRATEGY

The Directors intend to pursue further expansion of the Group by organic growth and by acquisitions and joint ventures. See "Maintain Technological Leadership" above, in this Part III, with regard to the joint venture with QinetiQ that was announced in August 2001.



## Products

### CURRENT PRODUCTS

IQE Europe and IQE US between them currently supply a wide range of bespoke compound semiconductor epiwafer products based mainly on GaAs and InP substrates. The principal end user markets include next generation mobile and satellite telephone systems; Internet infrastructure systems; fibre optic communications; satellite systems, wireless communications, display and illumination technology, computer and consumer products, automotive applications and the medical industry. Each device structure is designed specifically for a given customer and therefore maintaining confidentiality is a key factor in supporting the Group's customer base. Essentially, the competitiveness of each customer's end device is a combination of the epilayer design and the wafer processing technology used. The Group's intellectual property and expertise is in the detailed epitaxial processing used to produce high quality and highly uniform epilayer structures with the precise material requirements of the device manufacturer. A high degree of confidentiality is therefore a prerequisite to maintaining customers' confidence and expanding the foundry business. The Group does not sell 'standard' commodity products but does maintain a library of published data and, therefore, public domain structures for use by customers for their design requirements.

Wafer Technology manufactures a range of GaAs and InP and other specialist III-V substrates in diameters ranging from 2" to 4" which are supplied worldwide to major manufacturers of electronic and opto-electronic devices. Wafer Technology is also a key supplier of high purity bulk GaAs and InP polycrystalline feedstock to the rest of the industry.

Services provided by IQE Silicon Compounds include selective and buried layer Si epitaxy for BiCMOS and bipolar process, SiGe selective and other epi-services and wafer sizes of 100mm, 150mm and 200mm diameters will be catered for.

### PRODUCTS IN DEVELOPMENT

The Group has an intention to develop wafer technology for short wavelength (<570nm) opto-electronic devices such as LEDs and lasers based on Gallium Nitride, which is rapidly growing in importance since these materials enable production of blue and ultra-violet LEDs, and lasers which are needed for white light sources and next generation HD-DVD. The Group, also developing metamorphic P-HEMTs using antimony based compounds, is completing development on HBTs, based on GaInP, for use in next generation mobile and satellite telephone systems, and has embarked on a programme to develop long wavelength (1.3µm) VCSELs, based on InGaAsN, for future optical fibre communication systems. Several of these programmes are co-funded by the European Commission and involve close collaboration with the main users of such products, providing a closer relationship with the potential customers through their manufacturing cycle.

The Group also intends to vigorously develop the potential of the Technology by working closely with Motorola and with its customers to enable the full range of potential products to be realised as quickly as possible, as well as the widespread adoption of the technology.

## Research and Development

The Group selectively pursues contract research programmes co-funded with third parties to help support the development of new technical capabilities and products. These programmes have been selected to complement and enhance the Group's long-term development strategy under conditions that permit the Group to retain the technology it develops. During the years ended 31 December 2000, 1999 and 1998, third-party research and development contract gross revenue was £310,000, £215,000 and £188,000, or approximately 1.0 per cent., 1.1 per cent. and 1.2 per cent. respectively, of the Group's total gross revenues.

As part of this strategy, IQE Europe currently has seven externally funded projects in support of its research and development activities. Five of these projects are funded by the European Commission, one is funded by the UK Department of Trade and Industry and one is funded by the French Ministry of Defence.



QED had historically been involved in SBIR (Small Business Innovative Research) contracts which provide US government funding for leading-edge technology development. Following the Merger, QED became ineligible for SBIR contracts. The Group intends to pursue other US government research and development contracts, and since the Merger, QED has obtained funding from the US Army Research Lab for metamorphic HEMT development.

In addition to third-party co-funded research and development, the Group also supports internally funded projects. Such internal research and development projects are aimed primarily at process improvements leading to greater through-put, higher quality products, better manufacturing yield, increased production uptime and new product development.

The Group's internal research and development costs in the years ended 31 December 2000, 1999 and 1998 were £1,870,000, £1,302,000 and £1,529,000, or approximately 6.2 per cent., 6.8 per cent. and 9.6 per cent. respectively, of the Group's total gross revenues. All research and development costs are expensed and none are capitalised.

See "Maintain Technological Leadership" above in this Part III with regard to the joint venture with QinetiQ that was announced in August 2001.

### **Sales and Marketing**

The Group markets its products worldwide through direct sales and agency and long term trading relationships. Its efforts are directed toward developing strong supply links to high volume manufacturers of compound semiconductor devices across a wide range of products. Unlike wafers produced using the ion implant process which, in many instances, are mass produced on substrates based on industry standards, compound semiconductor epitaxial wafers are manufactured to customers' specific designs and device requirements. The Group supports its customers with technically proficient sales personnel and representatives and a skilled engineering team. Through this strategy, the Group aims to become an integral part of its customers' design and development cycles, with the consequence that its epiwafers become an integral part of the customers' manufacturing process.

The sales cycle for a new epiwafer customer or application is variable. It can be as short as two months, but may require more than twelve months for initial development of the epitaxial wafer and device designs to be finalised, and longer for the wafer production volumes to become significant. The initial contact is often with a device manufacturer's design and development or production group. Initially, the Group engages in a specification review during which the Group's engineers offer suggestions or modifications regarding the wafer design. If this phase is successful, the customer may place a "qualification order" of wafer samples for performance evaluation. The Group continues to assist the customer to refine the technical specifications of the wafers. After acceptance of the qualification wafers, several iterative lots of wafers are supplied to fully align the characteristics of the Group's wafers to the customer's device fabrication process. During this phase, the customer typically invests resources to create a manufacturing process which will utilise the Group's wafers. Once the customer's process is determined to be stable, production orders are issued. The Group has the ability to shorten this cycle to two to six months when it is engaged as a second source for a customer's established product.

The Group believes that this detailed sales process and high level of ongoing customer interaction, facilitated by the Group's wide ranging technical expertise, are a powerful asset in the development of long-term customer relationships and facilitating preferred supplier status.

### **Customers**

The Group's epiwafer customers encompass a wide range of compound semiconductor device and systems manufacturers, covering fibre optic component and systems suppliers, computer manufacturers, mobile communications components and systems providers, electronic systems integrators, display products manufacturers, consumer products manufacturers, defence contractors, space and satellite component and systems manufacturers, providers of advanced medical equipment,



research and development laboratories, universities and other research institutes, the US Government and the European Commission. The epiwafer customer list includes a significant proportion of the leading compound semiconductor device manufacturers worldwide by reference to turnover.

A summary of the Group's epiwafer customer concentration is set out below:

	Percentage of the Group's total gross revenues		
	31 December 1998	31 December 1999	31 December 2000
Largest Customer	20	25	9
Total top 5 customers	44	48	38
Total top 10 customers	58	59	59

The Group's main product is compound semiconductor epiwafers with Wafer Technology producing substrates for epiwafer manufacturers and optoelectronic devices. Wafer Technology supplies substrates to wafer manufacturers such as IQE as well as major manufacturers of electronics and IQE Silicon Compounds provides outsourced epitaxial services to the silicon based semiconductor industry. In 2000, customers in the US accounted for 72 per cent. of the Group's total gross revenues, customers in the Far East for 8 per cent., those in Europe for 14 per cent. and those in the rest of the world accounted for 6 per cent. In 1999, customers in the US accounted for 72 per cent. of the Group's total gross revenues, with customers in the Far East and Western Europe accounting for 14 per cent. each. In 1998, customers in the US accounted for 64 per cent. of the Group's total gross revenues, with customers in the Far East and Western Europe accounting for 23 and 13 per cent., respectively.

Both the US Government and the European Commission have been customers as sponsors of research and development programmes.

The first major customer of IQE Silicon Compounds was Bookham Technologies which is a leading manufacturer of optical components and circuits based on Si wafers. However there has been considerable interest shown in the services to be offered by IQE Silicon Compounds by many other major European industry players.

## Competitors

The markets for the Group's products are highly competitive and, as end user products become increasingly consumer orientated, there will continue to be significant downward pressures on the final component costs. This will put pressure on foundries to provide cost effective solutions. Since the capital cost of wafer growth and characterisation equipment is very high, economies of scale will only be achieved with large throughput, which is a core element of the Group's strategy.

The Group's main merchant competitors can be split into two categories, namely those pure play foundries with only epitaxy and characterisation facilities, like the Group, and those vertically integrated companies, who also have device manufacturing or other capabilities as part of a vertically integrated business structure. With the Group's first mover advantages, the Board believes that most of the independent pure play companies will find it difficult to compete with the scale and scope of the Group's epiwafer foundry service. The largest of these independent epiwafer manufacturers is the French company, Picogiga, who supply MBE produced wafers mainly for the electronics industry. Picogiga's total revenues for 2000, as disclosed in its published accounts, were approximately 40 per cent. of the total revenues for the Group for the same period.

The other category of competitors is those companies who sell epiwafers as part of their product range but who also manufacture devices or other components or systems. These companies include Kopin (US), a display manufacturer which also manufactures HBT epiwafers by MOVPE for use in wireless communications, EMCORE (US), an MOVPE equipment manufacturer which also supplies wafers, devices and components, and several of the large Japanese compound semiconductor device manufacturers which are vertically integrated and have epiwafer manufacturing capabilities, such as



Hitachi Cable, Mitsubishi Monsanto, Sumitomo Chemical, Nippon Sanso and Furukawa. The compound semiconductor operations of these companies only represent part of their overall revenue and cannot be separately identified.

Most of the Group's competitors do not have the capability of producing wafers by both MOVPE and MBE in significant volume, all have a more limited product range than the Group. In the case of the vertically integrated suppliers, there are strong disincentives for many customers since the supplier can compete with its own customer downstream.

The main source of competition and opportunity is that of in-house epiwafer manufacture by the potential customers themselves. Outsourcing is prevalent in many mature industries and is now common in the silicon industry and the Board believes that foundry supply is highly likely to be the dominant business model for epiwafer manufacture in the future.

In view of the Group's market position and its key strengths described above, the Board strongly believes that the Group is well positioned to remain one of the leading pure play compound semiconductor epiwafer foundries world-wide.

### **Competing Epitaxial Growth Technologies**

There are four different means of producing epitaxial layers of compound semiconductors:

- LPE and VPE are mature technologies used to produce simple structures at low cost such as standard low brightness LEDs; and
- MBE and MOVPE are more advanced technologies using multi-wafer processes to create larger wafers (up to 6"). These are versatile complex structures used in a rapidly increasing number of applications. MBE is used mainly in advanced electronic and some opto-electronic components. MOVPE is used mainly in advanced optoelectronic components, including high brightness LEDs and some electronic components.

LPE and VPE are now mature techniques for producing epitaxial layers and have several limitations, particularly with respect to producing the thin layers (less than  $0.5\mu\text{m}$ ) with abrupt transitions between the various layers which make up today's complex structures. They are therefore confined predominantly to manufacturing standard brightness LEDs and other simple device structures. The two most sophisticated techniques are MOVPE and MBE. Both of these techniques are now dominating production of most of the key devices used in the compound semiconductor industry and are capable of producing extremely high quality and complex epilayer structures. The two processes tend to be used for different device applications. The production of opto-electronic devices such as lasers, LEDs and solar cells is dominated by the MOVPE process, where thicker epilayers are generally required, whereas most thin electronic device structures, such as FETs and HEMTs, are made predominantly by MBE. However, each process has demonstrated the ability to produce high quality epilayers across a wide range of applications. Typically, because of the very different nature and technical demands of the two processes, most epiwafer producers tend to use only one of the technologies in their production, even though their end product range may well be better suited to a mixture of the two processes.

#### **METAL ORGANIC VAPOUR PHASE EPITAXY (MOVPE)**

The MOVPE process occurs in a reaction chamber held at pressures typically between 2000mbar and 1 bar. A mixture of gases containing group III metal organic compounds and group V hydride gases are passed over the compound semiconductor substrates which are located within the reaction chamber on a heated graphite block. The block is held at high temperature (700-900°C) and as the gas mixture passes over the block, the high temperature causes thermal decomposition of the gases into their constituent atomic species, which include the group III and V elements. These atoms deposit on the substrates and rearrange themselves under suitable reaction conditions to form the compound semiconductor epitaxial layer on the substrate surface. By rapidly switching the gas mixture in the reaction chamber, a series of epilayers are deposited to form the full epilayer device structure. Typical



growth rates are between 3 and 5 microns per hour, allowing the growth of thick epilayer structures in a relatively short time. Extremely high purity epilayer structures are now produced by the process and because of the wide range of chemicals available for use in the process, MOVPE has become a highly flexible and versatile manufacturing process with a rapid take-up in use over the past six years.

#### MOLECULAR BEAM EPITAXY (MBE)

The MBE process takes place in an ultra-high vacuum where the various III-V elements are thermally evaporated onto the substrate. Because the substrate is heated during the growth process, there is sufficient kinetic energy for the atoms to arrange themselves in a single crystal structure replicating that of the starting substrate material. The source materials such as gallium, aluminium, indium and arsenic are placed in high purity cubicles which are resistively heated causing them to evaporate. These evaporating source materials create a series of molecular beams which are directed at the substrate. The atoms which land on the substrate crystal arrange themselves to replicate the crystalline structure of the substrate only if the process conditions are optimal. Therefore, achieving such a set of optimal conditions forms the art and science of crystal growth. Very high purity epitaxial layers are produced as a result of this process.

Precise control over the growth process is achieved by placing mechanical, computer operated, shutters between the source material and substrate. Closing the shutter stops the molecular beam from reaching the substrate which results in abrupt transitions between layers of different material compositions. This is an important aspect of MBE compared to other epitaxial techniques because many of the current high performance electronic device designs require thin atomic layers with abrupt transitions.

In both the MOVPE and MBE processes, wafers are rotated during the growth procedure to ensure optimal uniformity of epitaxial thickness. The actual elemental composition and thickness of the various epitaxial layers varies according to the device type and end-user application. The switching sequence of layers in each process is controlled via computer with each customer wafer type having its own individual specifications. Once a customer's specifications have been entered into the computer, the process is replicated for subsequent orders, allowing unique programmes for each customer's precise specifications.

The key advantages of these advanced crystal growth processes are:

*Precise Control:* The high level of process control provides the ability to grow very different compositions to atomic layer accuracy and maintain uniformity across the wafer. The ability to produce abrupt transitions between layers of different compound semiconductor materials is essential to produce the electronic results desired by manufacturers of state-of-the-art semiconductors and integrated circuits used in high performance applications. The extremely high purity of semiconductor crystal produced by these processes allows the highly efficient conversion of electrical signals into light and vice versa compared with existing alternatives.

*Uniformity of Layers:* Both processes are able to produce material uniformity on a wafer which the Board believes offers superior manufacturing efficiencies for compound semiconductor device manufacturers. The Group has invested heavily in state of the art MOVPE and MBE equipment to the extent that it now has the largest outsource manufacturing capacity of complex compound semiconductor epilayers worldwide and can provide uniform products from 2" through 6" diameter (now the largest wafer size currently being adopted by electronic component manufacturers in the compound semiconductor industry). This allows customers to achieve higher yields of finished devices from each wafer than from less uniform epiwafer products.

*Monitoring:* The design of the newest epitaxy growth systems allows for a number of analytical probes to be used in the production process. As a result, both the chemical and structural properties of the epitaxial layers can be monitored before and during the growth cycle. This provides a highly accurate process and quality control mechanism that can be monitored throughout the growing cycle to improve the accuracy of the epitaxy process.



*Manufacturing Flexibility:* Both the MOVPE and MBE processes are capable of being swiftly changed between different structures, allowing the rapid shift between varied customer orders with minimal set-up time.

#### EPIWAFER CHARACTERISATION

Once the epilayers have been grown, they are evaluated to ensure compliance with customer specifications by measuring the various electronic, structural and optical properties. The Group has actively developed a series of sophisticated characterisation techniques to measure layer thickness, elemental compositions of each layer within the complete structure, optical properties of key layers, electronic carrier densities and defect levels as a key part of its advanced quality assurance programme. These techniques include high resolution x-ray diffraction, photoluminescence, Capacitance-Voltage profiling, laser surf scan measurements and non-contact resistivity measurements. The Group has actively worked with metrology equipment manufacturers to develop several of the most sophisticated techniques and the Group continues to pioneer advanced automated techniques to assure its customer base of the highest level of confidence in the shipped product.

#### Quality Assurance

The Group is committed to a quality culture to satisfy its customers' evolving requirements and expectations. Since many of the Group's customers are leading industry players, this places substantial onus on the Group's quality systems. IQE Europe has been certified to ISO 9002 since 1992, and indeed the Directors believe that IQE Europe was the first epiwafer manufacturing company to be awarded such status. Wafer Technology and QED obtained ISO 9002 certification in January 1994 and February 2000 respectively. In addition, the Group has been subjected to numerous detailed customer quality audits. Several awards have been won by IQE Europe to demonstrate its commitment to quality and training; including Wales Quality Award in 1997 and National Safety Award from the British Safety Council in 1998. IQE Europe is also registered as an Institute of Electrical Engineering (IEE) and Institute of Mechanical Engineering (I Mech E) Centre for Professional Training in 1999 and IQE Europe was a key participant in the development of National Personal Development Plans for the Semiconductor Industry (UK) in 1998.

The Board believes that customers will demand more consistency in the delivered product and a minimal level of inspection on delivery. The Group coordinates very closely with its customers' quality assurance programmes with the objective of replicating the customers' own methods of qualifying the wafers for introduction into their device production lines, in addition to the extensive non-destructive tests carried out by the Group as a matter of routine. All wafer characterisation is generally provided to the customer in the customer's desired format in order that the incoming epiwafer supply appears identical to that which may be supplied in-house.

The Board believes that the Group's sophisticated wafer characterisation systems, coupled with these advanced quality systems, offer a competitive advantage to the customer over other suppliers, including in-house supply. The Group is an active participant in setting worldwide standards for epiwafer characterisation in the compound semiconductor industry and key members of both IQE Europe and QED staff are members of the Epiwafer Characterisation Standards Committees (European and US groups respectively) of SEMI (Semiconductor Equipment and Materials Institute), the industry-wide body for setting standards within the silicon and compound semiconductor industries.

#### Raw Materials Suppliers and Supply Chain

The Group manufactures its epiwafer products predominantly on GaAs and InP substrates that are supplied by a limited number of suppliers. The Group is heavily dependent on a limited number of suppliers for the provision of its metal organic chemicals, its hydride gas supplies and its supply of gallium, indium and other raw materials. The Group's epiwafer products are also heavily reliant on the purity of its raw material supplies, since a very small level of impurity entering the growth chamber in either MOVPE or MBE can adversely affect the epiwafer quality and characteristics. The Group's strategy for ensuring reliability of supply, quality of raw materials and competitive pricing is to have





supply arrangements in place with its key raw material suppliers, whereby generally the Group commits to purchase all of its applicable raw materials from such suppliers, together with well defined purchase specifications, and to work very closely with each of these key suppliers to continually improve the level of service. The risk to the Group of its dependency on InP substrates has been eased since the acquisition by IQE in November 2000 of Wafer Technology securing for the Group, direct access to key InP substrates. Wafer Technology itself has a long-term supply agreement in place for certain of its critical raw materials, particularly high purity metals.

This close working relationship establishes a clear understanding of the Group's supply needs to its supplier base and, by providing constant feedback on raw material supply quality, the Group endeavours to ensure that it gains access to the best quality materials available and to improved raw material products in a timely fashion. Key suppliers are only admitted to the Group's approved supplier list if certain stringent requirements on quality, price and delivery are met. Supplier performance feedback is a key part of this process.

Despite these steps, however, there can be no absolute assurance that the stability of supply can be maintained or that the suppliers will continue to provide the requisite level of purity in their raw materials demanded by the epitaxy process.

Wafers produced using the Technology will complement the product range of Wafer Technology which is mainly concentrated on wafer sizes of 4" and less, whereas the cost advantage of using the Technology really becomes apparent when processing larger wafers.

The same principles apply to the Group's dealings with its suppliers for both reactors and metrology equipment. In particular, the Group has close dealings with its key MOVPE reactor supplier, AIXTRON AG, which also helps market the Group's products under a bilateral strategic agreement. This allows AIXTRON AG to offer their own customers access to the Group's products as a primary source of supply whilst the customer awaits reactor delivery and as a second source thereafter. Through this partnership, a customer can be offered a comprehensive range of services which helps tie the customer into a long-term relationship with the Group.

### **Backlog**

The Group includes, in its product revenue backlog, only those customer orders which have been accepted by the Group and for which shipment is generally expected within 12 months. As of 31 December 2000, the Group's backlog was £18.9 million. This compares with a product order backlog of £6.3 million for the Group as of 31 December 1999, an increase of £12.6 million (200 per cent.) year on year. The order book as at 30 September 2001 was £16.9 million (excluding IQE Silicon Compounds whose orders predominantly relate to development contracts).

Recent history suggests that the Group's accessible order book (i.e. wafers due for immediate production) is usually between one and three months production capacity. Order backlog can fluctuate greatly as a result of order and contract call off timing, order cancellations and rescheduled or postponed orders. The Group has experienced, and may continue to experience, cancellation, reduction or rescheduling of customer orders in its backlog. Therefore, the Group's backlog at any given point in time may not necessarily be a good indicator of sales for any future period of time.

### **Facilities and Equipment**

The Group has production facilities located in both the UK and in the US. The Group's executive offices and MOVPE production capabilities are located in a 40,000 square foot purpose built building at St Mellons, Cardiff, Wales, UK, the freehold of which is owned by IQE Europe, subject to mortgages with 3i plc, Barclays Bank PLC and the Welsh Development Agency. The manufacturing facility occupies approximately 20,000 square feet comprising two clean rooms for wafer handling and characterisation and sixteen reactor rooms, each capable of housing one MOVPE reactor, plus substantial ancillary space for other production support activities. At 31 March 2001, IQE Europe had 16 reactors in routine production, two of which are dual wafer reactors, two of which are AIXTRON 2000 multiwafer reactors capable of producing 7 × 2" or 5 × 3" wafers per run respectively,



two of which are AIXTRON 2400 multiwafer reactors capable of producing  $15 \times 2''$  or  $8 \times 3''$  or  $5 \times 4''$  wafers per run and the remaining ten of which are AIXTRON 2600 multiwafer reactors capable of producing  $5 \times 6''$  or  $9 \times 4''$  or  $15 \times 3''$  or  $35 \times 2''$  wafers per run.

In the US, QED leases approximately 40,000 square foot of a purpose built facility in Bethlehem, Pennsylvania, and has options on further space in the same building for further expansion. QED operates five VG Semicon V – 100 MBE systems which are capable of simultaneously producing  $12 \times 2''$  or  $5 \times 3''$  or  $3 \times 4''$  or  $1 \times 6''$  wafers per run. A further larger scale MBE reactor capable of producing  $9 \times 4''$  or  $4 \times 6''$  wafers per run was delivered in the summer of 1999. An additional five multi 6" reactors have been installed since that time and three Aixtron 2600 MOVPE reactors have been installed and are being commissioned. In addition, QED currently operates three Varian GEN II MBE systems which are capable of producing one 2" or 3" wafer per run. These systems are primarily used for in-house or customer R&D programmes.

Wafer Technology occupies leasehold premises of approximately 55,000 square feet in area in Milton Keynes, UK. The Company employs Czochralski and gradient freeze crystal growth technologies to produce bulk polycrystalline material and single crystal wafers of GaAs, InP, InSb, GaSb and InAs.

For Czochralski crystal growth, Wafer Technology possesses seven MR Semicon CI358 pullers capable of producing 2", 3" and 100mm diameter GaAs and InP and five MR Semicon CI351 pullers capable of producing 2" diameter InP, GaSb and InAs. In addition, it has four low pressure pullers for the production of GaSb and InSb.

For gradient freeze crystal growth, Wafer Technology possesses seven synthesis furnaces for InP and five for GaAs for the production of bulk polycrystalline materials. Most of Wafer Technology's GaAs wafers are produced from crystals growth by the Vertical Gradient Freeze method ("VGF") for which it has 60 furnaces for 2" diameter production, 18 for 3" diameter production and four for the pilot production of 100mm diameter ingots.

These extensive crystal growth facilities are matched with Meyer and Burger annular saws, Speedfam polishing machines and other specialised equipment for the volume production of single crystal wafers.

Additional equipment is being added during 2001 in synthesis, VGF growth and wafering to permit a doubling of 2" GaAs wafer output and a fivefold increase in 3" GaAs wafer output over 2000 levels.

IQE Silicon Compounds' manufacturing facility occupies 1,000 square meters and is adjacent to the Group's headquarters at St Mellons, Cardiff. Funding for the operation is predominantly lease finance, aided by a substantial development grant from the Welsh Assembly under Regional Selective Assistance of £1.7 million. Six ASM Epsilon 2000 reactors have been installed and are now fully operational. Together the reactors meet a variety of wafer handling requirements. 100mm, 150mm and 200mm are available today. These six reactors are the first instalment of a volume purchase agreement with ASM for epitaxial tools which will be used to expand and develop the facility over the next few years. The foundry contains a full 500m<sup>2</sup> of clean room. Facilities included Class 1 air with a continuous air quality monitoring system, ultrapure gases, palladium purification, a high quality DI water plant which operates at 64 MByte DRAM production with complete monitoring of particles, dissolved oxygen and total organic carbon.

### **Proprietary Information**

The Board believes that the success of the Group's business depends primarily on its proprietary information, intrinsic processes and know how rather than patents, trademarks and copyrights. Since much of the technology for manufacturing epiwafers is in the process itself, any patent regarding the process would be difficult to police and therefore patenting is believed to be an inappropriate means of protection. Nonetheless, the Group intends to protect its technology by patents, if appropriate. The Group relies upon trade secret protection for its confidential and proprietary information. All employees have entered into non-compete and confidentiality agreements. The Group usually enters into confidentiality agreements with its major customers whenever commercially sensitive information is being disclosed.

## **Environmental Regulations**

The Group is subject to certain environmental laws and other obligations in the UK and to federal, state and local laws in the US (“Environmental Laws”) concerning the use, storage, handling, generation, treatment, emission, management, release, discharge and disposal and, in certain circumstances, remediation of certain hazardous and non-hazardous materials and wastes (“Hazardous Materials”) used and generated in the production and in the research and development of the Group’s epiwafer products. In addition, there are regulations concerning employee health and safety. The growing of epiwafers and other operations involve the use of certain Hazardous Materials.

The Group endeavours to achieve compliance with all current regulations. At both the UK and US manufacturing sites, substantial monitoring and hazard response systems have been installed and considerable effort has been devoted to risk assessment and hazard response plans. The Board believes that the Group is in material compliance with all relevant environmental and health and safety legislation. IQE Europe was awarded a National Safety Award by the British Safety Council in 1998.

## **Directors and Officers**

### **DIRECTORS**

#### *Dr Andrew William Nelson, O.B.E., Chairman and Chief Executive Officer*

Drew Nelson joined BT Research Laboratories in 1981 and worked on MOVPE for opto-electronic devices for optical fibre communications. He was promoted to Group Head in 1985 and led the technology transfer from BT to British Telecom and DuPont (now Agilent Optoelectronics Ipswich) a leading manufacturer of fibre optic communication devices. In conjunction with Mike Scott, he founded IQE Europe in 1988 and became Managing Director in 1991, subsequently progressing to CEO in 1996. Dr Nelson also served as Chairman of EPIH and subsequently the Group between 1996 and 2001.

Dr Nelson was educated at Sheffield University and holds a BSc Honours (First Class) in Electronic Engineering and a PhD in Semiconductor Technology.

#### *Thomas Lawrence Hierl, Chief Technical Officer*

Tom Hierl was a founder of QED and has served as Chief Executive Officer and director of QED since 1988. From 1986 to 1988, Mr Hierl was Manager of Semiconductor Materials for GAIN Electronics, where he established the first domestic source of MBE wafers for the merchant market. He previously was employed by Loral Corporation and Varian Associates.

Mr Hierl has over 25 years of experience in the GaAs semiconductor industry. He earned his BSEE and MEE degrees from Cornell University in 1974 and 1975 respectively.

#### *Dr Michael Darak Scott, Sales and Marketing Director*

Mike Scott joined GEC Plessey Research (Caswell) in 1982 and led the development group working on MOVPE for InP based materials. In conjunction with Drew Nelson, he founded IQE Europe in 1988 as Technical Director and became Sales and Marketing Director in 1996.

Dr Scott gained a BSc in Chemistry and Physics, followed by a PhD in Semiconductor Technology at University of Wales, Aberystwyth.

In 2000 Dr Scott was appointed Honorary Professor in the Cardiff School of Engineering and the Department of Physics and Astronomy at Cardiff University.

#### *Richard John George Clarke, Finance Director*

Richard Clarke qualified as a Chartered Accountant with Ernst & Young in 1980 and subsequently joined Dowty Aerospace where he held various senior financial roles in the UK, USA and Singapore, including a period at the group head office. In 1994 he was appointed Finance Director of Avimo Group Limited, an international group of electro-optical businesses listed on the Singapore Stock Exchange. He was appointed to the Board of IQE on 8 March 2001.



Mr Clarke is a Fellow of the Institute of Chartered Accountants in England and Wales, and has a BSc in economics from University College London and an MBA from the University of Bath.

*Stephen Byars, Managing Director, IQE Europe*

Steve Byars has over 22 years experience in the semiconductor industry, having worked in a variety of senior management roles both in the UK and overseas. His experience includes acting as Chief Executive Officer of the European operations of QPL International Holdings, a Hong Kong based group providing advanced materials and sub-contract services to the semiconductor industry. Prior to joining IQE, he spent 8 years as Chief Executive Officer of Europe's largest dedicated silicon foundry, during which time he successfully led a management buyout of the Company. Mr Byars joined IQE Europe as Managing Director in August 2000 and was appointed to the Board of IQE in January 2001.

*Scott Tucker Massie, President IQE, Inc.*

Scott Massie has been President of IQE, Inc. since December 1999. He served as Vice President, Operations since January 1996 and was responsible for manufacturing and contract research. From 1993 to January 1996, Mr Massie was Director of Contract Research and was responsible for obtaining a number of government-funded development programmes. Mr Massie has over eight years experience in the MBE growth and characterisation of semiconductor materials businesses.

