

Redstone plc
Interim Report

30 September 2004



Converged Voice

Smart Buildings



Security

Remote Working

ONE communications solution
no limits

Redstone
one communications solution

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During the six month period to 30 September 2004, Redstone has continued to focus on providing core telecoms and IT solutions and is now seeing the benefits of our investment in sales and marketing over the last two years. The financial implications of this on the business are as follows:

Financial highlights

- Increase in order intake of over 40% when compared with the same period in the last financial year, and over 25% when compared with the six month period ended 31 March 2004. Order intake underpins approximately 50% of our revenue, the balance of our business being existing telecoms and support services.
- Revenue from Core Services increased by 11% to £23.57m compared with the six months to 31 March 2004. The 11% increase reflects the upturn in order intake and the ongoing policy of establishing profitable relationships with mid-sized business customers. This is a reduction of 2% compared with 30 September 2003 due to the cessation of a legacy ISP contract, which had been anticipated.
- Core Services gross margin performance at 35% of sales in comparison with 37% for the same period last year and 58% for the six months ended 31 March 2004. As indicated in the Report and Accounts to 31 March 2004, the gross margin in that year benefited significantly from the conclusion of some one-off supplier negotiations. The Group is pursuing revenue growth across its product range with new customers and this will have some impact on margins as previously reported. However, as further cross selling of the Group's services occurs within its customer base, overall margins are expected to recover.
- Selling and distribution costs have increased by £0.3m compared with both of the six month periods in the last financial year reflecting the investment in the sales force.
- Administrative expenses (excluding goodwill and exceptional items) have reduced by £0.5m compared with the same six month period last year as a consequence of disciplined cost controls and the streamlining of operations and back office activities.
- EBITDA loss of £0.99m compared with a profit of £0.25m for the six months to 30 September 2003 which is caused by:
 1. our withdrawal from Premium Rate Services associated with the adult and broker markets
 2. gross margin reduction of £0.6m related to the ending of legacy business
 3. net reduction in total overheads of £0.2m.
- Cash balances closed strongly at £11.94m as at 30 September 2004. Capital expenditure in the six month period was £0.5m including the cost of the new IN platform.

Operational highlights

Sales growth

Redstone has continued to invest in its sales and marketing infrastructure over the last two years, and is now beginning to see the benefit of that strategy. With the sales operation now almost at full strength, Redstone has won a number of significant contracts, which have resulted in order intake increasing by over 40% compared with the 6 months to 30 September 2003.

Key wins during the period included a contract with Nord Anglia Education PLC, (total of £0.36m, including multi year contract for support) for the provision of hosting and managed services for their education pathfinder project which provides an innovative learning environment for students. Another notable project win was a £0.34m order from British Land to install an integrated systems infrastructure including site wide CCTV & access control into the Peacocks shopping centre in Woking, Surrey. Redstone has been particularly successful in the retail property sector with installations at many leading developments such as the Bullring shopping centre in Birmingham, Centre West shopping centre in East Kilbride, the Oracle shopping centre in Reading and West Quay shopping centre in Southampton.

Redstone also completed its £1.2m revenue project at Crossways Academy, which included the installation of a comprehensive IT and communications infrastructure for the whole academy, including Smart B applications, such as CCTV and access control. Additional revenues will be generated from this project through a support contract in the current and subsequent periods.

Management Strength

During the period Redstone strengthened its management team with the appointment of Tim Perks as Chief Financial Officer. Given the management team's track record and experience, Redstone is well positioned to fulfil its growth aspirations both through organic and acquisition activity.

BTW Wholesale & New Telecom Services

As announced on 26 May 2004, Redstone has extended its outsourcing agreement with BT Wholesale to 2012 and, as part of that arrangement, BTW are providing a new intelligent networking (IN) platform based on Huawei technology. This new platform will provide customers with state of the art communications infrastructure to manage inbound telecoms services (eg 0845/0870) and will include the ability to control call traffic flows and obtain near real-time information via a web interface. This gives customers a far greater degree of control over their inbound traffic and permits them to respond rapidly to changing circumstances. When combined with our existing core telephony capability, the new services will provide a compelling range of converged voice solutions, particularly for use in contact centres. The new IN services were launched at the Call Centre Expo exhibition in September 2004 and are expected to be live by the end of January 2005.

In addition, Redstone has procured new switching technology from Digitalk Limited to enhance its "Away from the Office" portfolio of products. The new platform will be operational in 2005, and will result in an enhanced range of value added services, lower operating costs and improved service levels for our customers.

In August 2004, Redstone launched its own Directory Enquiries Service 118600 in conjunction with BT Wholesale. Specifically targeted at business customers that already use Redstone's other telecoms services, the service provides significant cost savings of up to 24% compared with other directory enquiries service providers for a typical 40 second call.

