

# CHAIRMAN'S STATEMENT



**Flomerics has achieved a profit before tax of £635,000 in the year ended 31 December 2002 (i.e. to double the £308,000 of the previous year). The difficult trading conditions encountered in the second half of 2001 persisted throughout 2002 and resulted in a decrease in turnover of 9% to £11.7 million (2001 - £12.9 million); at constant rates of exchange the reduction was 7%.**

**Although this reduction is naturally disappointing, the Directors consider that the Company has benefited from the importance of its products to customers in the electronics sectors around the world, many of whom have been under very considerable pressure to cut costs. Flomerics has worked extremely hard to support these customers through this challenging period, while at the same time maintaining a tight control of costs to improve profit margins and increase net cash balances.**

In some respects the results for the year as a whole are similar to the interim results for the first half, which also showed a reduction in turnover combined with an increase in profit. At the interim stage the Directors considered that there were reasonable prospects for the year as a whole showing some growth, particularly bearing in mind the weak second half of 2001. However, by October it had become clear that the second half was proving even more challenging and in the event turnover in that period was less than in the first half.

Earnings per share for the year before amortisation of goodwill were 3.8p (2001 - 2.3p) and at 31 December 2002 cash balances were £2.2 million (2001 - £1.1 million). The Directors propose to pay a dividend of 1p per share in respect of the year 2002, which would maintain the same level of dividend as in 2001 and 2000. Subject to approval by shareholders, the dividend will be paid on 9 May 2003 to shareholders on the register at the close of business on 11 April 2003.

## The Products

The Group's strategy continues to be that of addressing a larger market with a broader range of products. Its strong position in the provision of software and associated services to the electronics industry has been established with its flagship product, FLOTHERM. Significant investments have been made not only in developing new versions of this product but also in key new offerings, especially with FLO/EMC.

Sales of FLOTHERM and associated services have been those most affected by the downturn in the electronics, computing and telecommunications sectors. Growth in sales from the other products has been encouraging, although held back by the global economic situation.

**FLOTHERM** continues to be the Group's predominant revenue generator but to a lesser extent, accounting for 76% of turnover in 2002 (2001 - 81%). Revenue from this product contracted by 13% compared to flat revenue in 2001 and 32% growth in 2000. Renewals were at a lower level than expected due to many customers reducing their own costs and indeed some going out of business. The Group did not lose any of its major corporate accounts, but in some instances the level of renewal was lower.

**FLOVENT** accounted for 10% of the Group's turnover (2001 - 9%) with growth of 9% over the previous year (2001 - 12%). The product has benefited from the data centre initiative, which has enabled closer synergies with FLOTHERM.

**FLO/EMC** accounted for 6% of the Group turnover (2001: 4%) with growth of 43% over the previous year (2001 - 274%). The product has been well received in various quarters and the synergies that were expected are being realised with the product being sold to a good number of existing FLOTHERM customers. The product should receive a significant boost when the converged product of FLOTHERM and FLO/EMC is released in the first half of 2003. In 2003 it will also be more actively sold in some of the Group's smaller regional offices.

With the release of key new versions of products in 2003, the board believes that the Company's relative position in the market will strengthen and that it is well placed to benefit when economic conditions in the electronics sector start to improve.

**Microstripes** accounted for 8% of Group turnover (2001 - 6%) with growth of 7% over the previous year.

### International Development

From a geographical perspective revenues have been most affected by the downturn in the US. Total revenues from the US fell by 13% (at constant rates) compared to 2001. Japan has also been affected and sales of FLOTHERM were down by 20%. Europe on the other hand has been relatively resilient; despite the economic situation, the offices in France, Germany and Sweden all experienced growth in turnover in excess of 10%. Over the last two years new offices have been set up in China and Singapore. These have proved to be successful, with turnover more than doubled in China and growth of over 50% in Singapore.

### Employees and Management

In the fourth quarter of 2001 the number of employees was reduced from 157 to 138. During 2002 there has been a tight control on recruitment and staff numbers have been further reduced to 127, largely by normal leavers. The team has coped well with the additional pressures caused by this reduction in resources as well as the direct effects of the market downturn.