Mr Massie holds a BS in Mathematics and a BS and MS in Physics from Virginia Polytechnical Institute and Virginia State University. Mr Massie completed his doctoral studies in Physics at Virginia Polytechnical Institute and Virginia State University.

*Martin Steven Mark Lamb, Managing Director, Wafer Technology*

Martin Lamb joined GEC Plessey Research (Caswell) in 1982 as a Research Scientist working on the characterisation of III-V semiconductor materials and devices. In 1985 he joined Wafer Technology, becoming Quality Assurance Manager in 1986. In 1994 he was a key member of the management buyout team which acquired the Company from MCP Ltd and was subsequently appointed Manufacturing Director. He became Managing Director of Wafer Technology in 2000. Following the acquisition of Wafer Technology by IQE, he was appointed to the Board of IQE on 22 November 2000.

Mr Lamb graduated from the University of Durham in 1982 with a BSc in applied physics and electronics. He obtained an MBA from the University of Leicester in 1995.

*Dr Godfrey Howard Harrison Ainsworth, Non-executive Director*

Godfrey Ainsworth is the managing partner of Gambit Corporate Finance which he founded in 1992, a practice specialising in the provision of corporate finance services.

Dr Ainsworth, a chartered accountant, was employed with Coopers & Lybrand from 1980 to 1985 and was a corporate finance partner with Spicer & Oppenheim until 1989, when he left to take up the position of group finance director of a human resource consulting group. He has held several non-executive directorship appointments, including assignments for 3i plc and the Welsh Development Agency. He has provided advice to IQE Europe since 1988 and was appointed a Director of IQE Europe on 20 June 1997.

Dr Ainsworth is a Fellow of the Institute of Chartered Accountants in England and Wales and has PhD and BSc degrees from University College, Cardiff.

*Glen Bressner, Non-executive Director*

Glen Bressner is associated with NEPA and has been since shortly after its inception in 1985. Prior thereto, he managed the Boston office for Key Venture Capital Corporation. Mr Bressner sits on the board of directors of Innovative Solutions & Support, Inc., Any Time Access, Inc., MicroE, Inc., Mesa Systems Guild, Inc. and Midas Vision Systems, Inc.. He holds a BSBA, cum laude, from Boston University and an MBA from Babson College. He has been a Non-executive Director of QED since 15 December 1998.



## COMPANY SECRETARY

### *James Leslie Coventry, Company Secretary*

Leslie Coventry served a five year apprenticeship with a firm of Glasgow-based chartered accountants before moving into industry in 1968. He has been an Accountant and Company Secretary in a number of well known UK and international companies including British Oxygen (UK), British Shipbuilders (UK), Hydro Aluminium (Norway) and Seagram Distillers (US). He joined IQE Europe in December 1992 as Commercial Manager/Company Secretary with responsibility for all aspects of the Company's financial, reporting and secretarial requirements and was appointed to the board of Europe as Finance Director in January 1998.

Mr Coventry qualified as a Chartered Accountant from the Institute of Chartered Accountants of Scotland in 1967.

## DIRECTOR AND OFFICER COMPENSATION AND ARRANGEMENTS

The Group paid an aggregate of £575,000 in compensation to its directors and executive officers in 2000 for all services rendered to the Group. In addition, the Group accrued £19,000 to provide pensions and retirement or similar benefits for its directors and executive officers.

The Group has obtained customary directors' and officers' insurance against certain liabilities such persons may incur on behalf of the Group.

## EMPLOYEES

As at 31 December 2000, the Group had 385 employees, including executive directors. Of the Group's employees, 173 were located at the Group's headquarters in Cardiff, UK, 5 at IQE Silicon Compound's premises in the UK, 58 at Wafer Technology's premises in the UK and 149 at the Group's offices in Pennsylvania, USA. The Group has not experienced any work stoppages and believes its relations with employees to be good.

As at 31 December 2000, 273 of the Group's employees were engaged in production, 34 were engaged in research and development and 78 were engaged in administration (including sales).

In the last three years, not including the acquisition of Wafer Technology, the number of employees of the Group has more than doubled in size. In 1998, Europe had 99 employees and IQE US had 62, in 1999, Europe had 122 employees and IQE US had 80 and in 2000, Europe had 173 employees and IQE US had 149.

The Board actively grants options over Ordinary Shares pursuant to the Share Option Schemes to all full-time staff to promote productivity and loyalty to the Group.

## PENSIONS

IQE Europe operates two pension schemes, namely the EPI Retirement Benefits Plan for all staff and the EPI Directors Retirement Benefit Scheme for Dr Nelson and Dr Scott. Both schemes are administered by Standard Life in Edinburgh. IQE Europe's appointed pension scheme agents and independent financial advisers are Briggs Maunder Associates in Cardiff. Both schemes are money purchase arrangements and the EPI Directors Retirement Benefit Scheme is a small self administered pension scheme. IQE Europe contributes up to 10 per cent. of salary at the rate of twice the employee contribution.

Since December 1996, QED has maintained a 401(k) profit sharing plan (the "401(k)"). The 401(k), which is structured to be qualified under the US Internal Revenue Code, is available to all employees of QED. An employee may elect to defer, within the limits of deferrable compensation allowed by law, a percentage of his or her salary. Pursuant to certain qualifying conditions, QED may match the employee contribution or a portion thereof. Additionally, the 401(k) permits other discretionary contributions by QED in respect of net income. QED does not currently plan on making a contribution to the 401(k) in respect of 2000 net profit.



Generally, employees are 100 per cent. vested in the amounts contributed to the 401(k) through salary reductions and QED's contributions. Distributions from the 401(k) are permitted at age 59½ subject to provisions related to death, disability and termination of employment.

Wafer Technology has separate defined contribution pension schemes for its employees, the reasons for which are historical, as Wafer Technology was only acquired by IQE in November 2000. The principal scheme is a group personal pension plan which is administered by Norwich Union. Wafer Technology contributes one per cent. more than the employees (up to a maximum of five per cent.) and the employees contribute a minimum of two per cent. of salary. In addition, two employees are members of a Scottish Widows personal pension plan which predated the Norwich Union scheme from the time that Wafer Technology was owned by MCP Holdings Limited (see Section 3(f) of Part VIII "General Information – Changes in the Company's Share Capital"). The employees sacrifice five per cent. of salary and Wafer Technology makes contributions of a further five point five per cent. of salary. The WT Limited (SSAS) ERBS is a small self administered scheme for the benefit of those persons who were directors of Wafer Technology prior to its acquisition by IQE. A small component of the funds is invested with Perpetual and the balance is invested in an insured policy with National Mutual. In addition, Wafer Technology has the Wafer Technology Limited Retirement Benefit Scheme, an arrangement wholly invested in a policy held with Scottish Life. This scheme has been in winding up since 1999.

### **Corporate Governance**

The Group will endeavour to comply as far as is practicable with the principles of good governance and code of best practice prepared by the Committee on Corporate Governance, chaired by Sir Ronald Hampel, published in June 1998. Notwithstanding the above, the Group reserves the rights to grant options over Ordinary Shares to non-executive Directors from time to time and in recognition to Dr Ainsworth's contribution to the development of the Group, has granted options over 75,000 Ordinary Shares to him. The Company is actively seeking to appoint at least one additional independent non-executive director and to appoint a non-executive director to act as Chairman in recognition of the fact that the Board could be strengthened in this area and to comply with current best practice.

The Board has considered the guidance published by the Institute of Chartered Accountants in England and Wales concerning the internal control requirements of the Combined Code and has established an ongoing process for identifying, evaluating and managing any significant risks faced by the Group.

The Company will hold at least quarterly board meetings throughout the year at which reports from the Group's operations, together with finance reports, will be considered. The Board is responsible for formulating, reviewing and approving the Group's strategy, budgets, major items of capital expenditure and acquisitions.

The Audit Committee is chaired by Dr Ainsworth. It will always be chaired by a non-executive Director. It meets at least four times a year and is responsible for, amongst other things, ensuring that the financial performance of the Group is properly reported and monitored focusing particularly on compliance with legal requirements, accounting standards, the requirements of the UK Listing Authority and Nasdaq Europe and for meeting the auditors and reviewing the reports from the auditors relating to accounts and internal control systems. It meets once a year with the auditors without executive board members present. The Audit Committee currently comprises Dr Ainsworth and Glen Bressner.

The Remuneration Committee is chaired by Glen Bressner. This Committee reviews the performance of executive directors and within agreed terms of reference sets the scale and structure of their remuneration including pension rights, the Group's policy on compensation of executive directors and the basis of their service agreements with due regard to the interests of Existing Shareholders. It also determines the allocation of share options to employees. It is a rule of the Remuneration Committee that no Director shall participate in discussions or decisions concerning his own remuneration. The Remuneration Committee currently comprises Glen Bressner and Dr Ainsworth.



## Current Trading and Prospects

The unaudited third quarter results for the period ended 30 September 2001 are set out in Part VII of this document and show that despite the challenging environment, the Group's Q3 2001 sales were at £8.234m, representing a 28 per cent. increase over Q3 2000 (£6.431m) but down 37 per cent. on the previous quarter. For the first nine months of 2001, sales were £34.351m, up by 75 per cent. compared with the previous year (2000: £19.639m). As a result of the lower Q3 2001 sales, the Group incurred an operating loss for the quarter (before goodwill and exceptional items) of £2.228m (Q3 2000: profit £0.380m), partly reflecting a large increase in research and development expenditure (Q3 2001: £1.602m, Q3 2000: £0.289m) to support the exciting new product developments which the Group has embarked upon. However, taken as a whole, for the first nine months, the Group remained profitable (before goodwill and exceptional items) at £0.328m (2000: £1.167m), with an EBITDA of £4.791m (2000: £2.808m).

Overall, the current trading environment continues to be extremely challenging, particularly in the opto-electronic sector. However the Board believes that as the semi-conductor industry recovers, together with the exceptionally exciting opportunity open to the Group as a result of its agreements with Motorola relating to the commercialisation of the GaAs on Silicon Wafers, and as outsourcing becomes a much more significant part of the compound semi-conductor industry, IQE is well placed to consolidate its position as a leading outsource wafer supplier within the semi-conductor industry.

## The Motorola Subscription, Draw Down Facility and Share Warrants

### MOTOROLA SUBSCRIPTION AGREEMENT

Under the terms of the Motorola Subscription Agreement, the Company intends to issue 4,428,620 of the New Ordinary Shares to Motorola at the Placing Price. The Motorola Subscription Shares are not being offered to Existing Shareholders for the reasons set out in Part I "Letter from the Chairman".

The Motorola Subscription Shares will be voting shares in the capital of the Company and will when issued, rank *pari passu* with the existing Ordinary Shares. A summary of the rights and restrictions attaching to the Motorola Subscription Shares as set out in the Articles, is given in section 6 of Part VIII "General Information – Material provisions of the Memorandum and Articles of Association".

Completion of the Motorola Subscription will be conditional upon, among other matters, the satisfaction of the following conditions on or before 3.00 p.m. on 31 January 2002:

- (i) Admission;
- (ii) the passing of the Resolution at the Extraordinary General Meeting;
- (iii) there having been no material breach of the warranties set out in the Motorola Subscription Agreement and the Company not being in material breach of its obligations under the Motorola Subscription Agreement; and
- (iv) the Draw Down Facility not being terminated.

A summary of the Motorola Subscription Agreement is given in section 14 of Part VIII – "General Information – Material Contracts".

### MOTOROLA SHARE WARRANT

On Completion, the Company will execute the Motorola Share Warrant Instrument and grant the Motorola Share Warrants. The Motorola Share Warrant will be capable of exercise at any time during the period of five years from Completion and may be exercised in whole or in part, although if exercised in part, it must be exercised in minimum tranches of 10 per cent. of the number of Motorola Share Warrants.

The Motorola Warrant Shares will be voting shares in the capital of the Company and will, when issued, rank *pari passu* with existing Ordinary Shares. A summary of the rights and restrictions attaching to the Ordinary Shares as are currently set out in the Articles, is given in section 6 of Part VIII "General



Information – Material Provisions of the Memorandum and Articles of Association”. The Company has no current intention to alter any of these rights and restrictions whether with regard to the Ordinary Shares, the Motorola Warrant Shares or the Equity Providers’ Warrant Shares.

For a period of 35 days following the date of allotment and issue of the Motorola Warrant Shares, such Motorola Warrant Shares shall only be transferable to a company in Motorola’s group of companies (although such restrictions shall cease to apply in the event of a takeover offer being made for the Company).

Under the terms of the Motorola Share Warrant Instrument:

- (i) 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 Motorola 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 adjustment 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;
- (ii) the applicable subscription price per Motorola Warrant Share (the “subscription price”) is capable of increase over the term of the Motorola Share Warrant. The initial subscription price is equal to the Placing Price. Any adjustment to the prevailing subscription price will occur with effect from each anniversary of Completion (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 the Placing Price increased on each anniversary date by a sum equal to five per cent. of the Placing Price. 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;
- (iii) exercise by Motorola of its subscription rights under the Motorola Share Warrant is conditional upon the Motorola Warrant Shares being admitted to the Official List and to trading on the London Stock Exchange and admitted to listing on Nasdaq Europe;
- (iv) if a change of control of the Company occurs, Motorola must exercise the Motorola Share Warrant immediately or they will lapse;
- (v) during the period from the date of grant of the Motorola Share Warrant until exercise or lapse of the Motorola Share Warrant, the Share Warrant Holder will have the right to attend all general meetings of the Company but will not have any right to vote at such meetings in respect of the Motorola Share Warrant or the Motorola Warrant Shares;
- (vi) the Company is required to keep available for issue such number of Ordinary Shares as will enable the Motorola Warrant Shares to be issued if the Motorola Share Warrant is exercised in full;
- (vii) rights under the Motorola Share Warrant may be transferred in whole but not in part to any company in Motorola’s group of companies provided if the transferee ceases to be a member of Motorola’s group of companies it must transfer the Warrant to a company which is a member of Motorola’s group of companies; and



- (viii) if an order is made or effective resolution passed for the winding up or dissolution of the Company:
- (a) for the purpose of a reorganisation or amalgamation pursuant to a scheme of arrangement with the sanction of Motorola the terms of the scheme of arrangement will be binding on the Share Warrant Holder.
  - (b) otherwise than if (a) above applies, under the Motorola Share Warrant Instrument the Share Warrant Holder shall have three months to elect to be treated as if it had exercised its subscription rights under the Motorola Share Warrant Instrument and to be paid out of the assets which would otherwise be available in the liquidation to the holders of Ordinary Shares, such sum (less the subscription price payable) as it would have received had it exercised such subscription rights.

#### THE DRAW DOWN FACILITY

Under the terms of the Draw Down Facility, the Company will have the option to call for the Equity Providers to subscribe for new Ordinary Shares up to a maximum aggregate subscription by the Equity Providers of £14 million.

The Ordinary Shares to be issued under the Draw Down Facility will be voting shares in the capital of the Company and will when issued rank *pari passu* with the existing Ordinary Shares.

A summary of the Draw Down Facility is given in section 14 of Part VIII - “General Information - Material Contracts” of this document.

#### EQUITY PROVIDERS’ SHARE WARRANTS

Immediately following the passing of the Resolution, the Company will execute the Equity Providers’ Share Warrant Instruments and grant the Equity Providers’ Share Warrants.

The Equity Providers’ Share Warrants will be capable of exercise at any time during the period of three years from the date of issue (“the warrant term”) and may be exercised in whole or in part. The Equity Providers’ Warrant Shares will be voting shares in the capital of the Company and will, when issued, rank *pari passu* with existing Ordinary Shares.

Under the terms of the Equity Providers’ Share Warrants:

- (i) the subscription price per Equity Providers’ Warrant Share will be 178.25p, being a sum equal to 115 per cent. of the Placing Price;
- (ii) if exercised in part only, the Equity Provider’ Share Warrants must be exercised for a minimum of 50,000 Ordinary Shares;
- (iii) upon any sub-division or consolidation of the Company’s equity share capital, the number of Equity Providers’ Warrant Shares and the exercise price under the Equity Providers’ Share Warrants are capable of adjustment to reflect the occurrence of the sub-division or consolidation. There will also be an adjustment to the exercise price if the Company declares or makes any dividends during the warrant term;
- (iv) if the Company grants any rights to its shareholders to subscribe for Ordinary Shares during the warrant term, then the holder(s) of the Equity Providers’ Share Warrants are entitled to receive the benefit of such rights as if the warrant had been exercised in full prior to the granting of the right to the Company’s shareholders; and
- (v) the rights under the Equity Providers’ Share Warrants may be transferred in whole or in part to any affiliate of the Equity Providers and to any third party with the prior consent of the Company (such consent not to be unreasonably withheld or delayed).

The Equity Providers’ Share Warrants confers upon the holder(s) thereof the right to subscribe (in aggregate) for up to 2,000,000 Ordinary Shares.



## The Placing

The Company intends to issue Offer Shares to raise approximately £20,000,000 gross of underwriting commissions described below and before expenses to be paid by the Company in connection with the Transactions estimated to be £2,347,000 (exclusive of VAT).

Beeson Gregory, pursuant to the Placing Agreement to be entered into, will agree with the Company on the terms and subject to the conditions therein contained, to use its reasonable efforts to procure subscribers for or failing which itself to subscribe for a number of Offer Shares, to be determined and agreed between Beeson Gregory and the Company at the Placing Price less placing commissions.

The Company will pay to Beeson Gregory commission of 3.5 per cent. of the amount raised in the Placing and Open Offer if the amount so raised is less than £15,000,000 and a commission of 4 per cent. on the amount so raised if the amount raised is £15,000,000 or more. Such commission is payable in certain circumstances if the Placing and Open Offer is not completed as a result of certain defaults by the Company. In addition, the Company will reimburse Beeson Gregory in respect of its expenses in connection with the Placing and Open Offer and will indemnify it against standard liabilities in connection with the Placing and Open Offer.

Completion of the Placing will be conditional upon, among other matters:

- (i) Admission occurring in respect of all of the Placing Shares on or before 12 December 2001;
- (ii) the passing of the Resolution at the EGM;
- (iii) there having been no breach of standard representations, warranties and covenants to be set out in the Placing Agreement; and
- (iv) delivery of standard legal opinions.

Pursuant to the Placing Agreement, certain shareholders (namely Bankhill Trustees Limited as trustees of the Andrew Nelson Interest in Possession Settlement and as trustees of the Dr Scott Interest in Possession Settlement, Thomas Hierl and/or the trustees of his family trusts, Mid Atlantic Venture Funds, Scott Massie, Godfrey Ainsworth, Martin Lamb and Stephen Byars) will give certain orderly market undertakings to Beeson Gregory with respect to transactions in, *inter alia*, Ordinary Shares for a period of six months. In addition, the Company will agree that for a period of one year without the consent of Beeson Gregory it will not sell, contract to sell, grant any option to purchase or issue Ordinary Shares or any instrument or security convertible into or exchangeable for, or otherwise dispose of, any Ordinary Shares except pursuant to the Share Option Schemes, in connection with a dividend or pursuant to the Transactions.

In connection with the issue and sale of the Offer Shares, Beeson Gregory may engage in over allotment and stabilising transactions in relation to the Ordinary Shares. Over allotment involves sales in excess of the issue size, which creates a short position for Beeson Gregory. Stabilising transactions involve bids to purchase the Ordinary Shares in the open market for the purpose of pegging, fixing or maintaining the price of each Ordinary Share. Such stabilising transactions may cause the price of the Ordinary Shares to be higher than it would otherwise be in the absence of such transactions. Such activities, if commenced, may be discontinued at any time.

The Company will grant Beeson Gregory the Over Allotment Option, exercisable up to 30 days following Admission to acquire up to that number of Ordinary Shares equal to 15 per cent. of the Ordinary Shares take up under the Open Offer and placed under the Placing.

Ordinary Shares issued under the Over Allotment Option (if any) will be sold on the same terms and conditions as the Ordinary Shares that are placed under the Placing and will be sold at the Placing Price.



## Nature of the Issue

### GENERAL

It is the responsibility of any person receiving a copy of this prospectus and/or the Application Form outside the UK and wishing to make an application for Offer Shares to satisfy himself as to full observance of the laws of the relevant territory, including the obtaining of any governmental or any other consents which may be required or paying any issue, transfer or other taxes due in any such territory or observing any other formalities needing to be observed in such territory. Receipt of the prospectus or an Application Form will not constitute an offer in those jurisdictions in which it would not be legal to make such an offer and in such circumstances this prospectus and the Application Form will be deemed to have been sent for information and voting purposes only. IQE and Beeson Gregory reserve the right to treat an Application Form as invalid if they believe that the application may violate applicable legal or regulatory requirements.

Submission of an Application Form will constitute a warranty by the applicant that it has complied with all such requirements. Persons resident in overseas territories should contact their independent 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 the Offer Shares.

### *United Kingdom*

This prospectus has been approved by the UK Listing Authority as Competent Authority for the purposes of and as defined in the Prospectus Directive (80/390/EEC) and the Prospectus Directive (89/298/EEC) and a certificate for the purposes of mutual recognition under the terms of those directives has been delivered by the UK Listing Authority to the Commission Bancaire et Financière of Belgium.

### *United States*

The offer and sale of the Offer Shares have not been and will not be registered under the US Securities Act of 1933 (the "Securities Act") and therefore Shareholders who are citizens or residents of the United States may not purchase Offer Shares in the Open Offer. Application forms from such Shareholders will not be accepted. Further, any Application Forms mailed from within the United States will not be accepted. This document is being sent to such Shareholders solely in compliance with legal requirements relating to the Extraordinary General Meeting and is intended merely to inform such Shareholders about the matters to be voted on at the Extraordinary General Meeting and is not, nor is it intended to constitute, an offer to purchase any Offer Shares.

The Offer Shares may be offered and sold in the Placing in the US pursuant to an applicable exemption from registration under the Securities Act. Such Offer Shares cannot be resold or transferred in the US unless pursuant to an effective registration statement or pursuant to an applicable exemption from the Securities Act and in compliance with the securities laws of any applicable state.

The New Ordinary Shares, the Share Warrants, the Warrant Shares and the Draw Down Shares are not being registered under the Securities Act pursuant to an exemption from the registration provisions of the Securities Act for transactions not involving a public offering. As a result, the New Ordinary Shares, the Share Warrants, the Warrant Shares and the Draw Down Shares cannot be sold or otherwise transferred in the US unless such sale or transfer is subsequently registered with the US Securities and Exchange Commission or an exemption from such registration is available for such sale or transfer, and in compliance with the securities laws of any applicable state.

### *Belgium*

The New Ordinary Shares, the Share Warrants, the Warrant Shares and the Draw Down Shares will not be offered publicly, directly or indirectly, in Belgium at the time of the Motorola Subscription and Placing and Open Offer. Nevertheless, the admission to listing on Nasdaq Europe of the New Ordinary Shares constitutes a public offer in Belgium. This prospectus will be filed with the Belgian Banking and Finance Commission (Commissie voor het Bank-en Financiewezen/Commission



bancaire et financière) for recognition (prior to the Motorola Subscription and Placing and Open Offer being completed) in accordance with Article 34bis of the Royal Decree NR 185 of 9 July 1935. The recognition of this prospectus by the Banking and Finance Commission will not imply any judgement as to the appropriateness or the quality of the New Ordinary Shares nor of the situation of the Company.

#### *Germany*

The Offer Shares have not been offered and will not be offered to persons in Germany except to persons who acquire or dispose of securities as a part of the profession or as a business either for their own account or for the account of the parties (sec 2, no. 1 Security Sales Prospectus Act “Verkaufsprospektgesetz”) or otherwise only in circumstances where an exemption from the duty to publish a Sales Prospectus under the German Security Sales Prospectus Act is applicable. One of these exemptions is an offering which is only addressed to the existing shareholders.

#### *Deutschland*

Die angebotenen Aktien sind und werden in Deutschland nicht öffentlich angeboten mit Ausnahme von Personen, die beruflich oder gewerblich für eigene oder fremde Rechnung Wertpapiere erwerben oder veräußern (§ Nr. 2 VerkProspG), oder unter Umständen, nach denen nach dem Verkaufsprospektgesetz eine Ausnahme von der Pflicht zur Veröffentlichung eines Prospektes besteht. Eine dieser Ausnahmen ist ein Angebot, das sich nur an die Gruppe der Altaktionäre wendet.

#### *Sweden*

This prospectus is not a prospectus prepared in accordance with the Swedish Financial Investments Act (1991: 980) or the Swedish Financial Supervisor Authority Regulation, (1995: 21). This prospectus has not been registered or approved by any governmental or regulatory agency in Sweden. This prospectus may not be duplicated or distributed in, and no offering of the Offer Shares may be made to, the public in Sweden.

#### *Luxembourg*

This prospectus does not constitute a public offer to sell or the public solicitation of an offer to buy any Ordinary Shares in Luxembourg. No person is or has been authorised by the Company to distribute to the public in Luxembourg this prospectus.

#### *Ireland*

The Offer Shares will not be offered directly or indirectly to the public in Ireland. The Offer Shares will only be offered to persons in the context of their trades, professions or occupations whose ordinary business it is to buy or sell shares or debentures whether as principal or agent, or to a restricted circle of persons within the meaning of Article 2 of Directive 89/298/EEC as adopted by the European Communities (Transferable Securities and Stock Exchange) Regulations, 1992. This prospectus does not constitute or form part of any offer or invitation to the public or any section of the public in Ireland to sell or any solicitations or any offer from members of the public or any section of the public in Ireland to purchase or subscribe for nor does it constitute a form of application for any Offer Shares. If you are not the intended recipient of this prospectus you must return it forthwith to Beeson Gregory. This document is not an application for shares or a prospectus for the purpose of the Companies Acts 1963-2001 or the European Communities (Transferable Securities and Stock Exchange) Regulations 1992 or any other law applicable in Ireland.

#### *Switzerland*

The Ordinary Shares referred to in this prospectus may not be offered publicly, directly or indirectly, to investors in Switzerland. Only a limited circle of persons (not exceeding 20) will be approached by or on behalf of the Company in connection with the offering of the Offer Shares.



#### *France*

The placing of the Placing Shares does not and is not intended to constitute an offer to the public (“appel public à l’épargne”) under French Law. This prospectus is issued in France only to qualified investors (“investisseurs qualifiés”) as defined under French Law, and in particular under Article L 411-2 of the French Monetary and Financial Code, in conjunction with Article 1 of the Decree No 98-880 dated 1 October 1998. This prospectus has not been submitted for approval to the French *Commission des Opérations de Bourse* (COB), nor have any procedures required under French Law for the public offering of shares in France been followed. This prospectus may not be used in connection with any offer or sale of securities issued by the Company to the public in France. The qualified investors to which the prospectus is issued in France are informed that they can only act on their own account as specified under the Decree dated 1 October 1998 and that the dissemination to the public, either directly or indirectly, of the securities so acquired is subject to the rules set out in the Articles L 411-1 through L 412-1 and L 621-8 of the French Monetary and Financial Code.

#### *Netherlands*

The Ordinary Shares and Share Warrants referred to in this prospectus (“effecten”) may not be offered, sold, transferred, or delivered in The Netherlands, or to Dutch residents – neither at their initial distribution nor at any time thereafter, either directly or indirectly – other than to persons or companies who or which trade or invest in securities in the conduct of a business or profession (“Professionals”). The Placing and Open Offer is therefore solely made to Professionals.

#### *Austria*

The Offer Shares have not been offered and will not be offered to the general public in Austria but are only offered to individually identified existing shareholders and a limited number of individually identified institutional investors, or otherwise, and in all cases only in circumstances not constituting an initial public offering in Austria within the definition of the Austrian Capital Market Act (Kapitalmarkgesetz) or where an exemption from the duty to publish a securities sales prospectus under the Austrian Capital Market Act is applicable. Neither the identified existing shareholders nor the targeted institutional investors nor any other offeree may, in turn, offer the Offer Shares to any third parties in such way as to trigger the duty to publish a securities sales prospectus under the Austrian Capital Market Act.

#### *Finland*

The Offer Shares are not offered to the public in Finland. This document does not constitute an offering circular or listing particulars under the Finnish Securities Market Act (495/26.5.1989) and it has not been submitted for the approval of the Finnish Financial Supervision Authority.

#### *Norway*

No action has been taken by the Company that would, or is intended to, permit a public offer of Ordinary Shares in Norway. Accordingly, the Offer Shares are not being offered or sold, directly or indirectly in Norway, other than to existing shareholders in Norway and a limited number of institutional investors and neither this prospectus nor any other listing particulars, prospectus, offering memorandum, form of application, advertisement or other document or information may be distributed or published in Norway except under circumstances that will result in compliance with applicable Norwegian laws and regulations.

#### *The Republic of Italy*

The offering of the Offer Shares in the Republic of Italy has not been cleared with CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation. Accordingly, no Offer Shares may be offered, sold or delivered, and will not be offered, sold or delivered, nor may copies of this prospectus or any other offering material relating to the Offer Shares, be distributed and will be not distributed in the Republic of Italy other than: (i) to professional investors (“operatori qualificati”) as defined in Article 31, paragraph 2, of CONSOB Regulation No. 11522 of 1 July 1998, as subsequently



amended and supplemented; (ii) in circumstances which are exempt from the rules on offering (“*sollecitazione all’investimento*”) pursuant to Article 100, paragraph 1, letter b) of Legislative Decree No. 58 of 24 February 1998, as amended (the “Consolidated Financial Act”), and Article 33, paragraph 1, of CONSOB Regulation No. 11971 of 14 May 1999, as amended.

Any offer, sale or delivery of the Offer Shares or distribution of copies of this prospectus or offering material relating to the Offer Shares to professional investors in the Republic of Italy shall be: (i) made only by banks, investment firms or financial intermediaries enrolled in the special register provided for in Article 107 of Legislative Decree No. 385 of 1 September 1993, as amended (the “Consolidated Banking Act”), to the extent that they are duly authorised to engage in the placement and/or underwriting of financial instruments in the Republic of Italy in accordance with the relevant provisions of the Consolidated Financial Act; (ii) in compliance with Article 129 of the Consolidated Banking Act and the implementing guidelines of Bank of Italy; and (iii) in compliance with any other applicable laws and regulations.

