

Directors' report

Activities and review of operations

The Chairman and Chief Executive's statement on pages 4 to 7, the business review on pages 8 to 23 and financial review on pages 24 to 27 outline the activities and operations of the Company and its subsidiaries and how financial risk is addressed.

Dividends

The Directors have decided not to recommend a final dividend for the year ended 31 December 2005 (2004: nil). No interim dividend was paid (2004: nil). Dividend policy will be kept under review.

Directors

A list of the Directors appears on pages 28 and 29 and their interests in the shares of the Company are shown on page 44.

Mr Careless and the Hon. James Bruce retire by rotation under the Company's articles of association and offer themselves for re-election. Mr Neill also offers himself for re-election as he has served as a Non-Executive of the Company for more than nine years. Mr Gawler retires and offers himself for re-election given that he is stepping down from the position as Chief Executive on 30 June 2006 but has agreed to remain as Chairman. Brief biographical details of the Directors standing for re-election can be found in the notes to the notice of the annual general meeting on page 87.

No Director had any interest in any contract with the companies in the Group at any time during the period, other than service contracts and indemnity agreements. Information covering Directors' remuneration, interests in shares and interests in share options is included in the remuneration report on pages 42 to 45. Resolution 8 asks shareholders to approve the remuneration report.

Directors' indemnities

Each of the Directors has been granted an indemnity by the Company to an extent permitted by law in respect of certain liabilities incurred as a result of their office. In accordance with the Company's articles of association and The Companies (Audit Investigations and Community Enterprise) Act 2004 (which came into force on 6 April 2005), each Director is indemnified against liability to third parties, excluding criminal liability and regulatory penalties and certain other liabilities. In addition, the Company may pay the Directors' legal costs as they are incurred, subject to reimbursement if the Director is convicted, or if judgement is given against the Director in an action brought by the Company.

Increase in authorised share capital

In order to give the Company greater flexibility regarding future funding, the Directors wish to increase the Company's authorised share capital from £4,300,000 (being the authorised share capital of the Company following the passing of the resolution at the annual general meeting held on 24 June 2005) to £4,600,000 by the passing of an ordinary resolution (Resolution 9) in the notice of meeting. Such an increase would represent an increase in the Company's authorised share capital of approximately 7 per cent.

Authority to allot shares and disapplication of pre-emption rights

The articles of association of the Company place unissued shares generally at the disposal of the Directors but, under the provisions of the Companies Act 1985, cannot allot any new shares until they have shareholders' authority to do so. Whilst they have no present intention of utilising such authority (other than with respect to the issue of shares upon the exercise of share options), the Directors wish to renew for a further year the general authority granted to them on 24 June 2005. Approval of shareholders will be sought at the annual general meeting by the passing of an ordinary resolution (Resolution 10) whereby the Directors will be authorised to allot authorised but unissued ordinary shares of the Company representing approximately one third of the issued share capital. The total number of shares in respect of which this authority is sought is set out in the note to Resolution 10 in the notice of annual general meeting. This new authority will expire at the 2007 annual general meeting.

Shareholders are being invited to authorise the Directors to allot equity securities as if the pre-emption provisions in section 89(1) of the Companies Act 1985 did not apply in respect of rights issues and other pre-emptive issues, or otherwise for cash other than to existing shareholders up to an amount equal to 5 per cent of the issued share capital of the Company, the level permitted by the current guidelines of the investment committees of the Association of British Insurers and the National Association of Pension Funds. A resolution to this effect (Resolution 11), which will be proposed as a special resolution, is set out in the notice of meeting. The total number of shares in respect of which this authority is sought is set out in the note to Resolution 11. This authority will expire at the 2007 annual general meeting.

Authority to purchase own shares

The Directors wish to be given, until the earlier of the 2007 annual general meeting or 26 September 2007, the authority to allow the Company to purchase its own ordinary shares on a recognised investment exchange and Resolution 12 set out in the notice of annual general meeting seeks this. The authority is restricted to 16,000,000 ordinary shares, which is less than 10 per cent of the current issued share capital. The resolution also sets out the maximum and minimum prices at which the shares may be bought. Purchases will only be made if the Directors expect them to result in an increase in the Company's earnings per share and consider them in the best interests of shareholders generally. Any shares purchased in this way not held in treasury will be cancelled and the number of shares in issue will be accordingly reduced. Other than in relation to shares bought back and held in treasury as described above, it is not the Directors' current intention to offer to purchase shares in the market for any particular period.

The Directors intend to seek renewal of this power at subsequent annual general meetings.

Employees

The Company's policy is to encourage effective communication and consultation between employees and management. Subsidiary undertakings develop their own consultative and communication procedures as part of their employment practices.

The Company and its subsidiary undertakings give full and fair consideration to applications for employment made by disabled people, having regard to their aptitudes and abilities. Should employees become disabled during employment they would be considered for any necessary retraining and available work within their capabilities. For the purposes of training, career development and promotion, disabled employees are treated in the same way as other employees.

Creditor payment policy

Creditor payment policy observes the local practice in the countries in which it operates – standard payment terms in each country may also be varied by negotiation with individual suppliers. It is policy to settle in accordance with agreed terms. The Company had no trade creditors at the year end.

Charitable and political contributions

During the year the Company and its subsidiaries donated £84,000 (2004: £50,000) to charities of which £6,000 (2004: £5,000) was in the United Kingdom mainly for educational, community support and medical purposes. There were no political donations made during the year (2004: £nil).

Research and development

The Company and its subsidiaries continue to place strong emphasis on research and development to meet the changing needs of the markets they serve. Research and development expenditure which excludes engineering and production support costs, totalled £7.5 million (2004: £7.2 million) for the year of which £5.3 million (2004: £6.8 million) has been charged to the income statement for the year and £2.2 million (2004: £0.4 million) has been capitalised as intangible assets.

Substantial shareholdings

As at 16 March 2006, the Company has been notified of the following interests in its ordinary shares: Barclays PLC 5.42 per cent and Legal & General Group PLC 3.26 per cent. An update will be given in the notice of the annual general meeting.

The environment

Information on the Company's approach to environmental issues is set out in the corporate social responsibility report on page 33.

Statement of disclosure of information to Auditors

So far as the Directors are aware, there is no relevant audit information (that is, information needed by the Company's Auditors in connection with preparing their report) of which the Company's Auditors are unaware, and each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

Auditors

A resolution (Resolution 6) to reappoint PricewaterhouseCoopers LLP as Auditors to the Company and a resolution (Resolution 7) to authorise the Board to fix the Auditors' remuneration will be proposed at the annual general meeting.

By order of the Board

R A Careless

Company Secretary
16 March 2006
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