I am pleased to announce the appointment of Paul Ramshaw to the board of Flomerics Limited as the Regional Director responsible for Asia Pacific. Paul has been with the Company since 1994 and has successfully established regional offices in China, Singapore and Sweden. His appointment reflects the Group's increased focus on Asia Pacific, which should play an increasing part in its fortunes over the next few years.

### Bid Approach

On 23 October 2002, in response to a sharp movement in the share price, the Board of Flomerics Group plc was obliged to advise shareholders that it had received a preliminary approach for the acquisition of the Company. Subsequent

to that announcement the Board received further expressions of interest. The discussions with the interested parties were protracted and the Board concluded that it was unlikely to receive an offer that it would recommend to shareholders. The talks were therefore discontinued and the market was informed to this effect on 30 January 2003.

### Prospects

Along with many other companies in our sector, Flomerics continues to find trading conditions difficult and the Directors consider that this situation could last for some time. We do not expect any appreciable recovery in 2003 and any growth in revenues in the short term will be difficult to achieve. The Company has managed its cost base carefully and will ensure that costs do not increase until conditions improve.

The Company has an excellent suite of products, which address important and proven needs in the design of electronic equipment. With the release of key new versions of products in 2003, the board believes that the Company's relative position in the market will strengthen and that it is well placed to benefit when economic conditions in the electronics sector start to improve.

*I have always been impressed by the strong sense of loyalty and commitment that exists within Flomerics. I believe those qualities have been essential in enabling the staff and management to produce a very creditable performance in difficult circumstances. On behalf of the shareholders, I thank all the members of the team for their efforts and determination in this challenging period.*



**David Mann**

Chairman  
26 February 2003

# CHIEF EXECUTIVE'S REVIEW



## The End of the Tunnel?

**During 2002 Flomerics has continued to be affected by the prolonged economic slowdown. In particular, the FLOTHERM business (now 76% of our total) has clearly suffered from the continuing difficulties in the electronics industries – leading to the 13% contraction in FLOTHERM business we experienced during 2002.**

Looking forward, a number of questions arise:- What, while this is going on, is happening to Flomerics' customer base and market position? Is a recovery in industry design activity in sight? And, most importantly, are there reasons for confidence that the demand for FLOTHERM will bounce back as the industry recovers?

Focusing first on our customer base and market position – we have, during 2002, been successful in retaining all of our major corporate accounts, and in increasing our presence in a number of them, most notably Dell, Sun, Siemens, and Thales. Moreover, we are confident that we are retaining our worldwide position as "number 1" in electronics thermal software. Our success rate against competitors remains good – and this has enabled us to retain a market share that is significantly more than all competitors combined. Maintaining this leading market position is doubly important to us – it puts us in a strong position to benefit as the industry recovers – and it provides the ideal base from which to build complementary businesses, such as FLO/EMC.

Are we beginning to see any signs of the market recovery? While industry indicators would indicate that the worst is past<sup>1</sup>, all the signs are that the recovery, when it comes, will be slow and patchy. Certainly, our market remains weak, and we are not yet seeing any clear signs of immediate recovery in our business. On the other hand – looking beyond the very short term - we remain confident that, as the recovery progresses, and as the electronics industries do return to steady growth, we will benefit from a strengthening demand for our products.

## Continuing Opportunities in Electronic Thermal

Why the confidence? Consider first our current experience. The industry sectors which make up our primary markets are telecoms/networking and computing – both of which have suffered major contraction during the slowdown. Many of the smaller companies have disappeared, and even the leading industry players – who are major FLOTHERM customers – have shrunk, some by 50% or more.

Against this backdrop, the limited contraction (of 13%) in FLOTHERM business appears in a rather more positive light. This result does confirm what we have argued from the beginning of the slowdown – that thermal design (and the FLOTHERM thermal analysis which supports it) is an increasingly critical and necessary part of the design process for any new electronics equipment – so that, even in troubled times, companies need to maintain this investment in order to survive and to remain competitive.