#### *Denmark*

The Offer Shares will not be offered or sold in the Kingdom of Denmark except under circumstances that do not constitute an offer to the public within the meaning of the Danish Securities Trading Act Section 44 and the Danish regulation on prospectuses, section 2 (“Bekendtgørelse nr. 1207 af 15.12.2000”) as the Offer Shares are only offered to a limited number of sophisticated institutional investors. Consequently, this prospectus is not subject to the information requirements provided under the Danish Securities Trading Act and the Danish regulation on prospectuses and has not been pre-registered or approved by any governmental or regulatory agency in Denmark.

#### *Other Jurisdictions*

No action has been taken by the Company that would, or is intended to, permit a public offer of the Offer Shares. Accordingly, the Offer Shares are not being offered or sold, directly or indirectly, and neither this prospectus nor any other prospectus, offering memorandum, form of application, advertisement or other document or information may be distributed or published in any country or jurisdiction except under circumstances that will result in compliance with any applicable laws and regulations.

#### NON-RESIDENT OR FOREIGN OWNERS

There are no laws or regulations of the UK or provisions in the Articles that restrict the right of non-resident or foreign owners of any Ordinary Shares to hold or vote in relation to such Ordinary Shares.

#### TRADING ON THE LONDON STOCK EXCHANGE AND NASDAQ EUROPE

Application (i) will be made to the UK Listing Authority for the New Ordinary Shares to be admitted to the Official List and to trading on the London Stock Exchange, and (ii) will be made to Nasdaq Europe for admission of the New Ordinary Shares to listing on Nasdaq Europe.

The Ordinary Shares of the Company trade under the symbol “IQEP” both on the London Stock Exchange and on Nasdaq Europe. The Ordinary Shares are quoted in pounds on the London Stock Exchange and in US dollars on Nasdaq Europe.

Pursuant to the Nasdaq Europe Rules, all price sensitive information in respect of the Company shall continue to be made available to investors in Europe through the Nasdaq Europe Publication Means (as defined in the Nasdaq Europe Rules) according to the Continuing Obligations for Issuers. In addition, such information will also be made available to investors through the Company Announcements Office and Regulatory News Service of the London Stock Exchange.

#### NET PROCEEDS AND COSTS

Assuming issuance of all the Offer Shares pursuant to the Placing and the Open Offer, the net proceeds receivable by the Company from the issue of the New Ordinary Shares is estimated to be £26,864,361 before expenses payable by the Company, estimated to be £2,347,000 (exclusive of VAT, stamp duty and SDRT).



## USE OF PROCEEDS

The net proceeds of the Motorola Subscription will be used primarily to fund the capital cost anticipated to be necessary to successfully exploit the Technology.

Pending application of the net proceeds as described above, the Company intends to deposit them in interest bearing bank accounts.

## Payment, Clearing and Settlement Agencies

### INTRODUCTION

Following Admission, the Existing Ordinary Shares and the New Ordinary Shares will be in registered form and may be held either in certificated form or in electronic form, either through CREST or through Euroclear or Clearstream. Further details on CREST and Euroclear/Clearstream are set out below.

Transactions executed on Nasdaq Europe may only be settled in electronic form in Euroclear or Clearstream. Transactions executed on the London Stock Exchange may be settled either in electronic form in CREST or through the residual system involving share certificates and share transfer forms.

The New Ordinary Shares will be issued by the Company at the option of Motorola under the Motorola Subscription Agreement to Motorola or its nominee(s), by delivery of one or more share certificates to be held in certificated form.

Details of how transfers of Ordinary Shares may be made between CREST and Euroclear/Clearstream are set out below.

### CREST

CREST is a paperless settlement procedure enabling securities to be evidenced otherwise than by certificate and transferred otherwise than by written instrument. CREST was introduced in July 1996. The Articles provide for the Ordinary Shares to be settled through CREST.

Accordingly, settlement of transactions in the Ordinary Shares following Admission may take place within the CREST system if the relevant Shareholders so wish. CREST is a voluntary system and holders of Ordinary Shares who wish to receive and retain share certificates will be able to do so.

Each Shareholder who holds Ordinary Shares in CREST must hold such shares through a CREST participant account.

For stamp duty considerations of transferring Ordinary Shares into, out of or within CREST, please refer to the section on Taxation on pages 146 to 147.

### EUROCLEAR/CLEARSTREAM

The Euroclear and Clearstream operators provide Euroclear and Clearstream participants with, among other things, safekeeping, administration, clearance and settlement, securities lending and borrowing and related services. Euroclear and Clearstream participants are investment banks, securities brokers and dealers, banks, central banks, custodians, investment managers, corporations, trust companies and certain other organisations and include Beeson Gregory. In addition, shareholder notices (such as dates of shareholder meetings and annual reports) issued by the Company will be distributed to Shareholders through Euroclear and Clearstream.

Non-participants of Euroclear and Clearstream may hold and transfer book-entry interests in securities through accounts with a direct participant of Euroclear and Clearstream or any other securities intermediary that holds a book-entry interest in the securities through one or more securities intermediaries standing between such other securities intermediary and the Euroclear and Clearstream operators.

Although the Euroclear and Clearstream operators have agreed to the procedures provided below in order to facilitate transfers of securities among participants of Euroclear and Clearstream and between Euroclear and Clearstream participants and participants of other intermediaries, they are under no obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued at any time.



### *Initial distribution*

Investors electing to acquire securities through an account with the Euroclear and Clearstream operators or another securities intermediary must follow the settlement procedures of such an intermediary with respect to the Euroclear and Clearstream operators, and such securities will be credited to the securities clearance accounts of the respective Euroclear and Clearstream participants in the securities processing cycle for the business day following the settlement date for value as of the settlement date.

### *Secondary market*

Investors electing to acquire, hold or transfer securities through an account with the Euroclear and Clearstream operators or another securities intermediary must follow the settlement procedures of such an intermediary with respect to the settlement of secondary market transactions in securities.

Investors who are participants of Euroclear or Clearstream may acquire, hold or transfer interests in the securities by book-entry to accounts with the Euroclear or Clearstream operators. Investors who are not participants of Euroclear or Clearstream may acquire, hold or transfer interests in the securities by book-entry to accounts with a securities intermediary who holds a book-entry interest in the securities through accounts with Euroclear or Clearstream.

Each Shareholder who holds Ordinary Shares in Euroclear or Clearstream must hold such shares through a Euroclear or Clearstream participant account.

Shares held through a Euroclear or Clearstream participant may be transferred within Euroclear or Clearstream to another person with the same or a different Euroclear or Clearstream participant or even directly to a Euroclear or Clearstream participant.

For stamp duty considerations of transferring Ordinary Shares into, out of or within Euroclear or Clearstream, please refer to the section on Taxation on pages 146 to 147.

### *Transfers between CREST and Euroclear/ Clearstream*

At the date of this document, Ordinary Shares deposited with Euroclear or Clearstream may only be transferred to CREST and Ordinary Shares deposited with CREST may only be transferred to Euroclear or Clearstream in certificated form.

However, Ordinary Shares deposited with CREST for the account of Euroclear may be transferred in electronic form either (i) between different CREST participants, using the CREST system or (ii) between individuals within the Euroclear account, using the Euroclear or Clearstream system.

For stamp duty considerations of transferring Ordinary Shares between the Euroclear, Clearstream and CREST systems, please refer to the section on Taxation on pages 146 to 147.

### **PAYING AGENT SERVICES**

Any dividends or other distributions on Ordinary Shares held through Euroclear or Clearstream will be paid through a mechanism established by Euroclear and/or Clearstream. The costs for the distribution of dividends or other distributions will be borne by the Company. Euroclear and/or Clearstream will, on behalf of participants, collect all dividends, interest, cash distributions and any other payments due and received in respect of the Ordinary Shares. It will be the responsibility of the participants of Euroclear and/or Clearstream to pass on to their clients all dividends, other distributions and information in respect of the Ordinary Shares received from Euroclear and/or Clearstream. In case of any corporate actions to be taken by the Company, Euroclear and/or Clearstream will inform participants of such actions and request instructions regarding such actions, as applicable. Euroclear and/or Clearstream will also give notice to their participants holding Ordinary Shares in the Company if and when an annual or extraordinary general meeting of shareholders is called, giving the date and place of the meeting and information about what steps have to be taken to attend the meeting in order to vote. Upon request, Euroclear and/or Clearstream will make available all necessary material to effect proxy voting. The Company will inform Euroclear and/or Clearstream of the aforementioned transactions.





Shareholders who are or will be CREST sponsored members should refer to their CREST sponsors regarding arrangements for dividends, other distributions, corporate actions and general meetings of the Company.

Any dividends or other distributions on Ordinary Shares held in certificated form through the residual system involving share certificates and share transfer forms will be paid directly to the shareholder by the Company. The costs for the distribution of dividends or other distributions will be borne by the Company. In case of any corporate actions to be taken by the Company, the Company will inform participants of such actions. The Company will also give notice to the shareholders holding Ordinary Shares through the residual system in the Company if and when an annual or extraordinary general meeting of shareholders is called, giving the date and place of the meeting and information about what steps have to be taken to attend the meeting in order to vote. The Company will also make available all necessary material to effect proxy voting.



## PART IV

### RISK FACTORS OF THE GROUP

An investment in the Ordinary Shares involves certain risks. Prior to making any investment decision, prospective purchasers of Ordinary Shares should consider carefully all of the information set forth in these listing particulars and, in particular, the risks described below.

#### LIMITED OPERATING HISTORY AS AN INTEGRATED GROUP

Although the Company's main operating subsidiaries, IQE Europe and QED, have both been trading since 1989, the Group was only formed by the Merger in May 1999 with Wafer Technology and IQE Silicon Compounds being later additions. Although the Board believes that the integration of the individual businesses has been proceeding without material interruption, any failure of the Company to manage the integration of its operating subsidiaries effectively could have a material adverse effect on the Group's business, financial condition and results of operations. See Part III "Information on the Group – Introduction and Summary".

#### FACTORS AFFECTING OPERATING RESULTS: POTENTIAL FLUCTUATIONS IN RESULTS

Fluctuations in the Group's operating results have resulted in the past and may result in the future from the timing, quantity and pricing of orders, scheduled and unscheduled maintenance, variations in manufacturing yields, product mix, timing and scale of tax payments, currency exchange rates and other factors, many of which are beyond the Group's control. See "Summary of Financial Information" and Part V "Financial Information relating to the Group".

Factors which could cause the Group's operating results to fluctuate which relate to its internal operations include:

- the need for continual, rapid new product introductions;
- changes in the Group's product mix;
- the Group's inability to adjust its fixed costs in the face of any declines in sales;
- the availability of production capacity and fluctuations in the manufacturing yields at the Group's facilities;
- the timing and duration of routine shut down of reactors for cleaning and maintenance; and
- any unplanned shut down of the Group's production equipment.

Factors which could cause the Group's operating results to fluctuate which are influenced by its suppliers and customers include:

- the timing of significant product orders, order cancellations and reschedulings;
- the availability of production capacity and fluctuations in the manufacturing yields at third parties' facilities which manufacture devices incorporating the Group's products; and
- the cost of raw materials and manufacturing equipment from suppliers.

Factors which could cause the Company's operating results to fluctuate which are industry risks include:

- intense competitive pricing pressures; and
- emergence of new and competing technologies.

Typically, customers require a short lead time for the delivery of epitaxial wafers as they themselves react to their customer demands, making it difficult for the Group to accurately predict the precise demand for epiwafers in any given period of time. In addition, some of the Group's customers keep a sizeable inventory and may periodically reduce, postpone or cancel orders given their own supply and



demand situation. These factors may be more pronounced since the Group has generally not entered into long-term contracts with its customers. See Part III “Information on the Group Customers”. A significant proportion of the Group’s costs, however, are fixed. Therefore, the factors affecting revenues referred to above could cause fluctuations in the Group’s operating results. In addition, the timing of increases in some fixed expenses is based in large part on the Group’s forecast future revenues. If such revenues do not meet the Group’s expectations, the Group may be unable to quickly adjust expenses to appropriate levels for actual revenues, which could have a material adverse effect on the Group’s business, financial condition and results of operations.

#### SUBSTANTIAL CAPITAL EXPENDITURES: CONTINUING CAPITAL REQUIREMENTS

To meet the anticipated market demand for MOVPE and MBE wafers and GaAs on Silicon Wafers, the Group plans to purchase additional multi-wafer MOVPE and MBE systems and related equipment. See Part III “Information on the Group – Facilities and Equipment” and “The Group’s Strategy”. This equipment acquisition and the related increase in staffing will increase fixed costs and may adversely affect the Group’s short term operating results prior to the realisation of anticipated future benefits of such increased capacity. If the anticipated market demand for the Group’s MOVPE and MBE products does not occur, or if the revenues do not increase sufficiently to cover the additional costs of expansion, the Group’s business, financial condition and results of operations may be materially adversely affected.

Investments in new technology or sales growth, whether organically or through acquisition, beyond currently planned capacity would require further expenditure. If this arises the Group may issue additional capital in connection with such expansion. There can be no assurance that additional capital will be available at the appropriate time on acceptable terms, if at all. If additional equity securities are issued, dilution of the Company’s then existing Shareholders may result.

#### PRODUCTION SYSTEM COMPLEXITY

The design and operation of MOVPE and MBE systems is extremely complex and requires highly trained and experienced technicians and engineers to operate and maintain them in good working order. The introduction or redesign of production systems by the equipment suppliers has historically resulted in unanticipated problems associated with new and unproven designs. Although equipment suppliers have continually improved their product introductions, and the Group plans to balance its equipment purchasing in future between new technology and new designs in order to continue to improve production throughout, there can be no assurance that delays will not occur due to equipment design problems. Such delays may substantially affect the Group’s operations and subsequent delays in the delivery of wafers to customers may have a material adverse impact on the Group’s business, financial condition and results of operations.

The Group’s manufacturing processes are highly complex, require advanced and costly equipment and are continuously being modified in an effort to improve yields and product performance. Impurities or other difficulties in the manufacturing process can lower yields. The Group’s manufacturing efficiency will be an important factor in its future profitability, and there is no assurance that the Group will be able to maintain manufacturing efficiency to the same extent as the Group’s competitors.

In addition, as is common in the semiconductor industry, the Group has from time to time experienced difficulty in commencing production at new facilities or on new equipment, in effecting transitions to new manufacturing processes. As a consequence, the Group has suffered delays in product deliveries or reduced yields. The Group may experience manufacturing problems in achieving acceptable yields or experience product delivery delays in the future as a result of, among other things, capacity constraints, construction delays, upgrading or expanding existing facilities or changing the Group’s technologies, any of which could result in a loss of future revenues. The Group’s operating results could also be materially adversely affected by the increase in fixed costs and operating expenses related to increases in production capacity if revenues do not increase proportionately. See Part III “Information on the Group – Facilities and Equipment”.



## SUBSTANTIAL RELIANCE ON KEY CUSTOMERS

The Group's customer base has been and continues to be highly concentrated. For the years ended 31 December 1998, 1999 and 2000 the five largest customers accounted for approximately 44 per cent., 48 per cent. and 38 per cent., respectively of the Group's total revenues and the ten largest for approximately 52 per cent., 58 per cent. and 59 per cent.; respectively of the total revenues in each such period. Generally, the Group does not have long term or other non-cancellable commitments from customers to purchase its products, although based upon historical results and the long term relationships with customers, the Board believes a substantial proportion of its revenues will continue to be derived from sales to the Group's largest customers. There can be no assurance that the Group's current customers will continue to place orders with the Group or that the Group will be able to obtain or complete new orders from new customers. The loss of any one or more significant customers could have a material adverse effect on the Group's business, financial condition and results of operations. See Part III "Information on the Group – Customers".

## COMPETITION

The market for the Group's products is highly competitive and has been characterised by rapid and significant technological advances. In connection with the production of the Group's epitaxial wafers by MOVPE and MBE for the compound semiconductor device market, the Group competes with both merchant suppliers (some of whom are also device manufacturers) and the in-house capabilities of device manufacturers. Many of these competitors have substantially greater financial, research and development, manufacturing and technical resources than the Group. There can be no assurance that the Group's competitors will not succeed in developing technologies or operating methodologies that are more effective or less costly than the Group's. Device manufacturers may themselves invest in manufacturing capacity, which may reduce the orders placed with the Group. To remain competitive, the Group will continue to invest in leading edge production systems and technologies, research and development, sales and marketing and state of the art manufacturing methodologies. There can be no assurance, however, that the Group will be successful in such efforts. See Part III "Information on the Group – Competitors".

The Board believes that the primary competitive factors in the market in which the Group competes are, and will continue to be, price, quality, product range, confidentiality, reliability, technical capability and support, customer service and reliability of delivery and the ability to combine these to provide a comprehensive one-stop epiwafer service. There can be no assurance that other competitors will not be able to provide a more competitive service or that customers will not choose a different business model with which to meet their epiwafer needs. See Part III "Information on the Group – The IQE Solution", "The Group's Strategy" and "Competitors".

## ADOPTION OF TECHNOLOGY

The development of the Technology is believed by the Board to be wholly new and thus does not infringe third party rights. No searches or legal due diligence has been conducted by the Board to ensure that this assumption is correct. Motorola has not, in the draft licence to the Company, warranted ownership nor have indemnities been offered if infringement issues arise. With emerging technology these type of risks often arise.

MOVPE and MBE are two of several competing technologies used to produce compound semiconductor epiwafers. The Group believes that the use of and availability of both technologies to it gives it performance advantages over other competitors but there can be no assurance that other technologies will not develop further and diminish the performance or cost advantages of MOVPE and MBE or that end product manufacturers will continue to require the performance levels currently obtainable only by using wafers produced using the MOVPE or MBE technologies. See Part III "Information on the Group – The Group's Strategy", "Products" and "Industry Overview".



Equally, whilst both Motorola and IQE are extremely excited about the adoption and implementation of the Technology, as with the introduction of any new technology, there can be no guarantee of its commercial success or that it will be widely adopted.

The commercial success of the Technology will be largely dependent on further technological improvement being made and resulting in even greater cost savings. There is no guarantee that such further improvements can be made.

#### LIMITATIONS UNDER THE LICENCE AGREEMENT

The Licence Agreement licenses IQE to use the Technology to make wafers using GaAs on silicon substrates up to 12" in diameter. However, the cost saving benefits of manufacturing wafers using the Technology will be increased when using more costly InP substrates. There is no guarantee that IQE will be granted a licence to manufacture wafers using materials other than GaAs.

The exclusivity period granted by Motorola to IQE under the Licence Agreement will last for 15 months commencing on 1 November 2001 and is limited to wafers of up to 6". However, if IQE fails to achieve commercial production of epi-wafers based on the Technology within nine months of the exclusivity period commencing, the exclusivity period will end thereby reducing IQE's commercial advantage from 15 months to 9 months. The royalty rates for wafers with diameters in excess of 6" have not yet been set by Motorola and there is no agreed exclusivity period in respect of the same.

The commercial exploitation of the Technology is dependent on, *inter alia*, Motorola licensing component and device manufacturers to use this technology. Although the Board understands that Motorola has every intention to do so, there is no guarantee that Motorola will licence such technology to component and device manufacturers.

#### DEPENDENCE ON A LIMITED NUMBER OF EQUIPMENT MANUFACTURERS

There are few manufacturers of MOVPE and MBE wafer manufacturing systems. The increased demand for MOVPE and MBE systems could increase future costs of such systems and cause delays in increasing capacity to meet customer demand. Based on the Group's experience, the time from the ordering of a new system until installation, testing and qualification are complete can be longer than a year. There can be no assurance that this order lead time will not increase in the future or that system vendors will deliver in a timely manner. Although the Group has tried to mitigate against some of the effects of these factors by entering into long term supplier arrangements with its equipment suppliers, the existence of these factors could have a material adverse effect on the Group's business, financial condition and results of operations. See Part III "Information on the Group – Raw Material Suppliers and Supply Chain".

#### DEPENDENCE ON OUTSOURCING BY MAJOR PRODUCERS

Market research indicates a trend towards outsourcing of capacity by large compound semiconductor component manufacturers. If the outsourcing trend does not continue or is interrupted in any way, this could have a material adverse effect on the Group's business model.

#### LENGTH OF QUALIFICATION PERIOD

Prior to placing production orders for epiwafers with the Group, customers first qualify the Group's wafer products by making devices and testing the electrical optical and reliability performance of these devices. The qualification process may involve several cycles of qualification. Consequently, the qualification period is highly variable depending on the device being manufactured by the customer and its application, on the number of cycles demanded by the customer and on any changes the customer may require during the qualification period. There can be no assurance therefore on the length of the qualification period, nor can there be any assurance that the qualification will be successful, nor can there be any assurance that once qualified, the Group will receive any production orders for wafers. Any of the aforementioned issues arising out of qualification could have a material adverse effect on the Group's business.



## DEPENDENCE ON KEY MATERIALS

The Group manufactures its epiwafer products on GaAs and InP substrates which are supplied by a limited number of suppliers. In addition, the Group is heavily dependent on a limited number of suppliers for the provision of its metal organic chemicals, hydride gas and gallium, indium and other raw materials.

The Group's epiwafer products are also heavily reliant on the purity of its raw material supplies, since a very small level of impurities entering the growth chamber in either of the MOVPE or MBE processes can adversely affect the epiwafer quality and characteristics.

Although the Group has a number of supply agreements in place with its raw material suppliers, together with well defined purchase specifications, and works very closely with each of its key suppliers, there can be no assurance that the stability of supply can be maintained, nor that the supplies will continue to meet the requisite level of purity in their raw materials demanded by the process. Any disruptions to supply could materially adversely affect the Group's ability to continue routine production with a potentially material adverse affect on the Group's revenues. See Part III "Information on the Group – Raw Material Suppliers and Supply Chain".

In connection with some of these supply agreements, the Group has agreed to acquire certain raw materials exclusively from one supplier at a fixed price provided such supplier can meet such requirements. If other less expensive sources of supply emerge, the Group may be at a competitive disadvantage to some customers and, as a consequence, operations may be materially adversely affected.

## DEPENDENCE ON KEY PERSONNEL

The Group's continued success depends to a significant degree on the continued service of its founders, Dr Andrew Nelson (Executive Chairman and Chief Executive Officer), Mr Thomas Hierl (Chief Technical Officer), Dr Michael Scott (Sales and Marketing Director) and Mr Scott Massie (Chief Operating Officer), as well as its directors and certain of its senior managers and technical personnel. The loss of service of one or more of these key employees could materially and adversely affect the business of the Group and its future prospects. The Group relies on employing highly qualified technical personnel who are in short supply. The Group's ability to recruit, motivate and retain highly qualified technical personnel will be important to help grow the Group's revenues. There can be no assurance that the Group will be able to attract, motivate and retain such personnel, given the high degree of competition for such expertise in the marketplace. Although the Group relies on contractual non-compete agreements with its employees, if such agreements were breached or found to be unenforceable, the Group's prospects could be materially adversely affected. See Part III "Information on the Group – Directors and Officers".

## MANAGEMENT OF GROWTH AND EXPANSION

The Group has experienced substantial growth and expanded operations during the past five years. This growth has placed significant and increasing demands on the Group's management, operational, technical and financial resources. The Group expects both organic growth and growth by acquisitions to occur. Both of the MOVPE and MBE production processes are leading edge technologies and as such the continued growth of the Group may continue to challenge its senior management, as well as its technical and manufacturing personnel. The Group's ability to support any growth of its business will be substantially dependent upon, among other things, continued development of financial and management controls and information technology systems, increased marketing activities, increased project management activity, timely availability of country specific versions of its products and the hiring and training of new personnel. There can be no assurance that the Group will be able to manage its recent or any future expansion successfully and any inability to do so could have a material adverse effect on the Group. See Part III "Information on the Group – The Group's Strategy".



There can be no assurance that the Group will be successful in expanding its organisation, or find suitable acquisition candidates or manage effectively an increased level of operations or the integration of acquired businesses.

#### CENTRALISATION OF MANUFACTURING FACILITIES

The Group has previously manufactured all of its MOVPE products at its facility in St Mellons, Cardiff, UK, and all of its MBE products at its facility in Bethlehem, Pennsylvania, US. Due to the centralisation of its for each of the processes, the Group is susceptible to business interruptions resulting from power outages, natural disasters, equipment failure, work stoppages and other localised conditions. The Company may not have adequate disaster recovery plans in the event of such business interruptions. Prolonged business interruption could have a material adverse effect on the Group's business, financial condition and results of operations. See Part III "Information on the Group – The IQE Solution" and "Facilities and Equipment". The Group now has a MOVPE manufacturing capability at its Bethlehem facility which reduces this risk.

#### ENVIRONMENTAL REGULATIONS AND OTHER GOVERNMENTAL REGULATIONS

The production of epiwafers and other operations involves the use of certain Hazardous Materials. There can be no absolute assurance that the Group's extensive control systems will be successful in preventing the release of these materials or other adverse environmental conditions. Any such release or other failure to comply with current or future environmental regulations could result in the imposition of significant fines on the Group, the suspension of production or to a lesser extent a cessation of operations. Moreover, certain Environmental Laws hold current and former owners and/or operators of land or businesses liable for their own and previous owner's or occupant's releases of Hazardous Materials, subject to certain defences. Because of the prior use of the US facility for the production of steel, the US facility has the potential to be affected by such releases and accordingly the Group may be affected by such liability provisions of such Environmental Laws. With regard to the US facility, the Group is indemnified by the landlord for losses arising from environmental impacts caused by prior occupation. However, there can be no assurance that no environmental conditions which require remedial activities exist on the portion of the property utilised by the Group, or whether such remedial activities, if required, would materially impact the Group's operations.

Accordingly, the nature of the Group's ongoing operations exposes it to the risk of liabilities or claims with respect to environmental matters, including those relating to on- and off-site disposal and releases of Hazardous Materials and there can be no assurance that material costs will not be incurred in connection with these liabilities or claims.

Based on the Group's experience, the Board believes that the future cost of compliance with existing environmental and health and safety laws and regulations (and liability for known environmental conditions) will not have a material adverse effect on the Group's business, financial condition or results of operations. However, the Board cannot predict:

- what environmental or health and safety legislation or regulations will be enacted in the future;
- how existing or future laws or regulations will be enforced, administered or interpreted; or
- the amount of future expenditures which may be required to comply with these environmental or health and safety laws or regulations or to respond to future cleanup matters or other environmental claims. See Part III "Information on the Group – Environmental Regulations".

#### LIMITED PROTECTION OF PROPRIETARY TECHNOLOGY: RISKS OF INFRINGEMENT

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.



There can be no assurance that the Group's means of protecting its proprietary rights will be adequate or that the Group's competitors will not independently develop similar technology. In addition, the laws of some countries do not protect the Group's proprietary rights to as great an extent as the laws of either the UK or the US. See Part III "Information on the Group – Proprietary Information".

Vigorous protection and pursuit of intellectual property rights or positions characterise the semiconductor industry. This vigour and pursuit have resulted in significant and often protracted and expensive litigation. From time to time the Group has been and in the future may be notified of claims that it may be infringing third party patents or other intellectual property rights. In response to these claims or otherwise, the Group may seek licenses to use patents, software or other intellectual property rights. However, the Group cannot be certain that it will obtain these licences or that the terms of any offered licences will be acceptable to it. Any acquisition or licence could require expenditure of substantial time and other resources. The Group's failure to obtain a licence from a third party for technology which it uses could cause it to incur substantial liabilities and to suspend the manufacture or shipment of products or its use of processes requiring the technology. In addition, any litigation asserted against the Group could result in significant expense to the Group adversely affecting sales of the challenged product or technology and diverting the efforts of its technical and management personnel, whether or not the litigation is determined in its favour. In the event of an adverse outcome in any litigation, the Group may be required to:

- pay substantial damages and incur significant attorney's fees;
- cease the manufacture, use, sale or importation of infringing products;
- expend significant resources to develop or acquire non-infringing technology;
- discontinue the use of some processes; and/or
- obtain licenses to intellectual property covering the infringing technology.

#### CURRENCY FLUCTUATIONS

The Group sells its products in many parts of the world and, as a result, the Group's business is affected by fluctuations in currency exchange rates. The Group generates a significant percentage of its revenues, and a lower percentage of its operating expenses, in currencies other than pounds sterling, particularly the US dollar. The Group's operating profitability could be materially adversely affected by large fluctuations in the rate of exchange between pounds sterling and such other currencies. The Group engages in foreign exchange hedging activities when it deems it necessary to hedge against fluctuations in the exchange rates of the principal foreign currencies in which its receivables are denominated (in particular, the US dollar), but there can be no assurance that such hedging activities will continue or will limit the impact of movements in exchange rates upon the Group's results of operations.

#### INTERNATIONAL OPERATIONS

The Group cannot be certain to what extent its future operations and earnings may be adversely affected by the risks related to or any other problems arising from operating in international markets. It has significant operations in the US and the UK and generates approximately 95 per cent. of its revenue from outside the UK. Risks inherent in doing business on an international level include:

- unexpected changes in the laws and policies of the US and the UK and of the countries in which the Group manufactures and sells its products;
- economic and political instability;
- trade restrictions; and
- foreign currency fluctuations.





## INFLUENCE OF PRINCIPAL SHAREHOLDERS

Following completion of the Motorola Subscription and the Placing and Open Offer, certain Directors (and their related trusts) and NEPA will own or be interested in, directly or indirectly, more than 47.57 per cent. of the then issued Ordinary Shares (assuming no take up under Open Offer). See section 5 of Part VIII “General Information – Directors’ and others interest in the Company”. In addition, certain of the Group’s employees will be entitled to subscribe for Ordinary Shares pursuant to the Share Option Schemes. See section 9 of Part VIII “General Information – Share Option Schemes”. As a result, if these Shareholders were to act in concert they would be in a position to influence the outcome of matters submitted for shareholder consideration, including the appointment of the Company’s board of directors and the approval of significant change-in-control transactions. In addition, this influence may have the effect of making certain transactions more difficult without the support of the Directors and may have the effect of delaying or preventing a takeover bid or other change in control of the Company.