Ceased Services

In the last two years, Redstone has enjoyed increasing success in providing both comprehensive IT and communications infrastructure and telecoms services for medium to large organisations in both the private and public sectors. Redstone believes that focusing on providing these services to such organisations is a significant way of achieving growth and delivering long term shareholder value. It is for this reason that during the period ended 30 September 2004, Redstone commenced its withdrawal from providing Premium Rate Services (PRS) associated with the intermediary telecoms brokers and adult market, (the "Ceased Services"). This will result in the closure of a substantial part of Redstone's current PRS Business ("090" telecoms services), although Redstone will continue to provide premium rate and marketing number services to other businesses that fit its target market place. The closure is already underway and is expected to be completed in the next 90 days.

Margins within the Ceased Services were traditionally lower in comparison with the Group's other activities (4% for the period April 2004 to September 2004), as most of the revenue is passed directly onto individual service providers due to the limited amount of value that can be added. In addition, margin erosion is anticipated from the Ceased Services due to the costs increasing as a result of the tightening regulatory and legal environment. The Board therefore considered it appropriate to withdraw from this non-core, low margin business.

In Redstone's last financial year ended 31 March 2004, the Ceased Services accounted for £15.33m of revenue and generated gross margin of 6.1% of turnover. During the period to 30 September 2004, the Ceased Services were £3.89m with gross margins of 4.4%.

Outlook

The Outlook for the Group is strong. Whilst we will see a relatively flat second half in terms of core revenues due to a combination of increasing price pressure in the telecoms business and the ending of some legacy contracts, the strong growth in order intake is illustrative of the success of our investment in sales and marketing over the last two years. We expect to see the results of this investment in terms of revenue and EBITDA growth during the next financial year, when the full benefits drive through to the bottom line. Redstone is actively seeking acquisition opportunities.

Ian Brown

Chief Executive

16 December 2004

Consolidated Profit and Loss Account

		Six months ended 30 September 2004 £000	Six months ended 30 September 2003 £000	Six months ended 31 March 2004 £000	Year ended 31 March 2004 £000
Turnover	- Core Services	23,571	24,117	21,285	45,402
	- Ceased Services	3,893	7,064	8,261	15,325
		27,464	31,181	29,546	60,727
Cost of sales		(18,941)	(21,561)	(19,460)	(41,021)
Cost of sales - exceptional item	3	-	-	2,481	2,481
		(18,941)	(21,561)	(16,979)	(38,540)
Gross profit	- Core Services	8,351	8,972	12,282	21,254
	- Ceased Services	172	648	285	933
		8,523	9,620	12,567	22,187
Selling and distribution costs		(3,698)	(3,428)	(3,416)	(6,844)
Administrative expenses		(8,488)	(8,999)	(10,793)	(19,792)
Other operating income		145	188	410	598
Operating loss	- Core Services	(3,690)	(3,267)	(1,517)	(4,784)
	- Ceased Services	172	648	285	933
		(3,518)	(2,619)	(1,232)	(3,851)
- goodwill amortisation		2,050	2,050	2,050	4,100
- exceptional items - cost of sales		-	-	(2,481)	(2,481)
- exceptional items - administrative expenses	3	-	-	1,808	1,808
Operating (loss)/profit before goodwill amortisation and exceptional items		(1,640)	(1,217)	(140)	(1,357)
	- Core Services	172	648	285	933
	- Ceased Services	(1,468)	(569)	145	(424)
Interest receivable and similar income		258	202	261	463
Interest payable and similar charges		(12)	(13)	(13)	(26)
Loss on ordinary activities before taxation		(3,272)	(2,430)	(984)	(3,414)
Tax on loss on ordinary activities		-	-	-	-
Loss for the period		(3,272)	(2,430)	(984)	(3,414)
Basic and diluted loss per share	4	(1.17)p	(0.87)p	(0.35)p	(1.22)p
Gross profit %	- Core Services	35.4	37.2	57.7	46.8
	- Ceased Services	4.4	9.2	3.4	6.1
		31.0	30.9	42.5	36.5
EBITDA	- Core Services	(1,159)	(402)	1,138	736
	- Ceased Services	172	648	285	933
		(987)	246	1,423	1,669
EBITDA per share		(0.35)p	0.09p	0.51p	0.60p

	30 September 2004 £000	30 September 2003 £000	31 March 2004 £000
Note			
Fixed assets			
Intangible assets	23,320	27,420	25,370
Tangible assets	2,729	2,941	2,674
	26,049	30,361	28,044
Current assets			
Stocks	905	494	619
Debtors	9,859	12,346	11,072
Short term deposits	-	-	7,000
Cash at bank and in hand	7 11,942	12,355	6,191
	22,706	25,195	24,882
Creditors			
Amounts falling due within one year	(18,127)	(21,719)	(18,565)
Net current assets	4,579	3,476	6,317
Total assets less current liabilities	30,628	33,837	34,361
Creditors			
Amounts falling due after one year	-	(5)	-
Provisions for liabilities and charges	(3,217)	(2,165)	(3,678)
Net assets	27,411	31,667	30,683
Capital and reserves			
Called up share capital	8,472	8,472	8,472
Share premium account	185,336	185,336	185,336
Merger reserve	216	216	216
Profit and loss account	(166,613)	(162,357)	(163,341)
Shareholders' funds	27,411	31,667	30,683