The factor underlying this is the inexorable trend in all classes of electronics equipment of escalating functionality and power densities. In other words, slowdown or no slowdown, "Moore's Law" continues to apply. This means that thermal (and EMC) design problems appear certain to continue to intensify for the foreseeable future.

Hence our confidence that, as the industry recovers, we would expect to see intensifying demand for Flomerics' products, which our position of market leadership puts us in an ideal position to exploit.

## Even in the Slowdown – Strong Growth in EMC

The foregoing focuses on our core thermal market. However, as we have made clear previously, we see the future of Flomerics as being based on using our leading position in electronics thermal as a foundation for new, complementary analysis products addressing parallel needs in the "physical design of electronics".

As a first step, we have identified electromagnetics compatibility (EMC) as a critical electronics design need,

Our success rate against competitors remains good – and this has enabled us to retain a market share that is significantly more than all competitors combined.

which we are addressing via our FLO/EMC product. FLO/EMC is primarily aimed at existing FLOTHERM customers, for whom it provides a means of analysing the emissions of electromagnetic radiation from their equipment. The levels of such emissions are limited by legislation – and, as functional densities and clock speeds in present-day equipment escalate, reducing or containing such emissions is becoming an increasingly challenging design issue.

To reinforce this, our current experience would demonstrate the increasing recognition in industry of the importance of EMC issues – and of the unique solution that Flomerics is providing. In 2002, despite the industry slowdown, FLO/EMC showed continuing strong growth (of 43%), and increasing market penetration. It is now becoming established at over 40 organisations worldwide, including a number of major FLOTHERM accounts such as Intel, Dell, Lockheed Martin, and Siemens. This experience re-affirms our confidence that, with a long-term market potential comparable to our current core FLOTHERM business, FLO/EMC provides real growth opportunities even in the present depressed market conditions.

Up to now the FLO/EMC product has been based on the earlier electromagnetics software from Kimberley Communications Consultants Limited (KCC), which Flomerics acquired in 1999. In parallel, development has been underway on a new version, which will offer the same EMC analysis capabilities within the FLOTHERM product architecture. This “merged product” offers a number of major benefits:- it provides the user with the improved user interface available in Flomerics’ core products; it enables users to share data models between FLO/EMC and FLOTHERM (facilitating investigation of the often-necessary trade-offs between thermal and EMC design changes); and it ensures that future investments in the FLOTHERM code series also benefit FLO/EMC.

The first merged-product FLO/EMC release is scheduled during the first half of 2003. We are confident that this important release will enable us to maintain the momentum of FLO/EMC growth during 2003 and beyond, and to exploit

the major medium - and long-term - opportunities we see for FLO/EMC.

### Plus – Emerging Markets in Asia Pacific

In building and managing our international infrastructure, we are increasingly focussing on the Asia Pacific territories.

We see these territories (particularly China) as “emerging markets” for our electronics-industry products. The performance during 2002 – in which the Asia Pacific territories showed significant growth, against the trend of the rest of the world – would confirm this.

In recognition of the increasing importance of these markets, we have created a new Asia Pacific Division, under a new Director, Paul Ramshaw. In his previous capacity as Sales Manager at Flomerics, Paul has been responsible (among other things) for the establishment and management of many of our Asia Pacific operations. Now that he can focus entirely on Asia Pacific, we are confident that he will be able to maximise our opportunities in these increasingly important territories.

### To Sum Up

In summary – while we see another tough year in front of us – we are confident that our core thermal business offers good continuing growth opportunities. In addition, we see major opportunities from the FLO/EMC product, which is becoming increasingly well established alongside our thermal products.

We are confident that our worldwide market-leading position will enable us to exploit these opportunities as the industry recovers.



**David Tatchell**

Chief Executive

26 February 2003

<sup>1</sup> An important indicator is US technology spending, which has recovered from over 10% year-on-year contraction in mid 2001 to just under 5% growth at the end of 2002. Quarterly year-on-year growth figures for US Technology Investments, from U.S Department of Commerce, as quoted in Nov 2002 “Technology Spending Outlook” by W R Hambrecht & Co (www.wrhambrecht.com).