Following completion of the Motorola Subscription, Motorola will own 2.43 per cent. of the Company’s issued share capital and will have the further right to subscribe for additional Ordinary Shares (which would potentially increase such holding to 4.75 per cent. of the then issued share capital of the Company) pursuant to the Motorola Share Warrant in the future. In addition, the Company will have the right, pursuant to the Draw Down Facility, to issue new Ordinary Shares to the Equity Providers, the price for which will be set by reference to prevailing trading prices following issuance of drawdown notices by the Company. In addition, the Equity Providers will be granted the Equity Providers’ Share Warrants giving them the right to subscribe for 2,000,000 Ordinary Shares. Whilst the Group believes that there is no loss of independence as a result of Motorola’s or the Equity Providers’ respective shareholdings, as neither Motorola nor the Equity Providers have any right to Board representation or indeed influence at any operating level, the size of its shareholding may have the effect of making certain transactions more difficult without their support and may have the effect of delaying or preventing a takeover bid or other change in control of the Company.

## LITIGATION

IQE Europe is currently involved in litigation with Rockwell Technologies, LLC, et al. in the United States District Court in Delaware. See section 17 of Part VIII “General Information – Litigation”. An unfavourable outcome of this litigation could have a material adverse effect on the Group’s business.

## TRADING MARKET FOR THE ORDINARY SHARES

The market price of the Ordinary Shares has been and may continue to be subject to wide fluctuations. This is in response to many factors, including variations in the operating results of the Group, variations in industry growth rates, actual or anticipated announcements of technical innovations or new products or product enhancements by the Group or its competitors, general economic conditions in the semiconductor industry, divergence in financial results from analysts’ expectations, changes in earnings estimates by stock market analysts and other events and factors. In addition, international stock markets have from time to time experienced extreme price and volume fluctuations, which have affected the market prices of securities, particularly those of high technology and emerging growth companies, and which often have been unrelated to the operating performance of the specific companies. These broad market fluctuations, as well as general economic and political conditions, could adversely affect the market price of the Ordinary Shares.

## ADVERSE EFFECT OF FUTURE SALES OF ORDINARY SHARES

Sales, or the possibility of sales, of substantial numbers of Ordinary Shares in the public market following the Motorola Subscription could have an adverse effect on the market trading prices of the Ordinary Shares. See section 5 of Part VIII “General Information – Directors’ and other Interests in the Company”.



In addition, Ordinary Shares are reserved for issue pursuant to the Share Option Schemes. If some or all of these unissued Ordinary Shares are issued, it could have a material adverse effect on the market price of the Ordinary Shares. See sections 3 and 9 of Part VIII “General Information – Share Capital” and “Share Option Schemes”.

The exercise of the Draw Down Facility and the Share Warrants could result in the issue of a significant number of Ordinary Shares to Motorola and the Equity Providers, respectively which could have a material adverse effect on the market price of the Ordinary Shares.

#### RECENT ECONOMIC DOWNTURN AND TERRORIST ATTACKS.

The Group’s ability to sell its products is dependent upon the general economic environment in which its customers operate. The recent weakening consumer confidence in the U.S. and in the global marketplace could cause longer sales cycles and slower growth. In addition, the Group’s business depends upon personal interactions of the Group’s sales force and its customers. As a result of the recent terrorist attacks in New York City and Washington, D.C., heightened security measures have significantly disrupted air travel. If customers are unwilling to travel by air, the Group’s sales could be adversely effected.



**PART V**  
**FINANCIAL INFORMATION RELATING TO THE GROUP**

**Comparative Table on IQE plc**

The financial information in this Part V has been extracted without material adjustment from the audited consolidated financial statements of IQE for the two years ended 31 December 2000. The information relating to 1998 has been extracted from the comparative information in the 1999 financial statements which was restated to reflect the Merger (which took place on 16 May 1999). The financial information in this Part V does not constitute statutory accounts within the meaning of section 240 of the Companies Act. The statutory financial statements of IQE PLC and its subsidiaries have been delivered to the Registrar of Companies in England and Wales pursuant to section 242 of the Act. The auditors of IQE, Deloitte & Touche, have given unqualified reports under section 235 of the Act which did not contain a statement under section 237(2) and (3) of the Act in respect of the last three years ended 31 December 2000.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT**

		<i>Year ended 31 December</i>		
		<i>1998</i>	<i>1999</i>	<i>2000</i>
		<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
	<i>Notes</i>			
<b>Turnover: continuing operations</b>	2	15,856	19,043	29,128
<b>    acquisitions</b>		—	—	989
		<u>15,856</u>	<u>19,043</u>	<u>30,117</u>
Cost of sales	3	(10,170)	(12,558)	(19,785)
<b>Gross profit</b>		<u>5,686</u>	<u>6,485</u>	<u>10,332</u>
Administration and distribution costs:				
Research and development	3	(1,529)	(1,302)	(1,870)
Other administration and distribution costs	3	(3,032)	(3,803)	(6,467)
		<u>(4,561)</u>	<u>(5,105)</u>	<u>(8,337)</u>
Other operating income		45	74	—
Goodwill amortisation		—	—	(209)
Exceptional items	4	—	(171)	—
<b>Operating profit: continuing operations</b>	5	1,170	1,283	1,503
<b>    acquisitions</b>		—	—	283
		<u>1,170</u>	<u>1,283</u>	<u>1,786</u>
Interest receivable		17	327	1,630
Interest payable	4, 8	(405)	(917)	(422)
<b>Profit on ordinary activities before taxation</b>		<u>782</u>	<u>693</u>	<u>2,994</u>
Tax on profit on ordinary activities	9	(230)	149	(1,184)
<b>Profit on ordinary activities after taxation</b>		<u>552</u>	<u>842</u>	<u>1,810</u>
Dividends	10	(140)	—	—
<b>Profit retained for the financial year</b>		<u><u>412</u></u>	<u><u>842</u></u>	<u><u>1,810</u></u>
Undiluted earnings per Ordinary Share	11	0.53p	0.63p	1.24p
Diluted earnings per Ordinary Share	11	0.50p	0.59p	1.18p

For the year ended 31 December 1998 and the period to 19 May 1999, QED had elected to be treated as an "S" Corporation and as such the tax charge for these periods does not reflect any charge on the profits of this company (see note 9), but does include deferred tax charges/credits in respect of this company.



## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Profit retained for the financial year	412	842	1,810
Currency translation differences	1	96	680
Total recognised gains and losses relating to period	<u>413</u>	<u>938</u>	<u>2,490</u>

## RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Total recognised gains and losses	413	938	2,490
New shares issued	201	20,440	94,358
Cost of shares issued	—	(1,214)	(1,189)
Deferred consideration on acquisition of subsidiary	—	—	988
Adjustment in respect of further share capital issued by subsidiary	—	155	—
Total movements during the year	<u>614</u>	<u>20,319</u>	<u>96,647</u>
Shareholders' funds at 1 January	17	631	20,950
Shareholders' funds at 31 December	<u>631</u>	<u>20,950</u>	<u>117,597</u>

The total of shareholders' funds relates to equity interests.



CONSOLIDATED BALANCE SHEET

		<i>As at 31 December</i>		
	<i>Notes</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>
		<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
<b>Fixed assets</b>				
Intangible assets	12	—	—	36,543
Tangible fixed assets	13	5,498	11,483	47,848
		<u>5,498</u>	<u>11,483</u>	<u>84,391</u>
<b>Current assets</b>				
Stocks	14	1,591	2,573	7,885
Debtors	15	2,759	7,743	10,311
Cash at bank		763	8,117	39,512
		<u>5,113</u>	<u>18,433</u>	<u>57,708</u>
<b>Creditors: amounts falling due within one year</b>	16	<u>(4,835)</u>	<u>(4,518)</u>	<u>(17,405)</u>
<b>Net current assets</b>		<u>278</u>	<u>13,915</u>	<u>40,303</u>
<b>Total assets less current liabilities</b>		<u>5,776</u>	<u>25,398</u>	<u>124,694</u>
<b>Creditors: amounts falling due after more than one year</b>				
Convertible loans		(1,265)	—	—
Other creditors	17	(3,403)	(4,024)	(5,438)
Provisions for liabilities and charges	19	(467)	(331)	(1,590)
Deferred income		(10)	(93)	(69)
		<u>(5,145)</u>	<u>(8,452)</u>	<u>(12,597)</u>
<b>Net assets</b>		<u>631</u>	<u>20,950</u>	<u>117,597</u>
<b>Capital and reserves</b>				
Called up share capital	20	1,040	1,359	1,633
Share premium	21	—	18,907	111,802
Profit and loss account	21	439	1,281	3,091
Merger reserve	21	(760)	(605)	(605)
Shares to be issued		—	—	988
Other reserves	21	(88)	8	688
		<u>631</u>	<u>20,950</u>	<u>117,597</u>
<b>Total equity shareholders' funds</b>		<u>631</u>	<u>20,950</u>	<u>117,597</u>



CONSOLIDATED CASH FLOW STATEMENT

	Notes	Year ended 31 December		
		1998 £'000	1999 £'000	2000 £'000
<b>Net cash inflow/(outflow) from operating activities</b>	27	3,558	(2,740)	10,949
<b>Returns on investments and servicing of finance</b>				
Interest paid		(336)	(917)	(422)
Interest received		—	327	1,630
<b>Net cash (outflow)/inflow from returns on investments</b>		(336)	(590)	1,208
<b>Capital expenditure and financial investment</b>				
Payment to acquire tangible fixed assets		(1,988)	(9,416)	(33,566)
Proceeds from sale of tangible fixed assets		—	2,127	—
<b>Net cash outflow from capital expenditure</b>		(1,988)	(7,289)	(33,566)
<b>Acquisitions and disposals</b>				
Payments to acquire investments in subsidiaries		—	—	(14,501)
Net cash acquired with subsidiary		—	—	533
<b>Net cash outflow from acquisitions and disposals</b>		—	—	(13,968)
Equity dividend paid		(140)	—	—
Tax paid		(123)	(282)	(144)
<b>Net cash inflow/(outflow) before financing</b>		971	(10,901)	(35,521)
Issue of ordinary share capital		184	19,381	67,357
New loans received	28	3,807	2,908	—
Repayment of loans	28	(4,642)	(3,587)	(441)
Capital element of finance lease payments	28	—	(25)	—
<b>Net cash (outflow)/inflow from financing</b>		(651)	18,677	66,916
<b>Increase in cash</b>	28, 29	320	7,776	31,395



## NOTES TO THE FINANCIAL INFORMATION

### 1. Accounting Policies

The financial information is 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 period under review.

#### Turnover

Turnover represents amount 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.

#### 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 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.

#### 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 period 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 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 period. 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 period 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 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

	1999	2000		Total
	£'000	£'000		
	<i>Continuing</i>	<i>Continuing</i>	<i>Acquisitions</i>	
Turnover	19,043	29,128	989	30,117
Cost of sales	(12,558)	(19,230)	(555)	(19,785)
Gross profit	6,485	9,898	434	10,332
Operating expenses				
Distribution expenses	(1,414)	(2,027)	(25)	(2,052)
Research and development	(1,302)	(1,848)	(22)	(1,870)
Other administrative expenses	(2,315)	(4,311)	(104)	(4,415)
Goodwill amortisation	—	(209)	—	(209)
Exceptional items	(171)	—	—	—
	(5,202)	(8,395)	(151)	(8,546)
Operating profit	1,283	1,503	283	1,786

## 4. Exceptional Item

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.

## 5. Operating Profit

This is stated after charging/(crediting):

	Year ended 31 December		
	1998	1999	2000
	£'000	£'000	£'000
Depreciation of tangible fixed assets:			
– owned assets	1,437	1,479	2,616
– leased assets	—	30	223
Auditors' remuneration			
– audit services	31	45	115
– non-audit services	81	346	358
Operating lease rentals:			
– plant and machinery	64	71	423
– other	195	133	210
Exchange (gains)/losses	(45)	(74)	51



## 6. Employee Information

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Wages and salaries	3,927	5,104	7,623
Social security costs	653	813	1,061
Pension contributions	140	175	243
	<u>4,720</u>	<u>6,092</u>	<u>8,927</u>

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Average monthly number of persons employed by the Group during the period	<u>155</u>	<u>197</u>	<u>322</u>

## 7. Directors' Remuneration

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
<b>Dr Andrew Nelson</b>			
Salary	72	79	104
Bonus	6	—	59
Benefits in kind	9	8	7
Pension	7	7	7
<b>Dr Michael Scott</b>			
Salary	67	73	73
Bonus	6	—	28
Benefits in kind	9	12	12
Pension	7	7	7
<b>Thomas Hierl</b>			
Salary	116	115	117
Benefits in kind	3	3	—
<b>Scott Massie</b>			
Salary	63	81	102
Benefits in kind	3	3	—
<b>Martin Lamb (appointed 22 November 2000)</b>			
Salary	—	—	4
Benefits in kind	—	—	1
Pension contributions	—	—	1
<b>Non-Executive Director</b>			
<b>Dr G H H Ainsworth</b>			
Fees	—	—	10
	<u>368</u>	<u>388</u>	<u>532</u>

### Directors' share options

<i>Director</i>	<i>1 January</i>		<i>10 for 1 share split</i>	<i>Exercised</i>	<i>Lapsed</i>	<i>31 December 2000</i>
	<i>2000</i>	<i>Granted</i>				
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

<i>Director</i>	<i>31 December 2000</i>	<i>Exercise price</i>	<i>Date from which exercisable</i>	<i>Expiry date</i>
S T Massie	336,100	\$0.130	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	16.5.03 to 16.5.10	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.



## 8. Interest Payable

	Year ended 31 December		
	1998 £'000	1999 £'000	2000 £'000
Bank loans and overdrafts	405	917	422

## 9. Tax on Profit on Ordinary Activities

	Year ended 31 December		
	1998 £'000	1999 £'000	2000 £'000
UK corporation and deferred tax at 31%/30%/30%	239	258	1,184
US deferred tax	(9)	(407)	—
	<u>230</u>	<u>(149)</u>	<u>1,184</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.

## 10. Dividends

	1998 £'000	1999 £'000	2000 £'000
Dividends paid:			
EPIH – (4.67p per £1 Ordinary Shares)	140	—	—

## 11. 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 1998.

	1998 £'000	1999 £'000	2000 £'000
Basic and diluted earnings attributable to ordinary shareholders	552	842	1,810
	<i>No.</i>	<i>No.</i>	<i>No.</i>
Weighted average number of ordinary shares	104,031,090	132,717,220	146,203,992
Diluted share options	7,382,710	10,748,380	6,924,456
Adjusted weighted average number of ordinary shares	111,413,800	143,465,600	153,128,448
Earnings per share	0.53p	0.63p	1.24p
Diluted earnings per share	0.50p	0.59p	1.18p



## 12. Intangible Fixed Assets

### The Group

	<i>Goodwill</i> £'000
<b>Cost</b>	
At 1 January 2000	—
Additions in the year	36,752
At 31 December 2000	<u>36,752</u>
<b>Accumulated amortisation</b>	
At 1 January 2000	—
Charge for the year	209
At 31 December 2000	<u>209</u>
<b>Net book value</b>	
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>



The cash flow effects of the acquisition are:

**Net assets acquired:**

	<i>2000</i>
	<i>£'000</i>
Tangible fixed assets	2,403
Stocks	1,299
Debtors	1,062
Cash at bank and in hand	533
Creditors	(869)
Taxation	121
	<hr/>
	4,549
Goodwill	36,752
	<hr/>
	41,301
<b>Satisfied by:</b>	
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
	<hr/>
	41,301

### 13. Tangible Fixed Assets

	<i>Freehold land and buildings improvements</i> £'000	<i>Short leasehold improvements</i> £'000	<i>Fixtures &amp; Fittings</i> £'000	<i>Plant &amp; machinery</i> £'000	<i>Assets in the course of construction</i> £'000	<i>Total</i> £'000
<b>Cost:</b>						
At 1 January 1999	—	634	817	13,370	1,029	15,850
Additions	2,358	133	587	4,608	1,854	9,540
Disposals	—	(21)	—	(2,127)	—	(2,148)
Transfers	220	(220)	11	2,339	(2,350)	—
Exchange difference	—	10	7	146	—	163
At 31 December 1999	<u>2,578</u>	<u>536</u>	<u>1,422</u>	<u>18,336</u>	<u>533</u>	<u>23,405</u>
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>
<b>Depreciation</b>						
At 1 January 1999	—	256	446	9,650	—	10,352
Charge for year	55	73	170	1,211	—	1,509
Disposals	—	(21)	—	—	—	(21)
Transfers	87	(87)	5	(5)	—	—
Exchange difference	—	3	5	74	—	82
At 31 December 1999	<u>142</u>	<u>224</u>	<u>626</u>	<u>10,930</u>	<u>—</u>	<u>11,922</u>
<b>Depreciation</b>						
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>
<b>Net book value:</b>						
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>
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>

### 14. Stocks

	<i>31 December</i>	
	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>
Raw materials	2,239	6,796
Finished goods	334	1,089
	<u>2,573</u>	<u>7,885</u>



## 15. Debtors

	31 December	
	1999	2000
	£'000	£'000
Trade debtors	3,045	8,419
Other debtors and prepayments	4,565	1,532
Corporation tax	133	360
	<u>7,743</u>	<u>10,311</u>

## 16. Creditors: amounts falling due within one year

	31 December	
	1999	2000
	£'000	£'000
Other loans	504	508
Trade creditors	3,115	13,446
Corporation tax	—	—
Other creditors including taxation and social security costs	111	460
Accruals and deferred income	770	2,238
Amounts due under hire purchase and finance leases	18	753
	<u>4,518</u>	<u>17,405</u>

## 17. Creditors: amounts falling due after more than one year

	31 December	
	1999	2000
	£'000	£'000
Other loans	3,943	3,527
Amounts due under hire purchase and finance leases	81	1,911
	<u>4,024</u>	<u>5,438</u>

## 18. Borrowings

	31 December	
	1999	2000
	£'000	£'000
Other loans and hire purchase are repayable as follows:		
Within one year	522	1,261
Between one and two years	472	1,454
Between two and five years	1,657	2,413
Over five years	1,895	1,571
	<u>4,546</u>	<u>6,699</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 cent. 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 cent. 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.



## 19. Provisions for Liabilities and Charges

### Deferred taxation

	<i>Charged/ (credited) to profit and loss account £'000</i>	<i>At 1 January 1999 £'000</i>	<i>Charged/ (credited) to profit and loss account £'000</i>	<i>At 31 Dec. 1999 £'000</i>	<i>Charged/ (credited) to profit and loss account £'000</i>	<i>At 31 Dec. 2000 £'000</i>
UK deferred tax	60	60	271	331	1,259	1,590
Overseas deferred tax	(12)	407	(407)	—	—	—
	<u>48</u>	<u>467</u>	<u>(136)</u>	<u>331</u>	<u>1,259</u>	<u>1,590</u>

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

	<i>Provided 31 December</i>		<i>Unprovided 31 December</i>	
	<i>1999 £'000</i>	<i>2000 £'000</i>	<i>1999 £'000</i>	<i>2000 £'000</i>
Capital allowances in excess of depreciation	381	1,736	—	(540)
Other timing differences	(50)	(146)	—	—
	<u>331</u>	<u>1,590</u>	<u>—</u>	<u>(540)</u>

## 20. Share Capital

	<i>31 December</i>	
	<i>1999 £'000</i>	<i>2000 £'000</i>
<b>Authorised</b>		
Ordinary shares of 10p each	<u>1,900</u>	<u>2,500</u>
	<i>No.</i>	<i>No.</i>
Ordinary shares of 10p each	<u>19,000,000</u>	<u>250,000,000</u>
	<i>£'000</i>	<i>£'000</i>
<b>Allotted, called up and fully paid</b>		
Ordinary shares of 10p each	<u>1,359</u>	<u>1,633</u>
	<i>No.</i>	<i>No.</i>
Ordinary shares of 10p each	<u>13,595,517</u>	<u>163,250,498</u>

10,389,645 shares were issued during 1999 to acquire 100 per cent. of the ordinary share capital of Quantum Epitaxial Designs, Inc. and EPI Holdings Limited. The share capital of both companies was acquired at par, through a share-for-share exchange.

In the remainder of 1999, a further 3,205,872 shares were issued for cash at a total premium of £20,120,989.

During 2000 the Company carried out a 10 for 1 share split.

8,750,000 1p ordinary shares were issued during 2000 to acquire 100 per cent. of the ordinary share capital of Wafer Technology Limited and Wafer Technology International 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 2000 No.</i>	<i>Shares Issued prior to split No.</i>	<i>10 for 1 share split No.</i>	<i>Shares issued following share split No.</i>	<i>At 31 December 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>

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>

During 1999, 820,830 (1998 – 142,800; 1997 – 205,632) options were granted, 414,594 (1998 – nil; 1997 – nil) options were exercised and 69,669 (1998 – 41,437; 1997 – nil) options were cancelled.

## 21. Movement on Reserves

	<i>Share premium £'000</i>	<i>Merger reserve £'000</i>	<i>Foreign exchange translation £'000</i>	<i>Profit and loss account £'000</i>
At 1 January 1999	—	(760)	(88)	439
Foreign exchange translation difference	—	—	96	—
Profit for the year	—	—	—	842
Shares issued	20,121	—	—	—
Cost of shares issued	(1,214)	—	—	—
Adjustment in respect of further share capital issued by subsidiary	—	155	—	—
At 1 January 2000	18,907	(605)	8	1,281
Foreign exchange translation difference	—	—	680	—
Profit for the year	—	—	—	1,810
Shares issued	94,084	—	—	—
Cost of shares issued	(1,189)	—	—	—
	<u>111,802</u>	<u>(605)</u>	<u>688</u>	<u>3,091</u>

## 22. Obligations Under Operating Leases

Annual commitments under non-cancellable operating leases are as follows:

	<i>Land and buildings</i>		<i>Other</i>	
	<i>As at 31 December</i>		<i>As at 31 December</i>	
	<i>1999</i>	<i>2000</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Operating leases which expire:				
Within one year	—	28	15	7
In two to five years	165	373	597	657
In over five years	—	—	—	—
	<u>165</u>	<u>401</u>	<u>612</u>	<u>664</u>

## 23. Capital Commitments

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

	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>
Authorised and contracted for	14,653	16,690

## 24. Contingent Liabilities

The Group has no contingent liabilities requiring disclosure under the provisions of Financial Reporting Standard 12.

## 25. Subsequent Events

There have been no material events subsequent to 31 December 2000 within the Group requiring disclosure under the provisions of Statement of Standard Accounting Practice Number 17.



## 26. EPIH Adjustment

No group accounts for EPIH have previously been prepared as the group qualifies under S249 of the Act as a small group for which group accounts are not required.

The statutory financial statements of EPIH for the year ended 31 December 1996 show an investment in EPI of £5,995,001 being acquired, funded by loans of £5,965,000. During 1998, these loans were subsequently settled at a discount of £4,165,000. The financial data in this Prospectus has been adjusted to reflect this as being the fair value and the cost of investment and corresponding loans at 31 December 1996 adjusted accordingly to £1,830,001 and £1,800,000 respectively. The fair value of the assets of EPI at the date of acquisition was £1,545,655.

Notwithstanding the above the £4,165,000 discount on settlement of the loans is a realised distributable profit. At 31 December 1999, the distributable profits of EPIH stood at £3,924,750.

## 27. Reconciliation of Operating Profit to Net Cash Inflow/(Outflow) from Operating Activities

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Operating profit	1,170	1,283	1,786
Release of deferred issue costs	60	—	—
Depreciation and provision for diminution in value of fixed assets	1,437	1,509	2,839
Amortisation of goodwill	—	—	209
Increase in debtors	(719)	(4,851)	(1,157)
Increase in stocks	(286)	(982)	(4,013)
Increase in creditors	1,929	66	11,280
Government grants release	(33)	(29)	(24)
Government grants received	—	112	—
Other non-cash items	—	152	29
Net cash inflow/(outflow) from operating activities	<u>3,558</u>	<u>(2,740)</u>	<u>10,949</u>

## 28. Reconciliation of Net Cash Flow to Movement in Net Debt

	<i>Year ended 31 December</i>		
	<i>1998</i>	<i>1999</i>	<i>2000</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Increase in cash in the period	320	7,776	31,395
Loan repayments	4,642	3,587	441
Capital element of finance lease payments	—	25	—
Loans received	(3,807)	(2,908)	—
Change in net debt resulting from cash plans	1,155	8,480	31,836
Inception of new finance leases	—	(124)	(2,590)
Net movement for period	1,155	8,356	29,246
Net debt at 1 January	(5,870)	(4,648)	3,571
Exchange differences	67	(137)	(4)
Net debt at 31 December	<u>(4,648)</u>	<u>3,571</u>	<u>32,813</u>

## 29. Analysis of Changes in Net Debt

	<i>Change in the 1997 £'000</i>		<i>Change in the 1998 £'000</i>		<i>Change in the 1999 £'000</i>		<i>2000 £'000</i>
	<i>1997 £'000</i>	<i>Change in the year £'000</i>	<i>1998 £'000</i>	<i>Change in the year £'000</i>	<i>1999 £'000</i>	<i>Change in the year £'000</i>	<i>2000 £'000</i>
Cash	625	138	763	7,354	8,117	31,395	39,512
Bank overdraft	(606)	184	(422)	422	—	—	—
Debt due within one year	(864)	543	(321)	(183)	(504)	(4)	(508)
Debt due after one year	(5,025)	357	(4,668)	725	(3,943)	416	(3,527)
Finance leases	—	—	—	(99)	(99)	(2,565)	(2,664)
	<u>(5,870)</u>	<u>1,222</u>	<u>(4,648)</u>	<u>8,219</u>	<u>3,571</u>	<u>29,242</u>	<u>32,813</u>

## 30. Financial Instruments

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

	<i>Trade debtors £'000</i>	<i>Trade creditors £'000</i>
Sterling	641	1,906
US\$	6,968	5,975
Yen	175	291
Other	635	5,274
Total	<u>8,419</u>	<u>13,446</u>



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

	<i>Assets floating £'000</i>	<i>Assets fixed rate £'000</i>	<i>Liabilities floating rate £'000</i>	<i>Liabilities fixed rate £'000</i>	<i>Total £'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 per cent. 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.

### 31. 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 semi-conductor 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 semi-conductor 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 semi-conductor 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

### 32. Merger

The entire share capital of EPIH and QED was acquired by the Company, a new holding company established for that purpose, on 16 May 1999 and 20 May 1999 respectively. These transactions met the criteria set out in Schedule 4A:10 Companies Act 1985 and Financial Reporting Standard Number 6 for merger accounting and have therefore been accounted for on this basis. The following disclosures are required under Schedule 4A Companies Act and Financial Reporting Standard Number 6.

- (i) Analysis of pre and post merger profit and loss account for the year ended 31 December 1999:

	<i>Pre Merger</i>		<i>Post</i>
	<i>EPIH</i>	<i>QED</i>	<i>Merger</i>
	<i>£'000</i>	<i>£'000</i>	<i>IQE</i> <i>£'000</i>
Turnover	3,556	3,426	12,061
Operating profit	323	251	709
Exceptional costs	—	—	328
Profit/(loss) before tax	237	(111)	567
Taxation charge/(credit)	115	(471)	207
Profit after tax	122	360	360

- (ii) Book value of net assets on merger:

	<i>EPIH</i>	<i>QED</i>
	<i>£'000</i>	<i>£'000</i>
Net assets	452	661

- (iii) Consideration

The consideration given for the acquisition of EPIH was the issue of 5,997,180 10p ordinary shares in the Company. The directors are of the opinion that the fair value of the consideration given was £23,989,000.

The consideration given for the acquisition of QED was the issue of 4,392,465 10p ordinary shares in the Company. The directors are of the opinion that the fair value of the consideration given was £13,177,395.

### 33. 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.



## PART VI

### UNAUDITED SECOND QUARTER AND INTERIM RESULTS FOR THE PERIOD ENDED 30 JUNE 2001

Set out below are the Group's second quarter and interim results for the period ended 30 June 2001, which have been extracted from the unaudited quarterly financial information released by the Group for the 3 months ended 30 June 2001 and 30 June 2000, the 6 months ended 30 June 2001 and 30 June 2000 and the year ended 31 December 2000.

#### Introduction

The first half of 2001 has seen a high degree of turmoil in a number of key markets in which the Group operates, with many of the major players in the opto-electronics segment announcing sharply reduced sales and profitability as well as headcount reductions. Additionally, the electronics sector has remained relatively depressed throughout the period. However, despite these difficulties, I am pleased to report that IQE has delivered record half year sales and operating earnings pre-goodwill and exceptionals.

#### Results

Sales in Q2 reached their highest ever quarterly level of £13.158m, nearly double the level achieved in the second quarter of the last year (Q2/2000: £6.857m) and 1.5 per cent. higher than the previous quarter (Q1/2001: £12.959m). Sales for the half year to June were 97.7 per cent. higher than last year at £26.117m (H1/2000: £13.208m). The improvement in turnover resulted from bringing on line new reactors installed in the second half of last year as well as a full six months contribution from Wafer Technology and initial production sales from IQE Silicon Compounds.

Gross margins in Q2 were slightly lower than the previous quarter at 31 per cent. (Q1/2001: 33.9 per cent.) mainly due to capacity utilisation issues caused by the downturn in the opto-electronics market and the continued softness of the wireless market. In addition, the Group experienced lower margins at Wafer Technology resulting from high gallium prices which peaked in the period, and at Silicon Compounds which is currently engaged in a considerable number of production contract qualification cycles with customers.

Research and development expenditure increased during Q2 to £0.757m (Q2/2000 : £0.578m) representing 5.7 per cent. of sales, all of which was directly expensed during the quarter with no additional expenditure carried forward. Total research and development costs for the half year amounted to £1.296m (H1/2000: £1.123m), which was equivalent to 5.0 per cent. of sales (H1/2000: 8.5 per cent.). SG&A costs for the quarter were at £2.027m (Q2/2000: £1.397m) and represented 15.4 per cent. of sales, down from 20.4 per cent. in the same period last year. SG&A costs for the half year were £4.612m (H1/2000: £2.470m) and also continued to reduce as a percentage of sales to 17.7 per cent. (H1/2000: 18.7 per cent.).

Operating profit before goodwill amortisation and exceptional items was a record for the quarter at £1.292m, more than three times higher than the corresponding period in 2000 (Q2/2000: £0.365m) and 2.3 per cent. up compared with the previous quarter (Q1/2001: £1.264m). Cumulative operating profit before goodwill amortization and exceptionals was £2.556m (H1/2000: £0.786m), 224.9 per cent. higher than the first half of last year. This represents an operating margin of 9.8 per cent. compared with 6.0 per cent. in the first half of last year.