		Six months ended 30 September 2004 £000	Six months ended 30 September 2003 £000	Year ended 31 March 2004 £000
Net cash (outflow)/inflow from operating activities	5	(939)	630	1,628
Returns on investments and servicing of finance				
Interest received		265	192	440
Interest paid		(3)	-	(3)
Interest element paid on finance leases		(9)	(13)	(23)
Net cash inflow from returns on investments and servicing of finance		253	179	414
Capital expenditure				
Purchase of tangible fixed assets		(541)	(415)	(741)
Proceeds on disposal of tangible fixed assets		7	6	6
Net cash outflow from capital expenditure		(534)	(409)	(735)
Net cash (outflow)/inflow before management of liquid resources and financing		(1,220)	400	1,307
Management of liquid resources				
Decrease/(increase) in short term deposits		7,000	-	(7,000)
Financing				
Capital element paid on finance leases		(29)	(80)	(151)
Increase/(decrease) in cash at bank	6/7	5,751	320	(5,844)

1 Basis of preparation

The interim report is unaudited but has been reviewed by the auditors, Ernst & Young LLP, and their report to Redstone plc is set out below.

The financial information contained in this interim report does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. The financial information has been prepared using the same accounting policies as the audited accounts for the year ended 31 March 2004. The comparative financial information is based on the statutory accounts for the financial year ended 31 March 2004 and those accounts, upon which an unqualified auditors opinion has been issued, have been delivered to the Registrar of Companies.

The profit and loss account for the six months ended 31 March 2004 has been prepared to show a more meaningful comparison of the Group's results for the period.

The interim report for the six months ended 30 September 2004 was approved by the directors on 16 December 2004.

2 Segmental analysis

The Group operates as an end to end communications services provider and as such the Group operates in one principal area of activity. All turnover during the current and previous periods was derived from the United Kingdom and relates to continuing operations as defined by FRS3.

During the period ended 30 September 2004, Redstone commenced its withdrawal from providing Premium Rate Services (PRS) associated with the intermediary telecoms brokers and adult market (the "Ceased Services").

3 Items charged after operating loss

Exceptional Items

During the year ended 31 March 2004 the Group concluded some supplier negotiations, which resulted in a benefit of £2,481,000 in respect of liabilities that were reported at 31 March 2003.

Due to the worsening of market conditions in those areas where the Group holds excess property, an additional provision for surplus property costs of £1,808,000 was made at 31 March 2004.

The above exceptional items did not give rise to any cashflow movements.

4 Loss per share

Basic and diluted loss per share are both calculated using a loss of £3,272,000 (2003; £2,430,000, 31 March 2004; £3,414,000) and a weighted average number of shares of 278,907,064.

There were no dilutive share options or warrants at 30 September 2004, 31 March 2004 or 30 September 2003.

5 Net cash flow from operating activities

	Six months ended 30 September 2004 £000	Six months ended 30 September 2003 £000	Year ended 31 March 2004 £000
Operating loss	(3,518)	(2,619)	(3,851)
Amortisation	2,050	2,050	4,100
Depreciation	485	831	1,424
(Profit)/loss on disposal of fixed assets	(4)	(4)	(4)
(Increase)/decrease in stock	(286)	297	172
Decrease/(increase) in debtors	1,205	(328)	958
(Decrease)/increase in creditors	(410)	927	(2,160)
(Decrease)/increase in provisions	(461)	(524)	989
Net cash (outflow)/inflow from operating activities	(939)	630	1,628

6 Reconciliation of net cash flow to movements in net funds

	Six months ended 30 September 2004 £000	Six months ended 30 September 2003 £000	Year ended 31 March 2004 £000
Increase/(decrease) in cash in the period	5,751	320	(5,844)
Cash outflow from finance leases	29	80	151
Cash (inflow)/outflow from liquid resources	(7,000)	–	7,000
Cash inflow from amounts held on collateral loan notes	–	(87)	(87)
Change in net funds resulting from cash flows	(1,220)	313	1,220
Repayment of loan notes for acquisitions	–	87	87
Movement in net funds in the period	(1,220)	400	1,307
Net funds at 1 April 2004	13,129	11,822	11,822
Net funds at 30 September 2004	11,909	12,222	13,129

7 Analysis of net funds

	At 1 April 2004 £000	Cash flow £000	At 30 September 2004 £000
Cash at bank and in hand	6,191	5,751	11,942
Liquid resources/short term deposits	7,000	(7,000)	–
	13,191	(1,249)	11,942
Debt due within one year			
Finance Leases	(62)	29	(33)
	13,129	(1,220)	11,909

Introduction

We have been instructed by the Company to review the financial information for the six months ended 30 September 2004 which comprises the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Consolidated Cash Flow Statement, and the related notes 1 to 7. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the Company in accordance with guidance contained in Bulletin 1999/4 'Review of interim financial information' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 'Review of interim financial information' issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data, and based thereon, assessing whether the accounting policies and presentation have been consistently applied, unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 September 2004.

Ernst & Young LLP

London

16 December 2004

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