# OPERATING AND FINANCIAL REVIEW



## Areas of operation

The Group's head office and research and development function is located in Hampton Court in the UK. In the US, which accounts for a significant proportion of the Group's revenue, there are four sales and support offices. In addition there are four offices in Europe and three offices in the Asia Pacific region.

## Performance in 2002

A summary of the Group's trading performance is given in the Chairman's statement.

In the last quarter of 2001, in anticipation of slowing revenues, the cost base was reduced with a headcount reduction of roughly 12%. Throughout 2002 costs have been carefully controlled and the headcount has fallen by a further 8%. Compared with 2001 total costs were down by 12%. The result is an increase in profit before tax of over 100% to £635,000 and an improvement in the margin from 2.4% to 5.4%. This is below where we would like it to be but with a continued lead in the

thermal analysis market and other products coming on stream, we are well placed to deliver attractive margins when trading conditions improve.

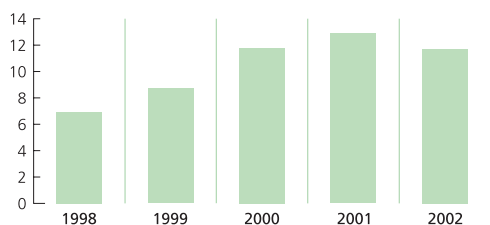
## Research and development

During 2002 considerable effort has been directed towards the new converged product of FLOTHERM and FLO/EMC version 4.1. The first release of this product is expected in the first half of 2003. This is a major release and is key to the strategy of providing multiple solutions to designers in the electronics sector. It will allow designers working on different aspects of the design – i.e. the thermal and EMC, to share data models and thereby obtain an optimum solution.

Total Research and Development costs, in line with other costs, came down in 2002 by about £300,000 but at £2.5 million still represents more than 21% of revenue. This figure includes a share of all of the central costs but at over 20% is higher than we would normally expect in the medium term.

Looking further forward the next release of the converged product is planned for 2004 and work is also in hand on new products that will help to deliver the strategy of exploiting the supply chain in our chosen markets.

Turnover (£'m)



Profit Before Tax (£'m)



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### Financing and the Balance Sheet

The balance sheet remains strong. The cash balance at the end of 2002 was over £2 million compared to £1 million at the end of 2001 and net funds have improved to £1.5 million from £235,000. Borrowings of £673,000 comprise a mortgage on a freehold property for £630,000 (2001 - £683,000) and finance leases of £43,000 (2001 - £130,000).

The Group had an overdraft facility of £800,000, which expired in August 2002. In view of the strong cash position this facility has not been renewed.

Because of the international nature of the business, there is exposure to exchange rate fluctuations and in particular the US dollar, accounting for more than 50% of the total turnover. Forward exchange contracts are taken out against significant cash receipts of foreign currencies expected in the UK.

Cash generated from operating activities was over £2million (2001 - £1.7 million). After capital expenditure of £362,000 (2001 - £1.7 million, including a freehold property for £1.1 million), tax paid of £234,000 (2001 - £260,000) and a dividend paid to shareholders of £146,000 (2001 - £146,000) cash inflow was £1.3 million (2001 - outflow £440,000).

Trade debtors for the business are always high at the end of the year because of the greater proportion of business transacted in the last quarter. Trade debtors at the end of

2002 were £3.3 million, representing 29% of the turnover compared to £3.8 million, or 30% of turnover at the end of 2001.

The freehold property referred to above was acquired in 2001, when it was expected that the UK operation would require additional space. In 2002 the property was refurbished and we are currently looking to let the premises short-term but the market for commercial property in the South East of England is very slow.

The Group is carrying £540,000 of goodwill on the balance sheet relating to the acquisition of Kimberley Communications Consultants Limited in 1999. This is being amortised over ten years.

There are few trade creditors and out of a total creditors figure of £3.5 million, £2.0 million represents deferred revenue. These are amounts that have been invoiced to our customers but not recognised in the profit and loss account, being attributable to the support element of the sale.



**Chris Ogle**  
Finance Director  
26 February 2003

Profit Before Tax Margin (%)



Net Funds (£'m)