Exceptional first half SG&A costs of £0.274m (H1/2000: £0.123m) related to legal costs in the US offset by provision adjustments for future national insurance charges against stock option awards. After crediting net interest income for the first half of £0.418m (H1/2000: £0.125m) and charging exceptional items and goodwill amortization relating to the Wafer Technology acquisition of £0.910m





(H1/2000: Nil), profit before tax was £1.790m (H1/2000: £0.789m). Profit after tax was £1.202m (H1/2000: £0.552m). Basic earnings per share were 0.73 pence (H1/2000: 0.40 pence) and 1.29 pence (H1/2000: 0.40 pence) excluding goodwill amortization.

The Group was broadly cash neutral for the six months excluding capital expenditure. A positive cash flow in the first quarter was eroded by working capital increases in the second quarter, in particular a short term increase in raw material stocks caused by the market slowdown. Capital expenditure remained on target in Q2 at £11.708m, bringing the total for the half year to £22.833m (H1/2000: £8.251m) which was partly funded by HP leases totalling £3.922m. The net cash outflow for the six months before financing was £19.674m (H1/2000: £4.371m). Capital expenditure will fall sharply in the second half as originally planned.

## **Operations**

The III-V epiwafer operations performed well in the first half despite a rapidly deteriorating optoelectronics market and continued softness in the wireless market. The UK facility generated an exceptional performance, partly due to focusing on advanced product areas such as VCSELs where demand has remained relatively robust and partly as a result of winning significant development work, which has helped to offset declining production volumes. However, capacity utilisation has remained weak in the US, although there have been some indications of an upturn in the wireless market due to customers having depleted inventories of various components. As a result, the Group's book to bill ratio in Q2 fell below one to 0.94 (Q1/2001: 1.06).

Significant progress was made during the first half in the area of new product development, in particular 980 and 1300 nm laser VCSEL structures, indium phosphide HBTs and metamorphic structures for both HEMTs and HBTs. In March it was announced that the Group had been selected by GTRAN, Inc. as supplier for InP HBT epitaxial wafers for use in their next generation 40Gb/s SONET products. In addition, the Group is continuing with qualification programs by a number of other players in this marketplace. Three MOVPE reactors have now been installed in the Bethlehem US plant but the programme for run-up and testing of these machines is being delayed due to the current state of the market.

IQE Silicon Compounds made its first production sales in the half year and investment in the new facility has been proceeding according to plan. Six reactors have now been delivered and installed, two of which are fully operational and the remainder have been run up and are progressing through internal qualification. Qualification wafers have been run for 9 customers and, more recently, the first silicon germanium wafers have been produced and are now in qualification. Customer interest in this new business remains strong with the demand showing no signs of softness. The total number of signed NDAs (Non Disclosure Agreements) has now reached 25, including agreements with Dynex, ESM, Semifab, Soitec and Zarlink (Mitel).

Wafer Technology has also performed well, showing significantly increased sales compared to last year. However, margins in the second quarter were adversely impacted by high gallium prices, which have subsequently begun to decline. Synergies between the Group companies are being realised as customers appreciate the attractiveness of IQE's broad based materials portfolio. In addition, the Group has significantly enhanced its profile in the industry by consolidating its brand image and demonstrating a key presence at CS-MAX in Boston in July, the world's first manufacturing exposition for the compound semiconductor industry.

## **Management and Employees**

I am pleased to report the appointment of Sandy Hutchon as General Manager of IQE Silicon Compounds. Sandy has considerable experience of the silicon industry, having previously worked for National Semiconductor, Siemens and ESM. We also welcome Nick Stork, who joined as Financial Controller of IQE (Europe) from Christie-Tyler Ltd where he was Group Accountant.



During the half year the Group retained a firm of remuneration consultants to review its Share Option Scheme and to propose new arrangements aimed at aligning the interests of employees with those of the shareholders and retaining key employees. Following their recommendations, the key principles of the new plans were approved at the Company's Annual General Meeting in May and the All Employee Share Ownership Plan ("AESOP") has now been launched to a favourable response from employees.

### **Trading Prospects**

A number of major opto-electronics companies have indicated that they are experiencing a significant downturn in business as a result of excess inventories which had been built up in the latter part of last year and early this year. As a consequence of this, customer requests for order rescheduling, cancellation or delays have increased during the last few months. However, we have largely been able to compensate for this to date thanks to the award of several substantial new product development contracts, which I believe will lead to increased production quantities in the future as customers design IQE wafers into their next generation products.

The wireless sector has remained soft, although there have been recent indications of a recovery in the second half of the year as some customers have begun to re-order production items, albeit at low levels. We expect order levels in the wireless sector to start to pick up during Q3 and accelerate through Q4.

The substrate business is currently stable as a result of good sales for speciality products, although margins during Q3 will be adversely impacted by the high price of gallium metal during the last few months. Gallium prices are now declining significantly so we expect margins to improve again in Q4. We also expect revenues to continue to increase at Silicon Compounds as qualification is completed and production contracts are awarded, particularly towards the end of the year as qualification cycles can be several months long. Customer feedback to date has been very positive.

As previously indicated in our Q1 announcement, visibility for the second half of the year continues to be very limited. The positive impact of improving wireless orders, continued success in winning development contracts, and increasing revenues at Silicon Compounds is unlikely to offset the strong decline in production orders for opto-electronic components as excess inventories in that sector are worked through. Consequently, we expect a significant sequential decline in revenues in Q3 followed by a sequential increase in Q4, although the overall position is likely to show continued substantial year on year growth compared with last year. In this difficult environment, management is focusing on tight control of overheads and effective cash management, while ensuring that the Group remains in strong shape to address the upturn as inventories are extinguished.

Notwithstanding current difficult market conditions, which we believe may well accelerate the trend towards the outsourcing of compound semiconductor wafer manufacture, we continue to be highly confident of our medium and long term prospects.

Dr Drew Nelson OBE  
Executive Chairman IQE plc



PROFIT AND LOSS ACCOUNT

(All figures GBP 000s)

	<i>3 months to 30 Jun 2001</i>	<i>3 months to 30 Jun 2000</i>	<i>6 months to 30 Jun 2001</i>	<i>6 months to 30 Jun 2000</i>	<i>12 months to 31 Dec 2000</i>
	<i>Notes</i>	<i>unaudited</i>	<i>unaudited</i>	<i>unaudited</i>	<i>unaudited</i>
<b>Turnover</b>		13,158	6,857	26,117	13,208
Cost of Sales		(9,082)	(4,517)	(17,653)	(8,829)
<b>Gross Profit</b>		4,076	2,341	8,464	4,380
Gross Profit %		31.0	34.1	32.4	33.2
<b>S G and A Costs</b>					
Research/Development		(757)	(578)	(1,296)	(1,123)
Selling/General/ Administration		(2,027)	(1,397)	(4,612)	(2,470)
Operating Profit/(Loss) before Goodwill/ Exceptionals		1,292	365	2,556	786
Operating Profit/(Loss) per cent. before Goodwill/Exceptionals		9.8	5.3	9.8	6.0
Goodwill Written off	2	(451)	(0)	(910)	(0)
Exceptional Items	3	(274)	(87)	(274)	(123)
<b>Operating Profit/(Loss) after Goodwill/ Exceptionals</b>		567	279	1,372	664
Operating Profit/(Loss) per cent. after Goodwill/Exceptionals		4.3	4.1	5.3	5.0
Interest Received/(Paid)		123	174	418	125
<b>Net Profit/(Loss) before Taxes</b>		690	453	1,790	789
Net Profit/(Loss) per cent.		5.2	6.6	6.9	6.0
Current Taxes		198	(133)	(321)	(237)
Deferred Taxes		(267)	(0)	(267)	(0)
Dividends		(0)	(0)	(0)	(0)
<b>Net Profit/(Loss) after Taxes</b>		621	320	1,202	552
Basic Earnings Pence/Share		0.38	0.23	0.73	0.40
Basic Earnings Pence/Share excl Goodwill		0.66	0.23	1.29	0.40
Diluted Earnings Pence/Share		0.37	0.22	0.71	0.38
Diluted Earnings Pence/Share excl Goodwill		0.64	0.22	1.25	0.38
Net Profit/(Loss) before Interest/ Taxes/ Depreciation and Amortization (EBITDA)		2,524	966	5,115	1,924



BALANCE SHEET

		<i>As at</i>	<i>As at</i>	<i>As at</i>
(All figures GBP 000s)	<i>Notes</i>	<i>30 Jun 2001</i>	<i>30 Jun 2000</i>	<i>31 Dec 2000</i>
		<i>unaudited</i>	<i>unaudited</i>	<i>audited</i>
<b>Fixed Assets</b>				
Intangible Fixed Assets	4	35,550	0	36,543
Tangible Fixed Assets		69,439	19,145	47,847
<b>Total Fixed Assets</b>		<u>104,989</u>	<u>19,145</u>	<u>84,390</u>
<b>Current Assets</b>				
Stocks		12,881	3,718	7,885
Debtors		13,652	8,652	10,312
Cash and Bank		19,706	47,359	39,512
<b>Total Current Assets</b>		<u>46,239</u>	<u>59,728</u>	<u>57,709</u>
<b>Creditors Falling Due within One Year</b>		<u>(21,358)</u>	<u>(8,295)</u>	<u>(17,406)</u>
<b>Net Current Assets</b>		<u>24,881</u>	<u>51,433</u>	<u>40,303</u>
<b>Total Assets less Current Liabilities</b>		129,870	70,579	124,693
<b>Creditors Falling Due after One Year</b>				
Deferred Income		(57)	(81)	(69)
Deferred Tax Liability		(1,857)	(331)	(1,590)
Long Term Borrowings		(8,228)	(3,925)	(5,438)
<b>Net Assets</b>		<u>119,728</u>	<u>66,242</u>	<u>117,596</u>
<b>Capital and Reserves</b>				
Called Up Share Capital		1,641	1,498	1,633
Merger Reserve		(605)	(605)	(605)
Share Premium Account		111,875	62,533	111,802
Shares to be Issued		655	0	988
Retained Earnings		4,292	1,833	3,090
Other Reserves		1,870	983	688
<b>Total Equity Shareholders' Funds</b>		<u>119,728</u>	<u>66,242</u>	<u>117,596</u>

JL COVENTRY  
Company Secretary



CASH FLOW STATEMENT

(All figures GBP 000s)

	<i>3 months to 30 Jun 2001 unaudited</i>	<i>3 months to 30 Jun 2000 unaudited</i>	<i>6 months to 30 Jun 2001 unaudited</i>	<i>6 months to 30 Jun 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
<b>Net Inflow/(Outflow) from Operations</b>	<u>(2,717)</u>	<u>3,914</u>	<u>(1,320)</u>	<u>3,783</u>	<u>10,949</u>
<b>Returns on Investment and Servicing Finance</b>					
Interest Received/(Paid)	<u>123</u>	<u>174</u>	<u>418</u>	<u>125</u>	<u>1,208</u>
<b>Capital Expenditures</b>					
Purchases of Fixed Assets	<u>(8,844)</u>	<u>(4,427)</u>	<u>(18,911)</u>	<u>(8,251)</u>	<u>(33,566)</u>
Intangible Fixed Assets	<u>(0)</u>	<u>0</u>	<u>(250)</u>	<u>0</u>	<u>(13,968)</u>
<b>Equity Dividends Paid</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Taxes Refunded/(Paid)</b>	<u>0</u>	<u>(8)</u>	<u>390</u>	<u>(28)</u>	<u>(144)</u>
<b>Net Inflow/(Outflow) before Financing</b>	<u>(11,439)</u>	<u>(347)</u>	<u>(19,674)</u>	<u>(4,371)</u>	<u>(35,521)</u>
<b>Financing</b>					
Issues of Ordinary Share Capital	<u>28</u>	<u>43,749</u>	<u>81</u>	<u>43,764</u>	<u>67,356</u>
Loans Received/(Repaid)	<u>(106)</u>	<u>24</u>	<u>(213)</u>	<u>(151)</u>	<u>(441)</u>
<b>Net Inflow/(Outflow) from Financing</b>	<u>(78)</u>	<u>43,773</u>	<u>(132)</u>	<u>43,613</u>	<u>66,915</u>
<b>Increase/(Decrease) in Cash and Bank Overdrafts</b>	<u><u>(11,517)</u></u>	<u><u>43,426</u></u>	<u><u>(19,806)</u></u>	<u><u>39,242</u></u>	<u><u>31,394</u></u>



RECONCILIATION OF PROFIT TO CASH  
INFLOW FROM OPERATIONS

(All figures GBP 000s)

	<i>3 months to 30 Jun 2001 unaudited</i>	<i>3 months to 30 Jun 2000 unaudited</i>	<i>6 months to 30 Jun 2001 unaudited</i>	<i>6 months to 30 Jun 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
Operating Profit after Goodwill/Exceptionals	567	280	1,372	664	1,786
Depreciation	1,506	687	2,833	1,261	2,839
Goodwill	451	0	910	0	209
(Gain)/Loss on Sale of Fixed Assets	0	0	0	0	29
(Increase)/Decrease in Stocks	(2,598)	(660)	(4,996)	(1,145)	(4,013)
(Increase)/Decrease in Debtors	(762)	377	(3,340)	(910)	(1,157)
Increase/(Decrease) in Creditors	(1,875)	3,236	1,913	3,925	11,280
Grants Released	(6)	(6)	(12)	(12)	(24)
Grants Received	0	0	0	0	0
<b>Net Cash Inflow/(Outflow) from Operations</b>	<u>(2,717)</u>	<u>3,914</u>	<u>(1,320)</u>	<u>3,783</u>	<u>10,949</u>



RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS (All figures GBP 000s)	<i>3 months to 30 Jun 2001 unaudited</i>	<i>3 months to 30 Jun 2000 unaudited</i>	<i>6 months to 30 Jun 2001 unaudited</i>	<i>6 months to 30 Jun 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
Increase/(Decrease) in Cash	(11,517)	43,426	(19,806)	39,242	31,394
Loans (Received)/Repaid	1,166	(24)	213	151	441
Change in Funds Resulting from Cash Flows	(10,351)	43,402	(19,593)	39,393	31,835
New Finance Leases	(3,922)	(0)	(3,922)	(0)	(2,590)
Net Movement	(14,273)	43,402	(23,515)	39,393	29,245
Net Funds at Start	23,481	(439)	32,813	3,571	3,571
Exchange Differences	90	1	0	0	(3)
<b>Net Funds at Close</b>	<b>9,298</b>	<b>42,964</b>	<b>9,298</b>	<b>42,964</b>	<b>32,813</b>
Analysis of Net Funds					
Cash and Bank	19,706	47,359	19,706	47,359	39,512
Debt Due after One Year	(3,395)	(3,850)	(3,395)	(3,850)	(3,527)
Debt Due within One Year	(578)	(452)	(578)	(452)	(508)
HP Creditors/Finance Leases	(6,435)	(93)	(6,435)	(93)	(2,664)
<b>Total</b>	<b>9,298</b>	<b>42,964</b>	<b>9,298</b>	<b>42,964</b>	<b>32,813</b>



## NOTES TO THE ACCOUNTS

### 1. Basis of preparation

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

- 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.
- Turnover represents amounts invoiced exclusive of value added taxation.
- 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. No depreciation is provided on land or assets in the course of construction.

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

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

The acquisition of IQE (Europe) Limited (formerly known as Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc on 27 March 1996 by EPI Holdings Limited, a new company established for that purpose, has been accounted for under acquisition accounting, whereby these Companies became part of the Group on the date of acquisition.

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

The acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited on 22 November 2000 by IQE plc has been accounted for under acquisition accounting, whereby these companies became part of the Group on the date of acquisition.

- Stocks are stated at the lower of cost and net realizable value.
- Research and development expenditure is fully written off when incurred except as noted in 4 (below)
- 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 (formerly Quantum Epitaxial Designs 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 a defined contribution pension scheme. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the scheme.



- 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 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 capitalized 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 utilized 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

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 the acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill. The goodwill arising on the acquisition of IQE (Europe) Limited (formerly 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 and 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 amortized over its useful life

The goodwill arising on the acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited has been capitalized and is being amortized over its useful life, which is considered by the Directors to be 20 years.

## 3. Exceptional items

	<i>2001</i>	<i>2000</i>
Exceptional items comprise :		
Provision for national insurance contributions on share options	(£41K)	£123K
Legal fees	£315K	£0K

Legal fees relate 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. There is a counter-claim by Rockwell alleging breaches of a licence agreement by IQE (Europe).

Two legal opinions obtained by IQE (Europe) in the US clearly support IQE's view that its processes were not covered by Rockwell's patent, the validity of which is separately being disputed by other companies in the US. It is uncertain whether the matter will ultimately go to trial or what the outcome will be.



**4. Intangible Fixed Assets**

Development costs in respect of new products have been carried forward where contracts of sufficient value exist or are likely to exist in the foreseeable future, and will be written off over a two year period commencing with the start of the contracts to which the costs relate.

**5. Contingent Liability**

There is a contingent liability covering further legal costs in respect of the actions between IQE (Europe) and Rockwell (see note 3 above). The Company estimates that legal fees of up to an additional £300K may be incurred in the second half of the year.



RECONCILIATION OF UK GAAP TO IAS  
(All figures GBP 000s)

	<i>3 months to 30 Jun 2001 unaudited</i>	<i>3 months to 30 Jun 2000 unaudited</i>	<i>6 months to 30 Jun 2001 unaudited</i>	<i>6 months to 30 Jun 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
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(1) Statement of Cash Flows

The following shows the statement of cash flows as if they had been presented under IAS

Cash Inflow/(Outflow) from Operations	(2,715)	3,906	(929)	3,755	10,805
Cash Inflow/(Outflow) from Investing	(7,663)	(4,253)	(18,743)	(8,126)	(46,326)
Cash Inflow/(Outflow) from Financing	(1,137)	43,773	(132)	43,613	66,915
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>	<b>(11,516)</b>	<b>43,426</b>	<b>(19,805)</b>	<b>39,242</b>	<b>31,394</b>
Opening Cash and Cash Equivalents per IAS	31,223	3,932	39,512	8,117	8,117
Exchange Difference	0	0	0	0	0
<b>Closing Cash and Cash Equivalents per IAS</b>	<b>19,707</b>	<b>47,358</b>	<b>19,707</b>	<b>47,359</b>	<b>39,511</b>

(2) Goodwill

Goodwill of £284,000 arose on acquisition of IQE (Europe) by EPIH on 27 March 1996.

Under UK GAAP, this has been written off directly to reserves. Under IAS, however, goodwill arising on acquisition should be recognized as an asset and amortized over its useful life. The following shows the retained profit and total net assets as if they had been prepared under IAS with goodwill amortized over 5 years.

Profit/(Loss) after Taxes and Exceptionals	(261)	321	320	552	1,810
Dividends	0	0	0	0	0
Retained Profit/(Loss) per UK GAAP	(261)	321	320	552	1,810
Goodwill Amortization	(14)	(14)	(28)	(28)	(57)
<b>Retained Profit/(Loss) per IAS</b>	<b>(276)</b>	<b>306</b>	<b>291</b>	<b>523</b>	<b>1,753</b>
Equity Shareholders' Funds per UK GAAP	119,728	66,242	119,728	66,242	117,596
Goodwill Capitalization at Cost	284	284	284	284	284
Accumulated Goodwill Amortization	(241)	(185)	(241)	(185)	(213)
<b>Equity Shareholders' Funds per IAS</b>	<b>119,770</b>	<b>66,341</b>	<b>119,770</b>	<b>66,341</b>	<b>117,667</b>



## PART VII

### UNAUDITED THIRD QUARTER RESULTS FOR THE PERIOD ENDED 30 SEPTEMBER 2001

Set out below are the Group's third quarter and nine months results for the period ended 30 September 2001, which have been extracted from the unaudited quarterly financial information released by the Group for the 3 months ended 30 September 2001 and 30 September 2000, the 9 months ended 30 September 2001 and 30 September 2000 and the year ended 31 December 2000.

#### Introduction

The Group's two principal markets both remained depressed throughout the third quarter, which was also impacted by a further downturn in global markets due to world events. In the opto-electronics market, many of the Group's key customers continued to announce worsening sales and profitability as well as further headcount reductions, while the electronics sector had yet to show any real signs of recovery, although that has now begun to happen in Q4. However, despite these being the worst market conditions ever faced by the semiconductor industry, IQE was able to show a year on year increase in sales of 28 per cent. and limit losses at the EBITDA level to only £0.547 million, resulting in a small net cash outflow from operations of £1.230 million. The Group has continued to assemble its production capabilities and resource to remain the largest pure play compound semi-conductor wafer manufacturer in the world and to take advantage of the eventual recovery in its key markets.

#### Results

As anticipated, the dramatic reduction in production volumes of opto-electronic products in Q3 could not be fully offset by new development programs and accordingly sales at £8.234 million were limited to an increase of 28 per cent. year on year (Q3/2000: £6.431 million), although down sequentially from the previous quarter by 37 per cent. Sales for the nine months to September were 75 per cent. higher than the previous year at £34.351 million (2000: £19.639 million). The improvement in turnover in the nine months resulted from bringing on line new reactors installed in the second half of the previous year, as well as a full nine months contribution from Wafer Technology and the initial sales from IQE Silicon Compounds. Gross margins in Q3 were much lower than the previous quarter at 15.8 per cent. (Q2/2001: 31.0 per cent.) mainly due to capacity utilisation issues in the UK and US III-V operations caused by the weak opto-electronic and electronic marketplaces during the quarter. At the same time, Wafer Technology continued to be adversely affected by high gallium prices, although these have now fallen back to historic levels.

In-house research and development effort was increased in Q3 to £1.602 million, representing 19.5 per cent. of sales (Q2/2001: £0.757 million, 5.8 per cent. of sales), to support increased development activity particularly in the areas of new products such as InP HBTs, long wavelength VCSELs, GaInP HBTs, Avalanche Photodiodes (APDs) and GaAs on silicon technology, all of which was expensed in the quarter. Total research and development costs for the nine months amounted to £2.898 million (2000: £1.412 million), which was equivalent to 8.4 per cent. of sales (2000: 7.2 per cent. of sales). Sustained efforts to control costs meant that SG&A expenses continued to reduce to £1.928 million (Q2/2001: £2.027 million), although increasing as a percentage of sales to 23.4 per cent. (Q2/2001: 15.4 per cent.).

As a consequence of the foregoing, the operating loss for the quarter before goodwill amortisation and operating exceptional items was £2.228 million, compared with a small profit in the corresponding period in 2000 (Q3/2000: £0.380 million) and a profit in the previous quarter of £1.292 million. Cumulative operating profit for the nine months before goodwill and exceptionals at £0.328 million was 72 per cent. lower than the first nine months of the prior year (2000: £1.167 million). This represents an operating margin of 1.0 per cent. as against 5.9 per cent. for the same period last year. After crediting net interest income of £0.320 million (2000: £0.619 million) and charging operating exceptional items of £0.506 million (2000: £0.180 million) and goodwill amortisation relating to the Wafer Technology acquisition of £1.363 million (2000: Nil), the Group operating result before tax was



a loss of £1.221 million (2000: profit of £1.606 million). The after tax loss was £1.173 million (2000: profit of £1.126 million) and basic loss per share was 0.72 pence (2000: earnings per share of 0.79 pence). Excluding goodwill amortisation, earnings per share were 0.12 pence.

Excluding capital expenditure, the Group incurred an operating cash outflow for the nine months of £2.550 million (2000: inflow of £5.836 million). A positive cash flow in the first quarter was eroded by working capital increases in the second quarter, in particular a short term increase in raw material stocks caused by the market slowdown, and further exacerbated by the operating losses incurred in Q3. Capital expenditure reduced substantially in Q3 to £3.475 million (Q2/2001: £8.844 million) following the completion of the initial investment programme for IQE Silicon Compounds. A considerable portion of this related to equipment required for the GaAs on silicon development. Total capital expenditure for the year to date amounts to £22.386 million (2000: £19.007 million), bringing the net cash outflow for the nine months before financing to £24.578 million (2000: £12.586 million). Ongoing capital expenditure will decline significantly in Q4 and beyond.

### **Operations**

Overall, during Q3, new development contracts at IQE (Europe) were not sufficient to offset the dramatic decline in production orders from opto-electronic manufacturers, who are currently suffering from a significant inventory backlog. However, major progress was made in new product developments for next generation systems, particularly in long wavelength 1.3mm VCSELs, where successful devices have now been demonstrated, and in advanced detectors (APDs) where a new product has been launched with world class device results. The HBT product from IQE (Europe) has also met with significant success and is being qualified by a number of manufacturers worldwide.

In the wireless marketplace, the Company is now seeing definite signs of improvement to trading conditions, with some significant production orders now being agreed with customers. In addition, new product development continues to be successful, particularly with InP HBTs which are now designed into several new customer products. Strong work continues on supporting the breakthrough new GaAs on silicon technology, as further detailed in today's announcements.

Wafer Technology continues to perform well on specialist wafer products, although their more mature business has also suffered as a consequence of the very difficult market conditions. Margins were adversely impacted in Q3 due to high metal prices but these are now well under control. Overall, Wafer Technology is outperforming its competitors in the marketplace and business has held up reasonably well.

IQE Silicon Compounds has now signed up a further 5 Non Disclosure Agreements making 32 in total and has run qualification wafers for 16 customers. The initial qualifications are now completing and the company recently received its first production orders from large European IC manufacturers. Progress continues to be very positive with excellent feedback on the new SiGe products and the successful completion of further qualification programs will lead to accelerating production over the next few quarters.

Overall, the current trading environment continues to be extremely challenging, particularly in the opto-electronics sector. Continued weakness in this area is being offset to an extent by the improving environment in the wireless sector and the success of IQE Silicon compounds in winning production orders. Consequently, in order to conserve cash, the Group has taken a number of cost control initiatives that are anticipated to help it to re-establish profitability in the coming quarters whilst maintaining critical production capability, resource and infrastructure in place to ensure the business is properly positioned to exploit its medium term potential.

Notwithstanding the current difficult marketplace, IQE has clearly established a clear leadership position as the pre-eminent global epiwafer supplier into the semi-conductor industry, as evidenced by Motorola's selection of IQE to further develop and commercialise what is potentially the most exciting discovery within the semi-conductor field for many years.



The agreements with Motorola relating to the commercialisation of GaAs on silicon, coupled with the increasing trend toward outsourcing within the semi-conductor industry, offer powerful opportunities for the future. Your Board believes that as the semi-conductor industry recovers, IQE is strongly positioned to build further upon its position as the leading outsource wafer supplier within the compound semi-conductor industry.

**Dr Drew Nelson**  
**Executive Chairman**  
**IQE plc**



## PROFIT AND LOSS ACCOUNT

(All figures GBP 000s)	Note	3 months	3 months	9 months	9 months	12 months
		to 30 Sep 2001	to 30 Sep 2000	to 30 Sep 2001	to 30 Sep 2000	to 31 Dec 2000
		unaudited	unaudited	unaudited	unaudited	audited
<b>Turnover</b>		8,234	6,431	34,351	19,639	30,117
Cost of Sales		(6,932)	(4,130)	(24,585)	(12,959)	(19,785)
<b>Gross Profit</b>		1,302	2,300	9,766	6,680	10,332
Gross Profit %		15.8	35.8	28.4	34.0	34.3
<b>S G and A Costs</b>						
Research/Development		(1,602)	(289)	(2,898)	(1,412)	(1,870)
Selling/General/Administration		(1,928)	(1,631)	(6,540)	(4,101)	(6,392)
Operating Profit/(Loss) before Goodwill/ Exceptionals		(2,228)	380	328	1,167	2,070
Operating Profit/(Loss) % before Goodwill/Exceptional		(27.1)	5.9	1.0	5.9	6.9
Goodwill Written off	2	(452)	0	(1,363)	(0)	(209)
Exceptional Items	3	(233)	(57)	(506)	(180)	(75)
Operating Profit/(Loss) after Goodwill/ Exceptionals		(2,913)	323	(1,541)	987	1,786
<b>Operating Profit/(Loss) % after Goodwill/ Exceptionals</b>		(35.4)	5.0	(4.5)	5.0	5.9
Interest Received/(Paid)		(98)	494	320	619	1,208
<b>Net Profit/(Loss) before Taxes</b>		(3,011)	817	(1,221)	1,606	2,994
Net Profit/(Loss) %		(36.6)	12.7	(3.6)	8.2	9.9
Current Taxes		635	(243)	315	(480)	75
Deferred Taxes		0	0	(267)	(0)	(1,259)
Dividends		0	0	(0)	(0)	0
<b>Net Profit/(Loss) after Taxes</b>		(2,375)	574	(1,173)	1,126	1,810
Basic Earnings Pence/Share		(1.45)	0.40	(0.72)	0.79	1.24
Basic Earnings Pence/Share excl Goodwill		(1.17)	0.40	0.12	0.79	1.38
Diluted Earnings Pence/Share		(1.41)	0.38	(0.70)	0.75	1.18
Diluted Earnings Pence/Share excl Goodwill		(1.14)	0.38	0.11	0.75	1.32
Net Profit/(Loss) before Interest/Taxes/ Depreciation and Amortisation (EBITDA)		(547)	884	4,791	2,808	4,832



## BALANCE SHEET

(All figures GBP 000s)

	<i>Note</i>	<i>As at 30 Sep 2001 unaudited</i>	<i>As at 30 Sep 2000 unaudited</i>	<i>As at 31 Dec 2000 audited</i>
<b>Fixed Assets</b>				
Intangible Fixed Assets	4	35,018	0	36,543
Tangible Fixed Assets		<u>72,246</u>	<u>29,408</u>	<u>47,847</u>
<b>Total Fixed Assets</b>		107,264	29,408	84,390
<b>Current Assets</b>				
Stocks		13,858	4,954	7,885
Debtors		10,554	9,948	9,952
Cash and Bank		<u>13,513</u>	<u>62,502</u>	<u>39,512</u>
<b>Total Current Assets</b>		37,926	77,404	57,349
<b>Creditors Falling Due within One Year</b>		<u>(15,274)</u>	<u>(12,432)</u>	<u>(17,046)</u>
<b>Net Current Assets</b>		<u>22,652</u>	<u>64,972</u>	<u>40,303</u>
<b>Total Assets less Current Liabilities</b>		129,916	94,380	124,693
<b>Creditors Falling Due after One Year</b>				
Deferred Income		(51)	(75)	(69)
Deferred Tax Liability		(1,857)	(331)	(1,590)
Long Term Borrowings		<u>(11,959)</u>	<u>(3,626)</u>	<u>(5,438)</u>
<b>Net Assets</b>		<u>116,048</u>	<u>90,348</u>	<u>117,596</u>
<b>Capital and Reserves</b>				
Called Up Share Capital		1,644	1,545	1,633
Merger Reserve		(605)	(605)	(605)
Share Premium Account		111,882	86,102	111,802
Shares to be Issued		575	0	988
Retained Earnings		1,917	2,407	3,090
Other Reserves		<u>635</u>	<u>900</u>	<u>688</u>
<b>Total Equity Shareholders' Funds</b>		<u>116,048</u>	<u>90,348</u>	<u>117,596</u>

The financial statements were approved by the Directors of IQE plc on 13 November 2001

JL COVENTRY  
Company Secretary





## CASH FLOW STATEMENT

(All figures GBP 000s)	<i>3 months to 30 Sep 2001 unaudited</i>	<i>3 months to 30 Sep 2000 unaudited</i>	<i>9 months to 30 Sep 2001 unaudited</i>	<i>9 months to 30 Sep 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
<b>Net Inflow/(Outflow) from Operations</b>	<u>(1,230)</u>	<u>2,053</u>	<u>(2,550)</u>	<u>5,836</u>	<u>10,949</u>
<b>Returns on Investment and Servicing Finance</b>					
Interest Received/(Paid)	<u>(98)</u>	<u>494</u>	<u>320</u>	<u>619</u>	<u>1,208</u>
<b>Capital Expenditures</b>					
Purchases of Fixed Assets less HP	<u>(3,475)</u>	<u>(10,757)</u>	<u>(22,386)</u>	<u>(19,007)</u>	<u>(33,566)</u>
Intangible Fixed Assets	<u>0</u>	<u>0</u>	<u>(250)</u>	<u>0</u>	<u>(13,968)</u>
<b>Equity Dividends Paid</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Taxes Refunded/(Paid)</b>	<u>(102)</u>	<u>(6)</u>	<u>289</u>	<u>(34)</u>	<u>(144)</u>
<b>Net Inflow/(Outflow) before Financing</b>	<u>(4,905)</u>	<u>(8,215)</u>	<u>(24,578)</u>	<u>(12,586)</u>	<u>(35,521)</u>
<b>Financing</b>					
Issues of Ordinary Share Capital	<u>11</u>	<u>23,615</u>	<u>91</u>	<u>67,379</u>	<u>67,356</u>
Loans Received/(Repaid)	<u>(1,299)</u>	<u>(257)</u>	<u>(1,512)</u>	<u>(408)</u>	<u>(441)</u>
<b>Net Inflow/(Outflow) from Financing</b>	<u>(1,288)</u>	<u>23,358</u>	<u>(1,421)</u>	<u>66,971</u>	<u>66,915</u>
<b>Increase/(Decrease) in Cash and Bank Overdrafts</b>	<u><u>(6,194)</u></u>	<u><u>15,143</u></u>	<u><u>(25,999)</u></u>	<u><u>54,385</u></u>	<u><u>31,394</u></u>

## RECONCILIATION OF PROFIT TO CASH INFLOW FROM OPERATIONS

(All figures GBP 000s)	<i>3 months to 30 Sep 2001 unaudited</i>	<i>3 months to 30 Sep 2000 unaudited</i>	<i>9 months to 30 Sep 2001 unaudited</i>	<i>9 months to 30 Sep 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
Operating Profit after Goodwill/Exceptionals	(2,913)	323	(1,541)	987	1,786
Depreciation	2,137	561	4,970	1,821	2,839
Goodwill	452	0	1,363	0	209
(Gain)/Loss on Sale of Fixed Assets	0	0	0	0	29
(Increase)/Decrease in Stocks	(976)	(1,236)	(5,973)	(2,381)	(4,013)
(Increase)/Decrease in Debtors	3,180	(1,297)	(603)	(2,206)	(1,157)
Increase/(Decrease) in Creditors	(3,104)	3,708	(748)	7,633	11,280
Grants Released	(6)	(6)	(18)	(18)	(24)
Grants Received	0	0	0	0	0
<b>Net Cash Inflow/(Outflow) from Operations</b>	<u><u>(1,230)</u></u>	<u><u>2,053</u></u>	<u><u>(2,550)</u></u>	<u><u>5,836</u></u>	<u><u>10,949</u></u>



## RECONCILIATION OF UK GAAP TO IAS

(All figures GBP 000s)	<i>3 months to 30 Sep 2001 unaudited</i>	<i>3 months to 30 Sep 2000 unaudited</i>	<i>9 months to 30 Sep 2001 unaudited</i>	<i>9 months to 30 Sep 2000 unaudited</i>	<i>12 months to 31 Dec 2000 audited</i>
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### (1) Statement of Cash Flows

The following shows the statement of cash flows as if they had been presented under IAS.

Cash Inflow/(Outflow) from Operations	(1,332)	2,047	(2,261)	5,802	10,805
Cash Inflow/(Outflow) from Investing	(3,572)	(10,262)	(22,316)	(18,388)	(46,326)
Cash Inflow/(Outflow) from Financing	(1,288)	23,358	(1,421)	66,971	66,915
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>	<b>(6,193)</b>	<b>15,143</b>	<b>(25,998)</b>	<b>54,385</b>	<b>31,394</b>
Opening Cash and Cash Equivalents per IAS	19,706	47,359	39,512	8,117	8,117
Exchange Difference	0	0	0	0	0
<b>Closing Cash and Cash Equivalents per IAS</b>	<b>13,513</b>	<b>62,502</b>	<b>13,514</b>	<b>62,502</b>	<b>39,511</b>

### (2) Goodwill

Goodwill of £284,000 arose on acquisition of IQE (Europe) by EPIH on 27 March 1996. Under UK GAAP, this has been written off directly to reserves. Under IAS, however, goodwill arising on acquisition should be recognised as an asset and amortised over its useful life. The following shows the retained profit and total net assets as if they had been prepared under IAS with goodwill amortised over 5 years.

Profit/(Loss) after Taxes and Exceptionals	255	574	574	1,126	1,810
Dividends	0	0	0	0	0
Retained Profit/(Loss) per UK GAAP	255	574	574	1,126	1,810
Goodwill Amortisation	(14)	(14)	(43)	(43)	(57)
<b>Retained Profit/(Loss) per IAS</b>	<b>240</b>	<b>560</b>	<b>532</b>	<b>1,084</b>	<b>1,753</b>
Equity Shareholders' Funds per UK GAAP	116,048	90,348	116,048	90,348	117,596
Goodwill Capitalisation at Cost	284	284	284	284	284
Accumulated Goodwill Amortisation	(256)	(199)	(256)	(199)	(213)
<b>Equity Shareholders' Funds per IAS</b>	<b>116,076</b>	<b>90,433</b>	<b>116,076</b>	<b>90,433</b>	<b>117,667</b>



## NOTES TO THE ACCOUNTS

### 1. Basis of preparation

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

- 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.
- Turnover represents amounts invoiced exclusive of value added taxation.
- 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. No depreciation is provided on land or assets in the course of construction.

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

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

The acquisition of IQE (Europe) Limited (formerly known as Epitaxial Products International Limited) and its subsidiary Epitaxial Products Inc on 27 March 1996 by EPI Holdings Limited, a new company established for that purpose, has been accounted for under acquisition accounting, whereby these Companies became part of the Group on the date of acquisition.

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

The acquisition of Wafer Technology International Limited and its subsidiary Wafer Technology Limited on 22 November 2000 by IQE plc has been accounted for under acquisition accounting, whereby these companies became part of the Group on the date of acquisition.

- Stocks are stated at the lower of cost and net realisable value.
- Research and development expenditure is fully written off when incurred except as noted in 4 (below)
- 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 (formerly Quantum Epitaxial Designs 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 a defined contribution pension scheme. Contributions are charged in the profit and loss account as they become payable in accordance with the rules of the scheme.



- 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 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

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 the acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill. The goodwill arising on the acquisition of IQE (Europe) Limited (formerly 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 and 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.

## 3. Exceptional items

	2001	2000
Exceptional items comprise:		
Provision for national insurance contributions on share options	(£51K)	£180K
Legal fees	£557K	£0K

Legal fees relate 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. There is a counter claim by Rockwell alleging breaches of a licence agreement by IQE (Europe).

Two legal opinions obtained by IQE (Europe) in the US clearly support IQE's view that its processes were not covered by Rockwell's patent, the validity of which is separately being disputed by other companies in the US. It is uncertain whether the matter will ultimately go to trial or what the outcome will be.



#### **4. Intangible fixed assets**

Development costs in respect of new products have been carried forward where contracts of sufficient value exist or are likely to exist in the foreseeable future, and will be written off over a two year period commencing with the start of the contracts to which the costs relate.

#### **5. Contingent liability**

There is a contingent liability covering further legal costs in respect of the actions between IQE (Europe) and Rockwell (see note 3 above). The Directors estimate that legal fees of up to an additional £300K may be incurred in the fourth quarter of the year.



## PART VIII

### GENERAL INFORMATION

#### 1. Directors responsibility

The Directors, whose names appear on page 3 of this document, accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

#### 2. The Company

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

The Company's name was changed to IQE plc on 26 April 1999.

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

On 27 May 1999 the Ordinary Share capital of the Company was admitted to listing on Nasdaq Europe and on 19 May 2000 the Ordinary Share capital of the Company was admitted to the Official List and to trading on the London Stock Exchange.

#### 3. Share Capital

The present authorised and fully paid up issued share capital of the Company is as follows:

<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>
250,000,000	2,500,000	164,403,090	1,644,030.90

At the date of this prospectus, the Company has options over 8,530,695 Ordinary Shares outstanding pursuant to the Share Option Schemes. In addition, the Company is under an obligation to issue a further 500,000 Ordinary Shares to certain individuals (formerly shareholders of Wafer Technology) subject to certain conditions. See section 14(b) of this Part VIII "General Information – Material Contracts".

#### 4. Changes in the Company's Share Capital

##### (a) THE COMPANY

The Company was incorporated on 1 April 1999 with an authorised share capital of £50,000 divided into 50,000 ordinary shares of £1 each, of which two ordinary shares were issued unpaid to the subscribers.

On 13 April 1999 the two subscriber shares were transferred to Bankhill Trustees Limited, one on trust for the Andrew Nelson Interest in Possession Settlement and one for the Dr Scott Interest in Possession Settlement.

By a Special Resolution passed on 13 April 1999, each of the ordinary shares of £1 each, both issued and unissued in the Company, was divided into ten ordinary shares of 10p each, and the authorised share capital was increased to £1,550,000 by the creation of a further 15,000,000 ordinary shares of 10p each.

On 3 May 1999, the Company entered into the EPIH Agreement with the shareholders of EPIH whereby, the Company agreed to acquire the entire issued share capital of EPIH in exchange for the issue by the Company of in aggregate 5,997,180 ordinary shares of 10p each credited as fully



paid, to the shareholders of EPIH (being Bankhill Trustees Limited as trustees for the Andrew Nelson Interest in Possession Settlement and the Dr Scott Interest in Possession Settlement) and the payment up of the 2 subscriber shares (later converted into 20 ordinary shares of 10p each), such issue and payment up being in proportion to the holdings of such shareholders' ordinary shares in EPIH. A further 382,799 ordinary shares of 10p each were reserved for the participants of the EPIH employee share option scheme. The agreement was completed on 16 May 1999.

On 3 May 1999, the Company and EQ Compounds, Inc. (a US company and wholly owned subsidiary of the Company formed for the purpose of effecting the merger) entered into the QED Agreement with QED and Thomas Hierl whereby EQ Compounds, Inc. agreed to merge with QED in exchange for the issue by the Company to the stockholders of QED of an aggregate 4,392,459 ordinary shares of 10p each, credited as fully paid, such issue being in proportion to their holdings of common stock in QED. A further 767,511 ordinary shares of 10p each were reserved for the participants of the QED employee share option schemes and a further 60,025 ordinary shares of 10p each were reserved for Progress Bank as the holder of warrants in QED. This agreement was amended and completed on 20 May 1999. On completion of the merger, QED became a 100 per cent. subsidiary of the Company and EQ Compounds, Inc. ceased to exist.

In connection with the acquisition of EPIH and the merger with QED, the Company entered into an agreement (the "Escrow Agreement") dated 20 May 1999, with amongst others, the former shareholders of EPIH and certain shareholders of QED to secure the potential liabilities of Dr Nelson, Dr Scott and Mr Hierl under warranties and indemnities given to the Company pursuant to the EPIH Agreement and the QED Agreement. Under the Escrow Agreement, the Company was granted a charge over 1,160,000 ordinary shares of 10p each (the "EPIH Escrow Shares") to secure the liabilities of Dr Nelson and Dr Scott and a charge over 949,091 ordinary shares of 10p each (the "QED Escrow Shares") to secure their indemnification obligations under the EPIH Agreement and the QED Agreement respectively. If the Company had a valid claim under the EPIH Agreement or the QED Agreement and liability for such claim is either admitted by the person(s) against whom it is made, or judgement is awarded in favour of the Company, then the Company was entitled to require a sale of such number of EPIH Escrow Shares or QED Escrow Shares (as the case may be) which have an aggregate value equal (or as near thereto as possible) to the value of the claim. The proceeds from such sale will be paid to the Company by way of damages for the claim. This was the only remedy available to the Company under the EPIH Agreement and the QED Agreement for breach of warranties and indemnities. Any such claims under such Agreement to be served by no later than two years after the date of completion of the Merger. No such claims have been made and accordingly all such shares the subject of the Agreement have been released from the escrow.

By an ordinary resolution passed on 26 May 1999, the authorised share capital of the Company was increased to £1,900,000 by the creation of a further 3,500,000 ordinary shares of 10p each and by an ordinary resolution passed on 12 May 2000, authorised share capital of the Company was increased to £2,500,000 by the creation of a further 6,000,000 ordinary shares of 10p each.

By a further ordinary resolution passed on 8 September 2000, each of the ordinary shares of 10p each, both issued and unissued in the Company, was divided into 10 ordinary shares of 1p each.

In connection with the acquisition of Wafer Technology and WTI on 22 November 2000, 8,750,000 Ordinary Shares were allotted and issued to the vendors of those companies by way of consideration and the Company agreed to allot and issue a further 500,000 Ordinary Shares on 28 February 2002 to certain of such vendors subject to each of them remaining employed by the Company or Wafer Technology (as the case may be) on 28 February 2002.



The following issues of Ordinary Shares have been made since 24 May 1999 in connection with the exercise of Share Option Schemes:

<i>Date</i>	<i>Issued</i>
03.09.99	2,499,910
21.09.99	373,040
12.10.99	158,170
02.11.99	270,540
10.12.99	74,140
16.12.99	78,980
05.01.00	61,720
05.01.00	557,620
17.01.00	58,900
11.05.00	269,900
19.05.00	304,710
07.07.00	430,210
07.07.00	438,740
18.07.00	68,850
19.09.00	241,390
19.09.00	213,630
29.09.00	41,588
08.01.01	244,748
03.04.01	281,189
20.04.01	90,700
04.06.01	241,822
18.07.01	41,356
17.09.01	252,777
06.11.01	6,150
	<hr/>
	7,894,780
	<hr/>

(b) EPIH

EPIH was incorporated on 11 March 1996 with an authorised share capital of £100,000 divided into 100,000 ordinary shares of £1.00 each of which one ordinary share of £1.00 was issued to the subscriber.

On 24 May 1996 the subscriber share was transferred to Shell Ventures UK Limited (“Shell Ventures”).

By a resolution passed on 24 May 1996 the subscriber share was reclassified as one non-voting subscriber share of £1.00 and was transferred to the joint names of Andrew Nelson and Mike Scott.

By further resolutions passed on 24 May 1996 and ratified on 22 March 1999 the authorised share capital was increased to £101,000 by the creation of 1,000 “A” ordinary shares of £1.00 each and one ordinary share of £1.00 was reclassified as one redeemable deferred share of £1.00 (“the Golden Share”).

On 24 May 1996 30,000 ordinary shares of £1.00 each were allotted and issued at par to Bankhill Trustees Limited (15,000 on trust for A Nelson and 15,000 on trust for M Scott) and the one Golden Share was allotted and issued for cash at par to Shell Ventures.

Also on 24 May 1996, EPIH issued to Shell Ventures £5,000,000 secured loan stock 1996/2006, £1,000 unsecured convertible loan stock 2005 and £964,000 unsecured loan stock 2003/2006. By virtue of the conditions governing the £1,000 unsecured convertible loan stock 2003 Shell Ventures had the right to convert the stock into 1,000 fully paid “A” ordinary shares of £1.00 in





the capital of EPIH and by virtue of the rights attaching to the Golden Share in the Articles of Association of EPIH then in force, Shell Ventures had enhanced voting rights whenever certain relevant resolutions of EPIH were proposed to be passed.

On 29 October 1998, all the loan stock referred to above was redeemed by EPIH entering into three Deeds of Settlement with Shell Ventures and paying to Shell Ventures the aggregate sum of £1,500,000.

On 2 November 1998, EPIH repurchased the Golden Share for a price of £1.00 out of its distributable profits in accordance with an agreement made between EPIH and Shell Ventures and approved by a written Special Resolution of EPIH passed on 2 November 1998.

On 31 March 1999, EPIH repurchased the one non-voting subscriber share of £1.00 for a price of £1.00 out of its distributable profits in accordance with an agreement made between EPIH and A Nelson and M Scott and approved by a written Special Resolution of EPIH passed on 31 March 1999.

By a resolution passed on 31 March 1999, each of the ordinary shares of £1.00 in the capital of EPIH, both issued and unissued were divided into 100 ordinary shares of 1p each. The Directors of EPIH were authorised to issue 191,489 shares of 1p each.

By a resolution passed on 28 April 1999, each of the authorised but unissued 1,000 "A" Ordinary Shares of £1.00 each, the Golden Share and the one non-voting subscriber share of £1.00 were re-classified as ordinary shares of £1.00 each and then each such share was divided into 100 ordinary shares of 1p each.

(c) IQE EUROPE

IQE Europe was incorporated on 9 March 1987.

On 24 May 1996 750,000 preference shares of £1.00 each in the capital of EPIH were reclassified as ordinary shares, Shell Ventures transferred 965,000 ordinary shares to EPIH in return for the issue of loan stock by EPIH (as referred to above in paragraph (b) and the issue of £1,000,000 secured loan stock 2004/2006 by IQE Europe and Bankhill Trustees Limited exchanged their ordinary shares in IQE Europe for ordinary shares in EPIH.

On 29 October 1998 the £1,000,000 secured loan stock 2004/2006 was redeemed by IQE Europe entering into a Deed of Settlement with Shell Ventures and paying to Shell Ventures the sum of £1,000,000.

IQE Europe's name was changed on 30 June 2000 from Epitaxial Products International Limited to IQE (Europe) Limited.

(d) QED

Since 21 February 1997, QED has not issued any additional capital stock other than 25,000, 50,000 and 10,000 shares of Common Stock to Scott Massie, Greg Olsen and Richard Elia respectively in each case following the exercise of options held by them. Mr Hierl, however, has transferred some of his Common Stock to 8 different trusts, 6 of which Stephen Loizeaux serves as the trustee and two of which Mr Hierl serves as the trustee.

On 17 June 1998, in connection with the loan facility with Progress Bank, QED issued Progress Capital, Inc. (an affiliate of Progress Bank) three warrants (in addition to the loan agreement) exercisable for 10 years to purchase a total of 30,000 shares of Common Stock at \$3.00 per share. In connection with the merger of EQ Compounds Inc. into QED these warrants were converted into warrants to purchase 40,333 Ordinary Shares at \$3.00 per Ordinary Share. Following the Nasdaq Europe Admission, Progress Capital exercised these warrants in whole.



On 29 April 1999, in connection with the renegotiation and extension of the loan facility from \$1,500,000 to \$1,900,000 with Progress Bank, QED issued Progress Capital, Inc. one warrant exercisable for 10 years to purchase \$160,000 worth of Common Stock at \$3.00 per share (i.e. 53,333 shares). In connection with the merger of EQ Compounds Inc. into QED and the Nasdaq Europe Admission, this warrant was converted into a warrant to purchase 19,692 Ordinary Shares at \$8.125 per Ordinary Share. Progress Capital has exercised these warrants in whole.

On 20 May 1999, as a result of the merger of EQ Compounds Inc. and QED, the articles of incorporation and bylaws of QED were amended and restated such that the provisions of the amended and restated articles and bylaws of QED would be identical to the articles of incorporation and bylaws of EQ Compounds, Inc.

On 8 February 2000, the amended and restated articles of incorporation of QED were amended to change QED's name to "IQE, Inc."

(e) WTI

WTI was incorporated on 12 May 1994.

On 22 November 2000, WTI established the Wafer Technology International Employee Share Trust ("the Trust"), the trustees of which were Martin Lamb and Karen Lamb and a total of 956 ordinary shares of £1.00 each were transferred by the Individuals (as defined in section 14 of Part VIII "General Information – Material Contracts (b)(i) Acquisition Agreement") to the trustees (as to 239 each).

Subsequently also on 22 November 2000, IQE acquired the entire issued share capital of WTI. See section 14(b) of Part VIII "General Information – Material Contracts".

(f) WAFER TECHNOLOGY

Wafer Technology was incorporated on 3 July 1984.

On 22 November 2000 IQE acquired the 391,084 ordinary shares of £1.00 each not owned by WTI from Compagnie Aramayo S.A.

(g) IQE SILICON COMPOUNDS

IQE Silicon Compounds was incorporated on 5 May 2000 with an authorised share capital of £100 divided into 100 ordinary shares of £1.00 each of which two ordinary shares of £1.00 were issued to the subscribers.

On 5 February 2001 the subscriber shares were transferred to IQE.



## 5. Directors' and other interests in the Company

- (a) The interests (all of which, unless otherwise stated, are or will be beneficial) of (a) any person who owns 3 per cent. or more of the outstanding Ordinary Shares and (b) the Directors and their immediate families and connected persons of the Directors for the purposes 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 or 328 of the Act and which are required to be entered in the Register of Directors' Interests maintained pursuant to Section 325 of the Act, (or, in the case of interests of connected persons of the Directors, who would have been required to be so notified if such connected persons were directors) at the date of this document and as those interests may be immediately following the Issue:

	<i>Prior to the Issue</i>		<i>After the Issue (assuming no take up of Open Offer)</i>	
	<i>Percentage of issued</i>		<i>Percentage of issued</i>	
	<i>Ordinary Shares held</i>	<i>share capital</i>	<i>Ordinary Shares held</i>	<i>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	15.9	26,057,970	14.3
Thomas Hierl	16,489,230	10.0	16,489,230	9.1
Dr Michael Scott (shares held on trust by Bankhill Trustees Limited for the Dr Scott interest in Possession Settlement)	26,057,970	15.9	26,057,970	14.3
Richard Clarke	0	0	0	0
Stephen Byars <sup>+</sup>	5,000	0.003	5,000	0.003
Scott Massie	108,620	0.07	108,620	0.06
Martin Lamb*	3,841,250	2.3	3,841,250	2.1
Dr Godfrey Ainsworth	5,410	0.003	5,410	0.003
NEPA (Glen Bressner)	14,036,030	8.5	14,036,030	7.7
All Directors and Senior Managers as a group	86,601,480	52.68	86,601,480	47.57

+ Stephen Byars' wife, Geraldine Morgan, is the holder of these 5,000 Ordinary Shares.

\* Of these shares, Martin Lamb's wife, Karen Lamb (a director of Wafer Technology and WTI) is beneficially interested in 1,670,625 Ordinary Shares (representing 1.02 per cent. of the issued share capital prior to the issue and 0.92 per cent. after the Issue assuming no take-up under the Open Offer). In addition, Martin Lamb and Karen Lamb are the trustees of the Wafer Technology International Employee Share Trust and 500,000 of these Ordinary Shares are held by them in such capacity. A description of the Wafer Technology International Employee Share Trust is set out in section 9(e) of Part VIII "General Information – Share Option Schemes – Wafer Technology International Employee Share Trust".

In addition, the Directors are interested in the following options over Ordinary Shares:

Richard Clarke	250,000
Stephen Byars	250,000
Scott Massie	1,258,300
Dr Godfrey Ainsworth	75,000



- (i) Save as disclosed in this section 5, none of the Directors, and no person connected with them for the purposes of Section 346 of the Act, has any interest (beneficial or non-beneficial) in any issued Ordinary Shares.
  - (ii) The interests of those Directors who, following the Motorola Subscription and the Placing and Open Offer are expected to represent 3 per cent. or more of the issued Ordinary Shares are as set out above in this paragraph (a) of section 5.
  - (iii) Save as disclosed in paragraphs (a) and (a)(ii) of this section 5, the Directors are not aware of any person who is, or, immediately following the Motorola Subscription and the Placing and Open Offer will be interested, directly or indirectly, in 3 per cent. or more of the issued share capital of the Company or who, directly or indirectly, jointly or severally, exercises or could exercise control over the Company.
- (b) Save as disclosed in paragraph (a) of this section 5 none of the Directors, their immediate families and persons connected with them within the meaning of Section 346 of the Act, has any interest in the share capital of the Company.
  - (c) Save for the persons disclosed in paragraph (a) of this section 5, none of the Directors are aware of any interest (within the meaning of Part VI of the Act) of any person who, directly or indirectly, jointly and severally, exercise or could exercise control over the Company.
  - (d) Save as disclosed in paragraph (a) of this section 5 and save for the following shareholders, none of the Directors are aware of any interest (within the meaning of Part VI of the Act) which represents 3 per cent. or more of the currently issued share capital of the Company or of any person who, directly or indirectly, jointly and severally, exercise or could exercise control over the Company:

<i>Shareholder</i>	<i>Number of Ordinary Shares</i>	<i>Percentage of Issued Share Capital</i>
Citivic Nominees Limited	21,813,640	13.3

Citivic Nominees Limited is a nominee company representing all of the Ordinary Shares held in the Nasdaq Europe system.

- (e) No Director has or has had any interest in any transaction which is or was unusual in its nature, or was or is significant to the business of the Group and was effected by the Group during the current or immediately preceding financial year, or which was effected by the Group during any earlier financial year and remains in any respect outstanding or unperformed except as follows:
  - (i) Dr Ainsworth is a partner in Gambit Corporate Finance which received payments for services provided to the Group amounting to £97,850 plus expenses of £10,730 during 2000. Such payments included £10,500 in respect of services provided by a non-executive director, £75,000 in respect of advice regarding the admission of the Existing Ordinary Shares to the Official List in May 2000 and £12,350 in respect of other corporate finance services. As at the date of this Prospectus, in respect of services provided in 2001, the Company has paid fees of £20,550 plus expenses of £8,145 to Gambit Corporate Finance.
  - (ii) Directors' service agreements are described more fully in paragraph (b) of section 10 of this Part VIII.
  - (iii) Mr Lamb was a shareholder of WTI which was acquired by the Company on 22 November 2000. Details of the agreement pursuant to which the acquisition was made are set out in paragraph (b) of section 14 of this Part VIII.
- (f) No loans or guarantees have been granted or provided to or for the benefit of the Directors by any member of the Group.

## **6. Material provisions of the Memorandum and Articles Of Association**

### **6.1 MEMORANDUM**

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 under section 19 of this Part VIII – “Documents Available for Inspection”.

### **6.2 ARTICLES**

The following describes the rights of Ordinary Shareholders as incorporated in the Articles. It is a description of significant rights and does not purport to be complete or exhaustive.

#### *(a) 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, on a show of hands, every shareholder personally present or, being a corporation, present by representative, shall 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.

#### *(b) Dividends, Other Distributions and Rights*

The Company anticipates that, following the completion of the Motorola Subscription, earnings will be retained for development of the Company’s business and will not be distributed for the foreseeable future. The declaration and payment by the Company of any future dividends and the amount thereof will depend upon the Company’s results of operations, financial condition, cash requirements, future prospects, profits available for distribution and other factors deemed to be relevant at the time. If dividends are declared out of distributable profits, subject to the terms on which any of such shares may be issued, holders of Ordinary Shares will be entitled to a gross dividend of the same amount for each share held.

#### *(c) 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.

#### *(d) 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.

#### *(e) Changes in Capital*

(i) Subject to the Act and every other statute for the time being in force concerning companies and affecting the Company (“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 other terms as the Board may determine.

- (ii) 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.
- (iii) 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.
- (iv) 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.

(f) *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:

- (i) 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;
- (ii) 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
- (iii) 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.

(g) *Transferability*

- (i) 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 the Nasdaq Europe Rules 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.
- (ii) The Directors may in their absolute discretion, and without assigning any reason therefor, refuse to register any transfer of a share:
  - (a) if the share is not fully paid and the Company has a lien on it; or
  - (b) (except in the circumstances specified in the Articles) if:
    - (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
    - (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
    - (3) the notice has not been complied with within the period stipulated in the notice (which must not be less than 14 days); or
  - (c) which is in favour of more than four persons jointly; or
  - (d) which is not listed or otherwise dealt in on a recognised investment exchange and is not fully paid up.
- (iii) 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.
- (iv) 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. Such provisions shall apply to the extent that the same are consistent with the Nasdaq Europe Rules.

(h) *Directors*

- (i) Subject to the provisions of the Articles, the Directors shall not be less than four nor more than 15 in number. At least two Directors shall be independent directors.
- (ii) 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.



- (iii) 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:
  - (a) 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
  - (b) 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
  - (c) 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
  - (d) 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
  - (e) 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
  - (f) the purchase and/or maintenance of any insurance policy for the benefit of Directors or for the benefit of persons including Directors.
- (iv) 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.
- (v) 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.
- (vi) 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 and the Nasdaq Europe Rules.

- (vii) 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.
- (viii) 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 from rotation.
- (ix) 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.
- (x) A Director shall not be required to hold qualification shares.
- (xi) 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.
- (xii) 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.

(i) *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).

(j) *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 Nasdaq Europe or a recognised investment exchange (as the case may be) 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.

(k) *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. Pre-emption and Subscription Rights**

### **EXTRAORDINARY GENERAL MEETING**

At the Extraordinary General Meeting to be held at 10.00 a.m. on 10 December 2001, the Resolution will be proposed to:

- (i) increase the authorised share capital to £3,000,000 by the creation of a further 50,000,000 Ordinary Shares.
- (ii) authorise the Directors to allot and issue the New Ordinary Shares, the Draw Down Shares and the Warrant Shares following exercise of the Share Warrants; and
- (iii) disapply pre-emption rights in respect of the allotment and issue of the New Ordinary Shares, the Draw Down Shares and the Warrant Shares (See Part I “Letter from the Chairman”).

## ANNUAL GENERAL MEETING

At the annual general meeting of the Company on 8 May 2001, the following general authorities were given by the Company:

(i) *Allot Shares*

The Directors were authorised, pursuant to Section 80 of the Act, to allot relevant securities (as defined in Section 80(2) of the Act) up to an aggregate amount equal to the lower of:

- (a) the authorised but unissued share capital of the Company immediately following the annual general meeting; and
- (b) the aggregate of one third of the issued share capital of the Company immediately following the annual general meeting and the nominal value of Ordinary Shares reserved for issue under the Share Option Schemes.

(ii) *Disapply Pre-emption Rights*

The Directors were authorised, 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 special resolution referred to above, as if Section 89(1) of the Act did not apply to such allotment provided that such power shall be limited to:

- (a) the allotment of shares in connection with a rights issue or other pre-emptive offer; and
- (b) the allotment of shares otherwise than pursuant to (a) above up to an aggregate nominal amount equal to five per cent. of the unissued share capital of the Company immediately following the annual general meeting.

These authorities are to expire on the earlier of:

- (i) 15 months after the passing of the special resolutions; and
- (ii) the conclusion of the annual general meeting next following the passing of the special resolutions.

Such authorities are separate from and independent of the authorities proposed to be given by the passing of the Resolution and are considered by the Directors to provide the Company with the necessary flexibility to pursue its commercial aims.

Any further authorities for the Directors to allot Ordinary Shares for cash without having regard to pre-emption rights will be subject to the passing of a special resolution of the Company. In the absence of any such authority, the Directors will be obliged to offer any new shares to be issued (except for those to be issued otherwise than for cash or pursuant to the Share Option Schemes) to existing Shareholders on a *pro rata* basis.

Section 89(1) of the Act confers on Shareholders rights of pre-emption in respect of the allotment of equity securities which are, or are to be, paid up in cash other than by way of allotment to employees under an employee share scheme. There are no pre-emption rights as regards the transfer of fully paid Ordinary Shares from members once they have been issued.

## 8. Form of the Ordinary Shares and Transferability

All of the existing issued Ordinary Shares are credited as fully paid and all the New Ordinary Shares to be issued pursuant to the Motorola Subscription and the Placing and Open Offer must be fully paid on Subscription. Upon commencement of trading in the New Ordinary Shares on Nasdaq Europe and the London Stock Exchange, all of the Ordinary Shares will be freely transferable, subject to compliance with any restrictions set out in the Articles (see section 6 of this Part VIII). For further information on rights attaching to the Ordinary Shares, see section 6 of this Part VIII.

For further information on transfer arrangements see Part III "Information on the Group – Payment, Clearing and Settlement Agencies".



Book-entry is mandatory for settlements of all financial instruments traded on Nasdaq Europe. Physical certificates cannot be used for settlements of market transactions. Physical deliveries are permitted on request by a Shareholder, who must bear the costs of delivery of the physical certificates.

## 9. Share Option Schemes

### (a) THE EPI HOLDINGS LIMITED UNAPPROVED EMPLOYEE SHARE OPTION SCHEME (THE "EPIH SCHEME")

The EPIH Scheme was adopted on 31 March 1999. It contains similar provisions to the IQE plc Share Option Scheme (see below). Options were granted pursuant to the EPIH Scheme over 191,489 ordinary shares of 1p each in EPIH. The Directors have agreed that no further options will be granted under the EPIH Scheme (or any other employee share scheme relating to shares in EPIH).

In connection with the Nasdaq Europe Admission, arrangements were made to enable optionholders in the EPIH Scheme to acquire Ordinary Shares on the exercise of options in place of EPIH ordinary shares.

### (b) QED STOCK OPTION PLANS

*1996 Stock Option Plan.* QED adopted the Quantum Epitaxial Designs, Inc. 1996 Stock Option Plan (as amended, the "QED 1996 Plan"). Selected employees, consultants and independent contractors of QED, its parent, subsidiaries or any successors thereto are eligible participants under the QED 1996 Plan. Pursuant to the QED 1996 Plan non-employee directors may not receive any award until 6 months after termination of registration under §12 of the Securities Exchange Act, if so registered. However, automatic awards of 1,000 shares pursuant to a non-qualified stock option under the QED 1996 Plan can be made to non-employee directors upon the effective date of registration of QED shares. The board of directors of QED administers the QED 1996 Plan and may appoint a committee of at least 2 persons to administer the QED 1996 Plan on its behalf. Options terminate after 10 years from the date of the award if not exercised. If an optionholder commits any disloyalty, felony, disclosure of confidential information or breach of duty or agreement with QED, the optionholder forfeits any shares pursuant to an unexercised option.

The stock subject to the QED 1996 Plan was 345,000 shares of Common Stock and may be awarded as either non-qualified stock options ("NQSOs") or incentive stock options ("ISOs"). The price per share payable upon the exercise of an NQSO must be at least \$0.01 per share. The price per share under an ISO to an employee must generally be at least the fair market value of the stock on the date of the award. However, the price per share under an ISO to an employee who owned 10 per cent. or more of the voting power at the time of the award must be at least 110 per cent. of fair market value of the stock on the date of the award. The term of the option(s) is generally 10 years from the award of the option(s), or 10 years after adoption of the QED 1996 Plan. However, the term is reduced to five years from the option award date, or 5 years after the adoption of the QED 1996 Plan, for an ISO of an employee owning stock with 10 per cent. or more of the voting power of QED. An option award with respect to a particular employee will not be treated as an ISO if the aggregate amount of all ISOs exercisable within a calendar year exceeds a yearly limitation set according to the provisions of the Internal Revenue Code of 1986, as amended. Any options in excess of such limits would be treated as NQSOs. In addition, options awarded to participants who are not employees are NQSOs. Fair market value is determined at the discretion of the board of directors if shares are not publicly traded, or the mean of the bid and asked prices on that date according to The Wall Street Journal report or per Nasdaq if publicly traded. No stockholder rights attach until the exercise of options and issuance of shares. Options are non-assignable and non-transferable *inter vivos*, but may pass by will or the laws of descent and distribution.



Subject to forfeiture provisions in the event of termination for cause, as defined in the QED 1996 Stock Plan, if an optionholder's employment with the company is terminated for any other reason other than death or disability, then the employee's options terminate three months after the optionholder's employment is terminated. If an optionholder dies or becomes disabled while employed by the company, any unexercised option terminates one year after the date of his death or disability. An option may be exercised by a disabled optionholder or an optionholder whose employment is terminated, or by the executors or administrators of a deceased optionholder or any person who acquires the option directly from an optionholder by bequest or inheritance, to the extent the option could have been exercised on the date of such disability, termination or death.

In the event of any stock dividend, stock split, recapitalisation, or other similar change affecting Common Stock, appropriate proportional adjustments must be made in the number of shares reserved for issuance under the QED 1996 Plan, the number of shares subject to outstanding options and the option prices thereof, subject to required action by the shareholders of the company, if any. The QED 1996 Plan also provides for the exercisability of options, and provides discretion to take whatever other actions it deems necessary or desirable with respect to all outstanding options upon the occurrence of a "Change of Control," as such term is defined in the QED 1996 Stock Plan, and a provision for the cancellation of options and a cash payment to the holders of such cancelled options upon the occurrence of certain of the events constituting a Change of Control.

In July 1997, QED granted ISOs to acquire 153,000 shares of Common Stock at a per share exercise price of \$1.75, 1,000 of which were cancelled and returned to the pool for further grant. In January 1998, QED granted ISOs to acquire 25,000 shares of Common Stock at a per share exercise price of \$1.75. In May 1998, QED granted ISOs to acquire 16,250 shares of Common Stock at a per share exercise price of \$1.75. In August 1998, QED granted ISO's to acquire 15,000 shares of QED Common Stock at a per share exercise price of \$1.75. In December 1998, QED granted ISO's to acquire 50,000 shares of Common Stock at a per share exercise price of \$1.75. In March 1999, QED granted ISOs to acquire 86,750 shares of Common Stock at a per share exercise price of \$2.47. All of the ISOs granted under the QED 1996 Plan vest rateably and annually over four years.

In April 1999, employee resignations resulted in the forfeiture of 13,250 ISOs granted under the QED 1996 Plan. These forfeited options were returned to the available pool of options to be granted under the QED 1996 Plan. On 7 May 1999, QED reallocated these forfeited options among other employees at a per share exercise price of \$8.18.

After giving effect to the merger contemplated by the QED Agreement, the options outstanding under the QED 1996 Plan were converted into the right to purchase 463,822 Ordinary Shares. In addition, the per share exercise price for these options was reduced by a factor of approximately 0.74. The Board of QED does not intend to grant additional options under the QED 1996 Plan.

*Employee Non-Qualified Stock Option Plan.* QED adopted the Quantum Epitaxial Designs, Inc. Employee Non-Qualified Stock Option Plan (as Amended and Restated, effective 3 October, 1996, the "QED 1991 Plan"). The QED 1991 Plan permitted all employees of QED, including employee directors, and employees of subsidiaries or parent companies of QED, to participate with the discretion of the board of directors. All options granted under the QED 1991 Plan are NQSOs. A committee of the board of directors administers the QED 1991 Plan. Outstanding options cannot be returned and then awarded in the future under the QED 1991 Plan. The option price must be at least \$0.01 per share. Awards must be granted within 10 years of the adoption of the QED 1991 Plan. Options must be exercised under the QED 1991 Plan within 10 years of the award date.



Subject to certain exceptions, an optionholder must exercise his or her options under the plan, if at all, within 3 months of termination of employment from QED. Termination of employment for “cause,” as determined by the board of directors for reasons such as disloyalty, fraud, conviction for a felony, or wrongful disclosure, causes an employee to forfeit any rights under the QED 1991 Plan. The rights under the QED 1991 Plan are non-assignable and non-transferable *inter vivos*. QED agreed to reserve sufficient shares for the exercise of options awarded under the plan. An employee must execute a Stock Restriction and Purchase Agreement upon exercising options under the QED 1991 Plan. The agreement states that an optionholder may exercise up to 20 per cent. of his or her award on the first anniversary of the grant of the award. After this time period, the optionholder may exercise 1/48th of the award monthly.

After giving effect to the merger contemplated by the QED Agreement, the options outstanding under the QED 1991 Plan were converted into the right to purchase 303,689 Ordinary Shares. In addition, the per share exercise price for these options was reduced by a factor of approximately 0.74. The Board of QED does not intend to grant options under the QED 1991 Plan.

(c) 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:

(i) *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 was a limit on the aggregate value of options which may be granted to an individual in any ten year period of four times their salary but this was removed by a special resolution of the Company on 8 May 2001, in its place an annual limit of 200 per cent. of remuneration was introduced in line with the Company’s grant policy for options which is changing from a limit based on each employee holding four times eligible options to annual grants of options.

(ii) *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. The Company proposes that the exercise of the next grant of options will be subject to comparative total shareholder return against a bespoke comparator group in the Information Technology Hardware Sector.

(iii) *Exercise price*

The exercise price of an option shall be not less than the greater of the nominal value of a share and (except in the case of options granted under the EPIH Scheme (see above) which are surrendered in exchange for new options granted under the Scheme) 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 or, the average of the mid-price for a share on Nasdaq Europe for the three consecutive dealing days preceding the date of grant.

*(iv) 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.

*(v) 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.

*(vi) 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.

*(vii) Scheme Limits*

Save for the grant of any options prior to the Nasdaq Europe Admission and which options shall be ignored in any limits set out below, no option could be granted by the Company if immediately following the grant of such option, the aggregate nominal value of the Ordinary Shares issued or then capable of being issued pursuant to options granted under the Scheme within the immediately preceding:

- 10 years, and those issued or then capable of being issued pursuant to options granted or rights obtained in such ten year period under any Other Relevant Scheme would exceed 5 per cent. of the nominal value of the Ordinary Shares at that time in issue;
- 10 years, and those issued or then capable of being issued pursuant to options granted or rights obtained in such ten year period under any other share option or profit sharing scheme approved by the Company in general meeting would exceed 10 per cent. of the nominal value of the Ordinary Shares at that time in issue;
- 3 years, and those issued or then capable of being issued pursuant to options granted or rights obtained in such three year period under any Other Relevant Scheme would exceed 3 per cent. of the nominal value of the Ordinary Shares at that time in issue; and

- 5 years, and those issued or then capable of being issued pursuant to options granted or rights obtained in such five year period under any other share option or profit sharing scheme approved by the Company in general meeting would exceed 5 per cent. of the nominal value of the Ordinary Shares at that time in issue.

However, by a special resolution of the Company passed on 8 May 2001, these flow limits were removed and replaced with a single corporate limit 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.

(viii) *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.

(ix) *National Insurance*

Following recent changes in legislation which are effective from 6 April 1999 and recent announcements by the Inland Revenue, a secondary class one national insurance charge will become 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 11.9 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.

(x) *Approval*

The Company is actively seeking UK Inland Revenue approval of a schedule to the Scheme in order to allow the Company to grant employees a maximum of £30,000 of tax efficient share options which will not be subject to income tax and national insurance (capital gains tax will be due on any gain on the subsequent sale of the shares). Shareholder approval of such intention was given by way of a special resolution passed on 8 May 2001.

(d) 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:

(i) *Operation*

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

(ii) *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.

(iii) *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.

(iv) *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).

(v) *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.

(vi) *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 contained in 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.

(vii) *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.



(viii) *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, including 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.

(ix) *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.

(x) *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.

(xi) *Duration*

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

(xii) *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.

(xiii) *General*

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

(e) **WAFER TECHNOLOGY INTERNATIONAL EMPLOYEE SHARE TRUST (“THE WTI EMPLOYEE SHARE TRUST”)**

The WTI Employee Share Trust was established on 22 November 2000 as a discretionary trust for the benefit of, amongst others, the employees of WTI and its subsidiary, Wafer Technology. Prior to the acquisition of WTI by IQE, the shareholders of WTI gifted a total of 956 ordinary shares of £1.00 each in the capital of WTI to the trustees for the WTI Employee Share Trust. On the acquisition, the trustees transferred these 956 ordinary shares of £1.00 each to IQE in consideration of the allotment and issue by IQE to the trustee of 500,000 Ordinary Shares credited as fully paid up:

(i) *Application of Funds*

The trustees may apply the assets of the WTI Employee Share Trust for the benefit of all or any of the employees of WTI in a number of ways, including, outright transfer of Ordinary Shares, sale of Ordinary Shares, loan, grant of options or gift.

(ii) *Payment of Tax*

Any tax payable by reason of any addition to the trust fund or the conferment of any benefit under the WTI Employee Share Trust shall be satisfied and paid by the trustees out of the assets of the WTI Employee Share Trust.

(iii) *Exclusion by Trustees*

The trustees may, with the consent of the company, exclude any person or class of persons from being beneficiaries under the trust provided that the number of beneficiaries shall not fall below two.

(iv) *General*

The trustees have the general powers and are subject to liabilities of a type usual in such trust documents.

**10. Directors and Service Agreements**

(a) **EXECUTIVE DIRECTORS**

Each of the executive Directors has entered into a service agreement with the Company terminable by either party on 12 months’ notice and, in the case of Messrs Hierl and Massie, terminable forthwith by IQE subject to a severance pay of twelve months salary. Pursuant to such agreement each of the executive Directors will in addition be entitled to a performance related bonus, payments into his personal pension scheme, life assurance, private medical and dental insurance and a company car (although not all of these benefits are applicable to the US executive directors, Messrs Hierl and Massie). 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. The salaries of the Directors for the current financial year are as set out below:

(i)	Dr Andrew Nelson:	£130,000
(ii)	Thomas Hierl:	£117,000
(iii)	Dr Michael Scott:	£90,000
(iv)	Richard Clarke:	£120,000
(v)	Stephen Byars:	£145,000
(vi)	Scott Massie:	£102,000
(vii)	Martin Lamb:	£75,000



(b) NON-EXECUTIVE DIRECTORS

Each of the non-executive Directors or the companies providing their services entered into agreements commencing in 1999 for the provision of their services as non-executive Directors on the terms set out below.

(i) *Godfrey Ainsworth*

A letter of appointment appointed Godfrey Ainsworth as a non-executive director of the Company from 22 April 1999 for a period of one year (extended by a letter of agreement between the parties dated 17 April 2000 for a further period of one year from 22 April 2000 and subsequently by a further letter of agreement dated 20 July 2001 for a further period of one year from 22 April 2001), although the Board (acting unanimously) may require Dr Ainsworth's resignation forthwith. Dr Ainsworth is required to give one month's notice of an intention to resign. Pursuant to the letter of appointment Dr Ainsworth is required to spend a minimum of 10 days per annum performing his duties for a fee of £750 per day, reviewed each 1 January. Dr Ainsworth is required to be a member of the Remuneration and Audit Committees of the Board. The Agreement terminates automatically for the usual grounds relating to Dr Ainsworth's status.

(ii) *Glen Bressner*

A letter of appointment appointed Glen Bressner as a non-executive director of the Company from 30 April 1999 for a period of one year (extended by a letter of agreement between the parties dated 17 April 2000 for a further period of one year from 22 April 2000 and subsequently by a further letter of agreement dated 20 July 2001 for a further period of one year from 22 April 2001), although the Board (acting unanimously) may require Mr Bressner's resignation forthwith. Mr Bressner is required to give one month's notice of an intention to resign. Pursuant to the letter of appointment Mr Bressner is required to spend a minimum of 10 days per annum performing his duties. He does not receive a fee at this point in time. Mr Bressner is required to be a member of the Remuneration and Audit Committees of the Board. The Agreement terminates automatically for the usual grounds relating to Mr Bressner's status.

(c) REMUNERATION

The aggregate remuneration including salaries, fees, pension contributions, bonus payments and benefits in kind of the Directors during the year ended 31 December 2000 amounted to £532,000. It is estimated that the aggregate amount of the remuneration to be paid 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 £840,000.

(d) OTHER DIRECTORSHIPS

Set out below are the details of the directorships other than that of 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 Welsh Development Agency	None
Thomas Hierl	Bethlehem Development Corporation	None
Dr Michael Scott	None	None
Richard Clarke	None	Avimo Business Development Limited Avimo Limited Avimo Middle East Limited Avimo Europe Limited W. Vinten Limited Helio Mirror Company Limited Avimo Optical Imaging Limited Avimo Thin Film Technologies Limited
Stephen Byars	None	Newport Wafer-Fab Limited Effergy Limited (formerly ASAT (UK) Limited) ESM Limited European Semiconductor Manufacturing Limited Eurotechnology (Europe) Limited QPL International Holdings Plc
Scott Massie	None	None
Martin Lamb	None	None
Dr Godfrey Ainsworth	Gambit Corporate Finance Ltd Peter's Food Service Ltd Peter's Savoury Products Ltd Riley Leisure Limited Omniport Plc	Clode Plc Sidney Clode Finance Limited Archway Supplies Plc Butetown Artists Ltd Sandwich Supplies Ltd RAMEL Limited Sandco Ltd Q-Ball Ltd Eurocaps Ltd New College (Cardiff) Ltd
Glen Bressner	Midas Vision Systems Inc. Micro E Inc. Innovative Solution & Support Inc. Anytime Access, Inc. Mesa Systems Guild Inc. MA VF Management Company Inc. Alum-a-Lift Inc.	Pocono Springs Inc. ARC Land Inc. Mobere Medical Inc. Magna Van Systems Inc. Sprockets.com, Inc. ParaProtect Inc.

(e) CONVICTIONS AND INSOLVENCY

No Director has:

- (i) any unspent convictions;
- (ii) a bankruptcy order made against him or entered into any individual voluntary arrangements;



- (iii) been a director of a company which has been placed in receivership compulsory liquidation, creditors voluntary liquidation, administration, company voluntary arrangements or any composition or arrangement with its creditors generally or any class of the creditors whilst he was a director of that company with an executive function at the time of or within twelve months preceding such events;
- (iv) been a partner of a partnership which has been placed in compulsory liquidation, administration or partnership voluntary arrangements whilst he was a partner of that partnership or within twelve months preceding such events;
- (v) any assets which were the subject of a receivership or was a partner of a partnership at the time of or within the twelve months preceding such event whose assets were the subject of receivership; or
- (vi) been publicly criticised by any statutory or regulatory authority or disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company;

except as follows:

Mr Byars was a director of Newport Wafer-Fab Limited, a company which was placed into administration on 10 December 1998. Mr Byars was a member of the management team which successfully purchased the business of Newport Wafer-Fab Limited in 1999 from the administrators prior to Mr Byars joining IQE.

Mr Byars was also a director of ASAT (UK) Limited, a sister company of Newport Wafer-Fab Limited as referred to above. ASAT (UK) Limited was also placed into administration on 12 March 1999 and its business was sold separately from that of Newport Wafer-Fab Limited's. ASAT (UK) Limited subsequently changed its name to Effergy Limited.

Mr Bressner was a director of Pocono Springs Inc., a company in which NEPA invested. Mr Bressner was appointed to the board of Pocono Springs Inc. by NEPA to supervise their investment. This company filed a petition in bankruptcy pursuant to Chapter 11 of the US Bankruptcy Code. This company has now emerged from the same.

Dr Ainsworth was a non-executive director of Sandco Limited, a company in which 3i plc invested. Dr Ainsworth was appointed to the board as part of an attempt to turn around the company's fortunes. This company is now in receivership, with a deficiency understood to be approximately £2 million.

(f) **PROMOTERS**

The Directors consider that the promoters of the Company are the Directors who at the date of this document are the holders of the number of Ordinary Shares set out against their names in paragraph (a) of section 5 of this Part VIII. No payment or other benefit has been paid or given or is to be paid or given other than to the Directors in connection with the promotion of the Company within two years immediately prior to the date of this prospectus.



## 11. Subsidiary Undertakings

The Company has the following subsidiaries, all of which are wholly owned:

<i>Name of Company</i>	<i>Date and Place of Incorporation</i>	<i>Registered Office</i>	<i>Issued Share Capital</i>
IQE Inc.	23 December 1998 Pennsylvania	119 Technology Drive Bethlehem Pennsylvania 18015 USA	1,000 common stock of no fixed par value
EPI Holdings Limited	11 March 1996 England and Wales	Pascal Close Cypress Drive St Mellons Cardiff CF3 0EG	3,000,000 ordinary shares of 1p each
IQE (Europe) Limited	9 March 1987 England and Wales	Pascal Close Cypress Drive St Mellons Cardiff CF3 0EG	159,540 ordinary shares of £1.00 each
Epitaxial Products Inc.	9 February Delaware	119 Technology Drive Bethlehem Pennsylvania 18015 USA	1,000 ordinary shares of no fixed par value
Wafer Technology Limited	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	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	5 May 2000 England and Wales	Beech House Pascal Close Cypress Drive St Mellons Cardiff CF3 0LW	2 ordinary shares of £1.00 each



## 12. Principal Establishments

The details of the principal establishments of the Group, are set out below:

<i>Address</i>	<i>Tenure</i>	<i>Area</i>	<i>Annual Rent</i>	<i>Term of Lease</i>
Pascal Close Cypress Drive St Mellons Cardiff CF3 0EG	Freehold	40,000 sq ft	£N/A	N/A
119 Technology Drive Bethlehem Pennsylvania 18015 USA	Leasehold	40,000 sq ft	\$290,000	14 April 2005
14 Maryland Road Tongwell Milton Keynes MK15 8HJ	Leasehold	4,300 sq ft	£25,000	6 years commencing 1 May 1998
28 Maryland Road Tongwell Milton Keynes MK15 8HJ	Leasehold	16,600 sq ft	£98,240	23 June 2010
32 Maryland Road Tongwell Milton Keynes MK15 8HJ	Leasehold	13,200 sq ft	£72,638	25 years commencing 24 June 1985
34 Maryland Road Tongwell Milton Keynes MK15 8HJ	Leasehold	17,800 sq ft	£93,330	25 years commencing 25 December 1984
Beech House Unit A Pascal Close Cypress Drive St Mellons Cardiff CS3 0LW	Leasehold	12,000 sq ft	£80,000	16 years from 7 December 1997



### 13. Taxation

The following is a summary of certain UK and Belgian tax consequences of ownership and disposal of the Ordinary Shares. This summary is based on current UK and Belgian Law and practice and is for general information only and does not discuss any tax legislation which may be pending, unless explicitly mentioned. It does not purport to be a complete analysis of all potential tax effects relevant to a decision to invest in the Ordinary Shares and prospective investors are urged to consult their tax advisers regarding the applicable tax consequences for acquiring, holding and disposing of the Ordinary Shares based upon their particular circumstances. The discussion below is based upon laws and relevant interpretations thereof in effect at the date of this prospectus, all of which are subject to change, possibly with retroactive effect. The following does not address any other tax laws than those of the UK and Belgium. Prospective investors who are in any doubt as to their tax position or who are not residents of the UK or Belgium should seek independent advice with respect to taxation consequences of acquiring, holding and disposing of Ordinary Shares.

#### UNITED KINGDOM TAXATION

The following information is intended only as a general guide to current UK tax legislation as at April 2001 and to what is understood to be the current practice of the UK Inland Revenue, which may change, as it applies to persons resident or ordinarily resident in the UK for tax purposes who are beneficial holders of Ordinary Shares as investments and not as trading stock and may not apply to certain classes of persons. Any person who is in any doubt as to his tax position is strongly recommended to consult his tax adviser immediately.

##### (a) *Taxation of Dividends on Ordinary Shares*

Under current UK taxation legislation, no tax will be withheld at source from dividend payments by the Company.

For individual beneficial owners of Ordinary Shares resident in the UK, a tax credit is available equal to 10 per cent. of the gross dividend (one ninth of the dividend), which may be set off against their tax liability on their total income. An individual who is liable to the higher (currently 40 per cent.) rate of income tax will be liable to tax at 32.5 per cent. on the total of the dividend and the tax credit, and the tax credit will satisfy that liability as to 10 per cent., leaving a further 22.5 per cent. (equal to one quarter of the cash dividend received) to pay. Basic, lower rate, taxpayers will not be liable to additional income tax on dividends received. Non taxpayers are not able to reclaim any part of the tax credit. Charities, certain heritage bodies and scientific research organisations may be eligible for compensation payable out of funds to be provided by the Exchequer for a five year transitional period with effect from 6 April 1999.

A UK resident corporate beneficial owner of Ordinary Shares will not normally be liable to corporation tax on any dividend received from the Company unless it is a dealer in securities or a financial institution for whom different considerations may apply. The dividend and the associated tax credit constitute franked investment income. Companies and pension funds are not able to recover any part of the tax credit accompanying dividends.

An owner of Ordinary Shares who is resident in a country other than the UK is liable to UK tax on dividends received but will not be entitled to any payment from the Inland Revenue in respect of the tax credit on dividends on the Ordinary Shares. For example, a Belgian resident is taxable on UK dividends, but is already deemed to have paid this tax liability. This is because of the UK tax credit attaching to the dividend. A Belgian tax resident is therefore not liable to pay any further UK tax. Furthermore, a Belgian tax resident is not entitled to any repayment of the tax credit, unless the Belgian tax resident is a corporate shareholder holding not less than 10 per cent. of the share capital of the UK company, in which case there would be a repayment of a small proportion of the tax credit (equivalent to 0.28 per cent. of the net dividend). Corporate



beneficial owners of Ordinary Shares benefiting from special treaty provisions relating to corporate investors holding not less than 10 per cent. of the voting power in the Company, are entitled to a very small part repayment of tax credit.

(b) *UK Stamp Duty and Stamp Duty Reserve Tax ("SDRT")*

- (i) **Transfers of Ordinary Shares out of the Clearstream and Euroclear Systems**  
Where no sale is involved, and Euroclear and Clearstream or its nominee transfers Ordinary Shares to the beneficial owners of the Ordinary Shares it should not be necessary to pay any *ad valorem* stamp duty or SDRT. By contrast, such a transfer directly to a purchaser for consideration may give rise to a liability to *ad valorem* stamp duty and/or SDRT calculated by reference to the amount or value of the consideration.
- (ii) **Transfers of Ordinary Shares within the Clearstream and Euroclear Systems**  
No *ad valorem* stamp duty or SDRT should be payable on transfers within the Clearstream and Euroclear Systems for transactions in Ordinary Shares executed on Nasdaq Europe.
- (iii) **Transfers of Ordinary Shares within and out of the CREST System**  
SDRT at a rate of 0.5 per cent. of the amount or value of the consideration is payable, generally for the account of the purchaser, on transfers within and out of the CREST system. No *ad valorem* stamp duty will generally be payable because there is no written instrument effecting the transfer. A person other than the purchaser may be accountable to the UK Inland Revenue for the notification and payment of SDRT.
- (iv) **Transfers of Ordinary Shares into the Clearstream and Euroclear Systems or into a depository receipt system**  
UK *ad valorem* stamp duty and/or SDRT is payable, generally by the holder of Ordinary Shares at the rate of 1.5 per cent. (rounded up to the nearest £5 in the case of stamp duty) of the amount of the value of the consideration (or in some circumstances the value of the Ordinary Shares) on a transfer of Ordinary Shares:
  - (a) to, or to a nominee for, a person whose business is or includes the provision of clearance services; or
  - (b) to, or to a nominee for, a person whose business is or includes issuing depository receipts.

Transfers of Ordinary Shares into Euroclear and Clearstream to be held under the listing on Nasdaq Europe will therefore be liable to charges at 1.5 per cent. as outlined immediately above. Similar charges apply on the issue of certain shares to the persons listed above.

- (v) **Transfer of Ordinary Shares in Registered Form**  
UK stamp duty is generally payable on instruments conveying or transferring shares or securities on sale and SDRT is imposed on agreements for the transfer of certain shares and securities. In the case of stamp duty the charge is normally at the rate of 0.5 per cent. (rounded up to the nearest £5) of the amount or value of the consideration given for the transfer and in the case of SDRT is 0.5 per cent. of such amount or value rounded up to the nearest £0.01. Both stamp duty and SDRT are generally borne by the purchaser.

Where a charge to SDRT arises on an unconditional agreement to transfer shares or securities and before the expiry of a period of six years beginning with the date of that agreement, an instrument of transfer is duly stamped, any liability to SDRT will be cancelled or SDRT repaid. The cancellation or repayment of SDRT will not cancel any penalty for a failure to report to the UK Inland Revenue a charge to SDRT by the accountable date.



A transfer of Ordinary Shares for no consideration whatsoever should not give rise to payment of *ad valorem* stamp duty or SDRT. A fixed stamp duty of £5 will apply, subject to appropriate certification of the document as exempt from duty where relevant. Certain categories of person and certain agreements and transfers may be exempt or eligible for relief from the 0.5 per cent. charges described above.

(c) *Capital Gains Tax*

UK resident individual beneficial owners of Ordinary Shares will be liable to capital gains tax on any chargeable gain realised on the disposal of the Ordinary Shares whilst they are resident or ordinarily resident for tax purposes in the UK, subject to any allowances, reliefs or exemptions which may be available to them. UK resident corporate beneficial owners of Ordinary Shares are liable to corporation tax on chargeable gains realised on disposal of their holding of Ordinary Shares, subject to certain reliefs and exemptions.

(d) *Inheritance Tax*

Ordinary Shares are assets situated in the UK for the purposes of UK inheritance tax. A gift of such assets by, or the death of, an individual holder of such assets may give rise to a liability to UK inheritance tax, subject to certain reliefs and exemptions, even if the holder is not domiciled in the UK or deemed to be so domiciled. No UK inheritance tax is payable when the total estate is less than £234,000 for 2000/2001 and £242,000 for 2001/2002. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and there are particular rules which apply to gifts where the donor reserves or retains some benefit. There are also special rules, which apply to close companies and trustees of settlements holding shares, which bring them within the charge to inheritance tax.

## BELGIAN TAX CONSIDERATIONS

The Company explicitly renounces to the advantage of the reduced withholding tax rate of 15 per cent. provided for in Article 269, section 3 of the Belgian Income Tax Code 1992.

(a) *Withholding taxes*

(i) *Individual Shareholders*

- Dividends distributed to individual Shareholders subject to the individual income tax are subject to a 25 per cent. withholding tax in case the dividends are distributed through a Belgian paying agent. This withholding tax is a final tax.
- Dividends distributed to individual Shareholders subject to the individual income tax are not subject to a withholding tax in case the dividends are not distributed through a Belgian paying agent. In this case, the individual shareholder should mention the amount of the dividend received in his annual individual income tax return. The dividend income will then be subject to a separate tax at a rate of 25 per cent. increased with the municipal surcharge.

(ii) *Corporate Shareholders*

According to Article 106, §1 RD/ITC 1992, dividend income distributed by a foreign company to a Belgian resident company is exempt from withholding tax.

(iii) *Shareholders subject to the Legal Entity Tax*

Similar to Belgian individual residents, a withholding tax of 25 per cent. is due.



*(b) Income tax*

(i) Individual Shareholders

For dividends distributed to individual Shareholders subject to the individual income tax which have not been subject to a withholding tax, the individual shareholder should mention the amount of the dividends received in his annual individual income tax return. The dividend income will then be subject to a separate tax at a rate of 25 per cent. increased with the municipal surcharge.

(ii) Corporate Shareholders

The tax regime of the received dividend distributions will depend upon whether or not and, if so, to what extent the “dividends received deduction” applies; if said deduction is applicable, only 5 per cent. of the dividends received from the Company will be taxed at the normal corporate tax rate of 40.17 per cent.; otherwise, the dividends will be fully taxable.

The “dividends received deduction” will apply if the Belgian corporate shareholder owns, at the time of attribution of the dividend, a participation of at least 5 per cent. or with an acquisition value of at least EUR 1,239,467.62 (EUR 1,200,000 as from tax year 2002) in the Company; these conditions do not apply to certain types of companies such as insurance and investment companies.

(iii) Shareholders subject to the Legal Entity Tax

The above-mentioned withholding tax constitutes a final tax. No further Legal Entity Tax is due.

*(c) Capital Gains Taxation*

(i) Individual Shareholders

Individual Shareholders holding the Ordinary Shares as a private investment are not subject to capital gains taxation on the disposal of shares in a foreign company. However, capital gains may become taxable at a rate of 33 per cent., increased with a 3 per cent. crisis surcharge and the municipal surcharge, in case the capital gains are considered as speculative income, i.e., income resulting from operations or speculations exceeding the normal administration of private investments. If the individual shareholder has invested the Ordinary Shares in his business activity, capital gains on the disposal of the shares become taxable at a separate rate of 16.5 per cent. increased with a 3 per cent. crisis surcharge and the municipal surcharge in case the shares are invested in the business for more than 5 years. If less, the progressive individual income tax rates apply.

(ii) Corporate Shareholders

Capital gains on the Ordinary Shares are tax-exempt if the dividends qualify for the “dividends received deduction”. The participation conditions, as set out above, do not apply for the capital gains exemption.

(iii) Shareholders subject to the Legal Entity Tax

Capital gains on the Ordinary Shares are tax-exempt.

*(d) Stock Exchange Tax*

A tax of 0.35 per cent. with a maximum of EUR 250.00 per transaction is levied upon the delivery following the subscription of Ordinary Shares through Belgian professional intermediaries. The rate applicable for each sale and purchase in the secondary market through the intervention of a Belgian professional intermediary is 0.17 per cent. with a maximum of EUR 250.00 per

transaction. An exemption of the Stock Exchange Tax applies to dealings between professional intermediaries and to dealings by professional intermediaries or non-residents acting on their own account.

(e) *Tax on report transactions*

Report transactions concluded or executed in Belgium are subject to a stamp tax at the rate of 0.085 per cent. in the hands of both contracting parties, in case a professional intermediary intervenes. A report transaction is an agreement whereby a person sells public securities and simultaneously agrees to purchase at a later date similar securities from the purchaser (or *vice versa*).

The above is only a guide to the general tax position as at the date of this prospectus, is based on current legislation and, in the case of the UK, Inland Revenue practice. If any person is in any doubt as to his tax position or is subject to tax in a jurisdiction other than the UK or Belgium, he should consult his own professional adviser.

## 14. Material Contracts

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by members of the Group and are either material contracts entered into within the two years immediately preceding the date of this document or are other contracts, which contain provisions under which a member of the Group has an obligation or entitlement which is material to the Group as at the date of this document and are or may be material:

(a) AGREEMENTS/CONTRACTS RELATING TO ADMISSION TO THE OFFICIAL LIST

*Purchase and Agency Agreement*

Pursuant to a Purchase and Agency Agreement (“the Purchase and Agency Agreement”) dated 16 May 2000, between Beeson Gregory International LLC and Lehman Brothers Inc. (as “US Initial Purchasers”) (1), Beeson Gregory and Lehman Brothers International (Europe) (as “International Initial Purchasers”) (2), the Company (3) and Bankhill Trustees Limited as trustees of the Andrew Nelson Interest In Possession Settlement, Bankhill Trustees Limited as trustee of the Dr Scott Interest in Possession Settlement, Thomas Hierl, NEPA, Dr Nelson and Dr Scott as Selling Shareholders and/or Selling Directors (4), the Company agreed to issue and the Selling Shareholders agreed to sell, in aggregate 1,403,508 ordinary shares of 10p each in the capital of the Company (“the Firm Shares”) to the US Initial Purchasers and the International Initial Purchasers (“the Initial Purchasers”).

In addition, the Company and the Selling Shareholders granted the Initial Purchasers an option to subscribe for or purchase, as applicable, up to an aggregate of 280,701 additional ordinary shares of 10p each in the capital of the Company (“the Optional Shares”).

The Company and the Selling Shareholders agreed to pay to the Initial Purchasers an underwriting commission of 6 per cent. of the price per share placed multiplied by the aggregate number of ordinary shares sold by them.

The Purchase and Agency Agreement contained certain warranties to be given by the Company, the Selling Directors and the Selling Shareholders (other than NEPA) in favour of the Initial Purchasers.

(b) AGREEMENTS/CONTRACTS RELATING TO THE WAFER TECHNOLOGY ACQUISITION

(i) *Acquisition Agreement*

Pursuant to an agreement dated 22 November 2000 entered into between Martin Lamb, Karen Lamb, Ian Grant and Brian Seccull (“the Individuals”) and Compagnie Aramayo S.A. (“Aramayo”) and together with the Individuals “the Vendors”) (1) and the Company



(2), the Company purchased the entire issued share capital of WTI together with all the shares in the capital of Wafer Technology which were not owned by WTI. The consideration was comprised of £7,000,000 in cash, £7,000,000 in nominal value of loan stock (see (ii) below) and 8,750,000 Ordinary Shares (“the Consideration Shares”). In addition, a further 500,000 Ordinary Shares are to be issued to certain of the Individuals (“the Additional Consideration Shares”) (namely Martin Lamb, Karen Lamb and Ian Grant) within 14 days of 28 February 2002 provided that they all remain employed within the Group at that date.

Each of the Vendors accepted a lock up period in respect of the Ordinary Shares issued to them on completion of the Acquisition (six months in the case of Aramayo and until 1 March 2002 in the case of the Individuals).

The Company received the benefit of the usual warranties and representations from the Individuals but Aramayo’s warranties were limited to those relating to title and authority.

In addition, the Company received the benefit of a covenant against liability for unprovided taxation from the Individuals.

Each of the Vendors entered into restrictive covenants not to be engaged in a competing business for a period of four years.

The Company gave certain warranties to the Vendors principally regarding its ability to allot the Consideration Shares and the Additional Consideration Shares.

(ii) *Loan Stock*

Pursuant to an instrument of the Company dated 22 November 2000 (“the Instrument”), the Company created £7,000,000 in nominal value of loan notes (“the Loan Notes”) for the purpose of issuing Loan Notes to the Individuals in accordance with the terms of the Acquisition Agreement.

The Loan Notes are guaranteed as to principal and interest by Barclays Bank PLC (“the Guarantor”) and the guarantee is backed by the deposit by the Company of £7,000,000 in cash with the Guarantor.

The Loan Notes are interest bearing at the rate of one per cent. less than the Guarantor’s Treasury Deposit Rate from time to time.

The Loan Notes are not capable of repayment before 1 July 2001 but thereafter will be repayable at par on 30 days notice in writing to be given by a noteholder to the Company. The Loan Notes will be capable of repayment in tranches of £100,000.

The Loan Notes will become payable immediately on written demand following the occurrence of any of the events of default which are specified in the Instrument.

The Loan Notes may be freely transferred in whole or in part in multiples of £100,000.

If there is a Valid Claim (as defined in the Instrument) for breach of any of the warranties given by the Individuals, any payment of interest and/or principal shall be paid to the noteholders’ solicitors, Vizards Staples and Bannisters, who are to hold the amount on trust for the Company and the noteholders pending resolution of the claim.

(c) AGREEMENTS/CONTRACTS RELATING TO THE TRANSACTIONS

(i) *Initial Cooperation and Services Agreement*

On 30 March 2001, the Company entered into the Initial Cooperation and Services Agreement and on 14 September 2001 the Company entered into the Interim Agreement, in each case with Motorola, pursuant to which the Company agreed to perform certain services for Motorola relating to the development of the Technology in relation to growing GaAs layers on silicon materials. Motorola has paid a commercial rate to the Company for the provision of these services.

Under the terms of the Initial Cooperation and Services Agreement, the Company agreed that the ownership of any intellectual property rights or proprietary rights arising from the performance of the services will be for the benefit of and vest in Motorola and agreed to take such action as is necessary to give Motorola full ownership thereof.

There were mutual confidentiality obligations whereby each party is obliged to keep the other's confidential information secret and not to use or otherwise disclose the same save as may be authorised.

Due to the commercial sensitivity of the Technology and Motorola's desire to ensure that the same is maintained in strict confidence, if the Company wilfully, intentionally or negligently breaches the confidentiality provisions, Motorola shall be entitled to seek liquidated damages of US\$50 million. This will be without proof of loss and will last until 31 December 2002. The Company was required to implement an internal procedure for tracking and controlling the dissemination of information in the form of an exhibit to the Initial Cooperation and Services Agreement together with a group wide standard operating procedure for the handling of proprietary material.

The Initial Cooperation and Services Agreement was terminated in accordance with its terms on 31 August 2001 and the Interim Agreement was terminated in accordance with its terms on 13 November 2001.

(iv) *Exclusivity Agreement*

In connection with the entering into of the Initial Cooperation and Services Agreement, an agreement between Motorola (1) Dr Nelson, Dr Scott, Thomas Hierl, Steven Loizeaux, Bankhill Trustees (2) and the Company (3) was entered into on 30 March 2001 pursuant to which the Company agreed not knowingly to solicit interest from any person (other than Motorola) in relation to the issue or other acquisition of shares in the Company nor (other than pursuant to the exercise of any options pursuant to the Share Option Schemes) to negotiate, arrange, agree or conclude with any person (other than Motorola) any issue or other acquisition of shares in the Company or to dispose of material assets of the Company.

In addition, the individual Shareholders (being Drew Nelson, Mike Scott and Tom Hierl) agreed not to sell any shares that they hold in the Company.

The above obligations lasted for the period from the date of the Initial Cooperation and Services Agreement until its termination.

(iii) *Phase II Cooperation and Services Agreement*

On 13 November 2001, the Company entered into the Phase II Cooperation and Services Agreement with Motorola, pursuant to which the Company agreed to perform further services for Motorola relating to the development of the Technology in relation to growing GaAs on silicon materials (and commercialisation of this), the development of



InP on silicon materials systems and development of InGaAs/GaN on silicon materials systems. Motorola will pay a commercial rate to the Company for the provision of these services.

Under the terms of the Phase II Cooperation and Services Agreement, the Company has agreed that the ownership of any intellectual property rights or proprietary rights arising from the performance of the services will be for the benefit of and vest in Motorola and has agreed to take such action as is necessary to give Motorola full ownership thereof.

There are mutual confidentiality obligations whereby each party is obliged to keep the other's confidential information secret and not to use or otherwise disclose the same save as may be authorised.

The Company is required to implement an internal procedure for tracking and controlling the dissemination of information in the form of an exhibit to the Phase II Cooperation and Services Agreement together with a group wide standard operating procedure for the handling of proprietary material. Due to the commercial sensitivity of the Technology and Motorola's desire to ensure that the same is maintained in strict confidence, if the Company wilfully, intentionally or negligently fails to maintain an effective internal procedure in accordance with the exhibit and this results in the unauthorised disclosure of dissemination of Highly Sensitive Information (as defined in the Phase II Cooperation and Services Agreement), Motorola shall be entitled to seek liquidated damages of US\$50 million. This will be without proof of loss and will last until 31 December 2003.

The Phase II Cooperation and Services Agreement will terminate on 31 December 2003 (subject to the rights of either party to terminate earlier for the other is in material breach which is not remedied within 45 days of a notice requiring it to be remedied or insolvency) unless extended upon the mutual agreement of the parties.

(iv) *Motorola Subscription Agreement*

The Motorola Subscription Agreement which is conditional, *inter alia*, on the matters set out in Part III "Motorola Subscription Agreement" and "Motorola Share Warrant" ("the Conditions"), obliges the Company to, *inter alia*, despatch a circular to the Company's Shareholders as soon as reasonably practicable (such circular being contained within this document), convene the Extraordinary General Meeting, and to make an application for Admission in respect of the Motorola Subscription Shares. The Company is required to use all reasonable endeavours to procure the fulfilment of the Conditions.

If any of the Conditions have not been fulfilled (or waived by Motorola) on or before 3.00 p.m. on 31 January 2002 ("the Long Stop Date"), the Motorola Subscription Agreement shall be terminated.

On the date that the last of the Conditions to be fulfilled is fulfilled (or waived by Motorola), Motorola shall subscribe (or will procure that its nominee(s) subscribes) for the Motorola Subscription Shares in cash at the Motorola Subscription Price.

At Completion, Motorola will pay the aggregate Motorola Subscription Price at which time the Company will allot and issue the Motorola Subscription Shares.

Pursuant to the Motorola Subscription Agreement, at Completion, the Company is obliged to execute and issue the Motorola Share Warrant to Motorola. See Part III "Motorola Subscription Agreement" and "Motorola Share Warrant".

If an Adjustment Event (as defined in the Motorola Subscription Agreement), which includes an allotment or issue of equity shares or any sub-division, consolidation or redesignation of equity shares, occurs the nominal value of the Motorola Subscription Shares and the Motorola Subscription Price will 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 adjustment and the aggregate Motorola Subscription Price shall be as nearly as possible the same as it was prior to such adjustment.

For the period between the date of the Motorola Subscription Agreement and the date of Completion, the Company has undertaken to operate its business in its usual and proper course and to keep Motorola informed of all material matters relating to its business (subject to obligations of confidentiality).

The Motorola Subscription Agreement contains certain warranties by the Company in favour of Motorola which were given as at the date it was entered into and which are repeated at Completion. If a Material Breach (as defined in the Motorola Subscription Agreement) of any of the warranties occurs between the date of the Motorola Subscription Agreement and Completion, Motorola will be entitled to terminate the Motorola Subscription Agreement.

(v) *Licence Agreement*

The Licence Agreement governs the on-going relationship between the Company and Motorola with regard to ownership and use of the various rights in the Technology following achievement of proof of concept. The Agreement was entered into on the same date as the Motorola Subscription Agreement but the effective date of the Licence Agreement will be the date of Completion.

Any improvements in the Technology made by either party in the two years following the date of the Licence Agreement must be disclosed to the other within 30 days of the same being implemented in production and (subject to certain restrictions dealing with third party confidentiality) the other party will have a licence to use the technology rights in those improvements.

The Company will have an exclusivity period of 15 months in relation to the commercial production and merchant market sale of GaAs on Silicon Wafers having a diameter of 6" or less although Motorola has retained the right to use and disclose the Technology to third parties provided that disclosure shall be on a confidential basis which is at least as restrictive as the obligations on the Company in the Licence Agreement and to licence the Technology (but not for the purpose of commercial production and merchant market sale of GaAs on Silicon Wafers having a diameter of 6" or less during the exclusivity period). The Company will lose the right to the balance of the exclusivity period if it does not achieve commercial production of GaAs epi-wafers grown on silicon substrates using the Technology having a diameter of 6" or less within 9 months of the start of the exclusivity period. Commercial production in this context means the publication and merchant market offering by the Company of a commercial specification for GaAs on Silicon Wafers based on the Technology for general use by the Company's customers in purchasing IQE products.

If Motorola subsequently licences the Technology to a third party for the manufacture of GaAs on Silicon Wafers having a diameter of 6" or less on a royalty rate which is less than that payable by the Company, the Company shall have the right to accept a new licence from Motorola at the lesser royalty rate provided that, at Motorola's option, IQE must accept other material terms and conditions as are contained in the third party's licence agreement ("most favoured nation").

In the event that the Company undergoes a change of control (in respect of voting shares which in aggregate confer more than fifty per cent. of the voting rights normally exercisable at general meetings of the Company) at any time prior to 31 December 2004, at Motorola's



Option, (i) the most favoured nation provision, (ii) the obligation of Motorola to licence back improvements and (ii) certain rights of the Company to confidential information of Motorola shall cease.

The grant of the licence of Motorola's patents to the Company is royalty bearing with royalties being payable to Motorola by reference to the volume of wafers sold as a proportion of the total volume of epitaxial wafers grown by the Company on GaAs substrates having a diameter of 6" or less.

The scope of the licence by Motorola is limited to wafers that are grown on gallium arsenide and silicon substrates having a diameter of 12" or less although the royalty rates applicable to 8" and 12" wafers remain to be agreed.

There are mutual confidentiality obligations whereby each party is obliged to keep confidential the confidential proprietary information of the other.

(vi) *Draw Down Facility*

The Draw Down Facility provides the Company with an equity draw down facility of up to £14 million ("the Facility"). The Company may draw down the Facility by serving a notice on the Equity Providers ("a Draw Down Notice").

There are certain pre-conditions to be satisfied prior to the Company serving a Draw Down Notice. These conditions include a requirement for the Resolution to have been passed and that the closing bid price (as reported by Bloomberg Financial Markets) for an Ordinary Share ("the Closing Bid Price") on the date that the Draw Down Notice is served be greater than or equal to 50 pence.

The Facility is available to the Company for a period of three years commencing on the date that the Draw Down Facility was entered into, or until the date by which the full amount of the Facility has been drawn down, if earlier.

Each Draw Down Notice is required to state the number of Ordinary Shares the Company wishes the Equity Providers to subscribe for (a "Draw Down Amount"). The maximum number of Ordinary Shares to be included in any Draw Down Amount is the aggregate of 150 per cent. of the average daily trading volume (excluding certain block trades) of Ordinary Shares on the London Stock Exchange during the thirty trading days immediately preceding the date that the Draw Down Notice is served.

Subject to certain conditions, the Equity Providers are obliged to subscribe for not less than two-thirds by number of the Draw Down Amount and may subscribe for the full amount of the Draw Down Amount.

The subscription price to be paid by the Equity Providers (the "Subscription Price") will be set separately for each draw down under the Facility and will be equal to 93 per cent. of the average of the volume weighted prices of the Ordinary Shares on the London Stock Exchange, as reported by Bloomberg Financial Markets (the "VWA Price"), for such 12 days in the 17 trading day period immediately following the date upon which the Company issues a Draw Down Notice as Marblegate may elect.

The Company may specify in the Draw Down Notice a minimum price below which it is not prepared to issue Ordinary Shares in respect of the relevant draw down ("the Floor Price"). The Floor Price may not be greater than 70 per cent. of the Closing Bid Price on the trading day immediately prior to the date upon which the relevant Draw Down Notice is served. If the Subscription Price is less than the Floor Price the Ordinary Shares will not fall to be issued.



The Company has agreed to pay a commitment fee to the Equity Providers of US\$300,000. This fee is payable subject to, and following the passing of the Resolution. The Company has agreed to issue the Equity Providers' Share Warrants to the Equity Providers upon the passing of the Resolution.

A summary of the terms of the Equity Providers' Share Warrants is set out in Part III "The Draw Down Facility" and "Equity Providers' Share Warrants".

(d) OTHER CONTRACTS IN THE ORDINARY COURSE OF BUSINESS MATERIAL TO THE GROUP

(i) *Silicon ASM America*

Pursuant to an agreement dated 10 November 2000 with ASM America, ASM America has agreed terms for the volume supply of Epsilon epitaxial systems for the period up to 31 December 2003. The agreement may then be extended for a further two year interval by mutual agreement until 31 December 2005.

As a strategic customer IQE shall have priority for any new equipment ASM America introduces in the future.

IQE will pay the list price subject to discounts on capital equipment purchases depending on the number of reactors ordered, the date when the order is placed and the date for scheduled delivery. For orders received before 31 March 2000 with deliveries before December 2003, ASM America's list price current at contract signing will apply. For orders received after that date ASM America's then current list price will apply.

(ii) *AIXTRON agreement*

By an agreement dated 23 November 2000 between IQE and AIXTRON AG, AIXTRON AG agreed to supply 13 MOVPE crystal growth reactors over a four year period.

IQE will pay the list price for the reactors with AIXTRON AG entitled to increase its list price at the end of each year of the contract by up to five per cent. A discount of the list price will be applicable depending on the year that the order is placed. An additional discount will be given for orders placed earlier than the contract requires. A penalty is charged if any order is placed later than the contract requires. If AIXTRON AG fails to deliver within two months of the scheduled date of delivery then a further discount from the price list will be given.

AIXTRON AG warrants that all equipment sold shall conform in all respects to its specification and further that the reactors (and the ten reactors purchased under the long term purchasing agreement dated 24 February 1999 between IQE Europe and AIXTRON AG) will be free from defects in materials and workmanship for a period of 18 months from completion of the installation tests.

If the equipment does not pass the process tests within six weeks of the date of delivery a further discount from the list price will be given.

If IQE fails to order any item of equipment in any year in accordance with the agreed schedule then the discount from the list price in respect of previously supplied equipment shall be reduced for each and every item of equipment not purchased as agreed. If the shortfall is subsequently made good then these sums will be refunded.

In addition, certain contracts which are material to the Group are not summarised here as they have previously been available for inspection in the last two years (at the time of the Company's admission to the Official List in May 2000). Such contracts will be made available for inspection. See section 19 of this Part VIII "Documents Available for Inspection".



## **15. Placing Agreement**

In connection with the Placing it is anticipated that prior to Admission the Company and Beeson Gregory will enter into the Placing Agreement, certain terms of which are referred to on page 57 of Part III of this document under “The Placing”.

## **16. Working Capital**

The Company is of the opinion that the working capital available to the Group, including the net proceeds of the Motorola Subscription, is sufficient for its present requirements, that is 12 months from the date of this document.

## **17. Litigation**

No member of the Group is engaged in, nor has pending or threatened by or against it, any legal or arbitration proceedings which may have or have had a significant effect on the financial position of the Group other than that which is disclosed below.

On 22 December 2000, IQE Europe filed a complaint against Rockwell Technologies, LLC, et al. (“Rockwell”) in the United States District Court for the District of Delaware, No. 00-1069-SLR. IQE Europe amended its complaint on 25 January 2001. In this case, IQE Europe is seeking, among other things, a declaratory judgment that Rockwell’s U.S. Patent No. 4,368,098, which is entitled “Epitaxial Composite and Method of Making” (the “’098 Patent”), is invalid and/or unenforceable and IQE Europe’s epitaxial wafers do not infringe the ’098 Patent. Rockwell filed a counterclaim against IQE Europe claiming, among other things, that IQE Europe breached its contractual obligation to inform its customers that they needed to obtain a licence from Rockwell to use IQE Europe’s epitaxial wafers in the US. The parties have commenced the discovery process as of 2 July 2001. The case is scheduled to be ready for trial in January 2003. IQE Europe intends to litigate this case vigorously.

## **18. General**

- (a) Save as disclosed in “Current Trading and Prospects” on page 22 of Part III of this document, there has been no significant change in the financial or trading position of the Group since 30 September 2001, being the date of the latest unaudited quarterly results.
- (b) The costs and expenses of, and incidental to, the Motorola Subscription and Placing and Open Offer payable by the Company are estimated to amount to approximately £2,347,000 (exclusive of VAT, stamp duty and SDRT). These include the cost of the application for Admission in respect of the New Ordinary Shares, accountancy fees, the Company’s and Beeson Gregory’s legal fees, the costs of printing this document and the fees and expenses of the Registrar.
- (c) Beeson Gregory and Motorola have given and not withdrawn their written consent to the inclusion in this document of their names in the form and context in which they are included.
- (d) Beeson Gregory is regulated by The Securities and Futures Authority Limited and is also a member of the London Stock Exchange and Nasdaq Europe. Beeson Gregory is, registered in England and Wales with number 2316630 and its registered office is at The Registry, Royal Mint Court, London EC3N 4LB.
- (e) No Ordinary Shares are being marketed or are available to the public, in whole or in part, in connection with the application for Admission.
- (f) The Company’s Ordinary Shares were admitted to listing on Nasdaq Europe on 27 May 1999 and to trading on the London Stock Exchange on 19 May 2000.
- (g) The Ordinary Shares are in registered form and are capable of being held in uncertificated form.
- (h) The financial information set out in this document relating to the Group does not constitute statutory accounts of the Group within the meaning of section 240 of the Act. The auditors of the Company are Deloitte & Touche, Chartered Accountants and Registered Auditors of Blenheim House, Fitzalan Court, Newport Road, Cardiff CF24 0TS. Deloitte & Touche have



reported on the Company's accounts since its incorporation for the period ended 31 December 1999 within the meaning of section 235 of the Act. Each such report was unqualified within the meaning of section 262(1) of the Act and did not contain a statement under sections 237(2) or (3) of the Act. Statutory accounts of the Company for the periods ended 31 December 1999 and 31 December 2000 have or will be delivered to the Registrar of Companies in England and Wales pursuant to section 242 of the Act. With the exception of such statutory accounts, no information relating to the Group in this document has been audited by Deloitte & Touche.

- (i) Annual and quarterly reports of the Group are published on the Group's and Nasdaq Europe's website, as well as being made available through Euroclear.
- (j) Payment for the New Ordinary Shares must be made in full on Completion.
- (k) The mid-market prices of an Ordinary Share on the Daily Official List on the first dealing day of each of the six months, and the last dealing day, preceding the date of this document were as follows:

1 June 2001	193.5p
2 July 2001	138.0p
1 August 2001	175.0p
3 September 2001	145.0p
1 October 2001	104.0p
1 November 2001	139.5p
13 November 2001	168.0p

## 19. Documents available for inspection

Copies of the following documents may be inspected at the offices of Dechart, 2 Serjeants' Inn, London EC4Y 1LT 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.

- (a) the Memorandum and Articles of Association of the Company;
- (b) the audited accounts of the Group for the three financial years ended 31 December 2000;
- (c) the service agreements referred to in section 10 of this Part VIII;
- (d) the material contracts referred to in section 14 (1) of this Part VIII and those material contracts which have previously been available for inspection in the last two years;
- (e) the rules of the EPI Holdings Limited Unapproved Employee Share Option Scheme, the QED Stock Option Plan and the IQE plc Share Option Scheme, the Deferred Bonus Scheme and the AESOP;
- (f) the consents referred to in section 18 above;
- (g) a copy of the deed constituting the WTI Employee Share Trust; and
- (h) a copy of this document.

## 20. 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 Beeson Gregory at The Registry, Royal Mint Court, London EC3N 4LB UK and at the offices of Nasdaq Europe, Kolonienstraat, 56 Rue des Colonies, Box 15, B-1000, Brussels, Belgium during normal business hours on any weekday (Saturdays and public holidays excepted) from the date of this document until 14 days from the time and date on which Admission takes place, which is expected to be on 12 December 2001. Annual and quarterly results and price sensitive information will be made available to investors in Europe through the Nasdaq Europe Regulatory Company Reporting System according to the continuing obligations for issuers on Nasdaq Europe and the Company Announcements Office and Regulatory News Service of the London Stock Exchange.

Date 14 November 2001

